STEPAN CO
Form 10-K/A
March 22, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

Amendment No. 1

(MARK ONE)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission File Number 1-4462

STEPAN COMPANY

(Exact name of registrant as specified in its charter)

Delaware	**36-1823834**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

Edens and Winnetka Road, Northfield, Illinois **60093**
(Address of principal executive offices) **(Zip Code)**

Registrant s telephone number including area code: 847-446-7500

Securities registered pursuant to Section 12 (b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1 par value	**New York Stock Exchange**
	Chicago Stock Exchange
5 1/2% Convertible Preferred Stock, no par value	**New York Stock Exchange**
	Chicago Stock Exchange

Securities registered pursuant to Section 12 (g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in part III of this Form 10-K or any amendment to this Form 10-K. ¨.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes ¨ No x

Aggregate market value at June 30, 2006, of voting stock held by nonaffiliates of the registrant: $204,204,002*

Number of shares outstanding of each of the issuer s classes of common stock as of February 28, 2007:

Class	Outstanding at February 28, 2007
Common Stock, $1 par value	9,238,521

Documents Incorporated by Reference

Part of Form 10-K	**Document Incorporated**
Part III, Items 10-14	Proxy Statement dated March 22, 2007

* Based on reported ownership by all directors, officers and beneficial owners of more than 5% of registrant s voting stock. However, this determination does not constitute an admission of affiliate status for any of these holders.

EXPLANATORY NOTE

Stepan Company (the Company) is filing this Amendment No. 1 on Form 10-K/A to correct for a typographical error in the Per Diluted Share amount in the 2006 first quarter column of the Selected Quarterly Financial Data table included in Item 8 of the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2006, as filed with the U.S. Securities and Exchange Commission on March 8, 2007 (the Original Filing). The $0.37 Per Diluted Share amount on page 88 of the Original Filing has been replaced with $0.31 Per Diluted Share. This change is reflected on page 46 of this Form 10-K/A. No other information in the Original Filing is amended hereby. This Form 10/K-A continues to describe conditions as of the date of the Original Filing, and accordingly, the Company has not updated the disclosures contained herein to reflect events that occurred at a later date.

As required by Rule 12b-15 promulgated under the Securities Exchange Act of 1934, as amended, the Company s principal executive officer and principal financial officer are providing Rule 13a-14(a) certifications in connection with this Form 10-K/A (but otherwise identical to their prior certifications) and are also furnishing, but not filing, Rule 13a-14(b) certifications in connection with this Form 10-K/A (but otherwise identical to their prior certifications).

Item 8. Financial Statements and Supplementary Data

The following statements and data are included in this item:

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Stepan Company

Northfield, Illinois

We have audited the accompanying consolidated balance sheets of Stepan Company and subsidiaries (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Stepan Company and subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2006, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 2, 2007, expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP
DELOITTE & TOUCHE LLP

Chicago, Illinois
March 2, 2007

Stepan Company

Consolidated Statements of Income

For the years ended December 31, 2006, 2005 and 2004

(In thousands, except per share amounts)	***2006***	***2005***	***2004***
Net Sales (Note 1)	**$ 1,172,583**	$ 1,078,377	$ 935,816
Cost of Sales	**1,046,797**	955,515	824,849
Gross Profit	**125,786**	122,862	110,967
Operating Expenses:			
Marketing	**34,452**	32,467	29,615
Administrative	**45,844**	35,339	36,204
Research, development and technical services (Note 1)	**29,637**	29,588	25,969
	109,933	97,394	91,788
Operating Income	**15,853**	25,468	19,179
Other Income (Expense):			
Interest, net (Note 5)	**(8,885)**	(7,801)	(7,237)
Income (Loss) from equity in joint venture (Note 1)	**(812)**	(729)	2,320
Other, net	**1,233**	708	371
	(8,464)	(7,822)	(4,546)
Income Before Provision for Income Taxes and Minority Interest	**7,389**	17,646	14,633
Provision for income taxes (Note 7)	**900**	4,170	4,320
Minority interest (Note 1)	**(181)**	(53)	(11)
Income Before Cumulative Effect of Change in Accounting Principle	**6,670**	13,529	10,324
Cumulative effect of change in accounting principle, net of income taxes (Note 2)		(370)	
Net Income	**$ 6,670**	$ 13,159	$ 10,324
Basic earnings per share of common stock (Note 16)			
Income before cumulative effect of change in accounting principle	**$ 0.64**	$ 1.41	$ 1.06
Cumulative effect of change in accounting principle	**$**	$ (0.04)	$
Net Income Per Common Share	**$ 0.64**	$ 1.37	$ 1.06
Diluted earnings per share of common stock (Note 16)			
Income before cumulative effect of change in accounting principle	**$ 0.63**	$ 1.39	$ 1.05
Cumulative effect of change in accounting principle	$	$ (0.04)	$
Net Income Per Common Share	**$ 0.63**	$ 1.35	$ 1.05
Shares Used to Compute Net Income Per Common Share (Note 16):			
Basic	**9,133**	9,005	8,970
Diluted	**9,284**	9,725	9,038

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Stepan Company

Consolidated Balance Sheets

December 31, 2006 and 2005

(Dollars in thousands)	*2006*	*2005*
Assets		
Current Assets:		
Cash and cash equivalents	**$ 5,369**	$ 16,641
Receivables, less allowances of $3,540 in 2006 and $3,119 in 2005	**160,525**	149,922
Inventories (Note 4)	**82,837**	76,399
Deferred income taxes (Note 7)	**10,362**	8,239
Other current assets	**9,376**	8,047
Total current assets	**268,469**	259,248
Property, Plant and Equipment:		
Land	**10,792**	10,125
Buildings and improvements	**101,230**	94,188
Machinery and equipment	**722,616**	685,832
Construction in progress	**25,072**	16,214
	859,710	806,359
Less: accumulated depreciation	**634,106**	595,240
Property, plant and equipment, net	**225,604**	211,119
Goodwill, net (Note 3)	**7,841**	7,414
Other intangible assets, net (Note 3)	**7,360**	8,775
Other non-current assets	**36,781**	29,603
Total assets	**$ 546,055**	$ 516,159
Liabilities and Stockholders Equity		
Current Liabilities:		
Current maturities of long-term debt (Note 5)	**$ 23,761**	$ 16,777
Accounts payable	**108,084**	102,264
Accrued liabilities (Note 12)	**48,650**	43,863
Total current liabilities	**180,495**	162,904
Deferred income taxes (Note 7)	**2,046**	2,210
Long-term debt, less current maturities (Note 5)	**107,403**	108,945
Other non-current liabilities (Note 13)	**74,574**	74,361
Commitments and Contingencies (Notes 6 and 14)		
Minority Interest (Note 1)	**751**	905
Stockholders Equity (Note 8):		
5 $^1/_2$ percent convertible preferred stock, cumulative, voting, without par value; authorized 2,000,000 shares; issued and outstanding 572,854 shares in 2006 and 575,254 shares in 2005	**14,321**	14,381
	10,343	10,143

Common stock, $1 par value; authorized 30,000,000 shares; issued 10,342,762 shares in 2006 and 10,142,853 shares in 2005		
Additional paid-in capital	**33,553**	26,812
Accumulated other comprehensive loss (Note 1)	**(14,292)**	(23,867)
Retained earnings (approximately $32,219 unrestricted in 2006 and $32,520 in 2005)	**161,184**	162,663
Less: Treasury stock, at cost, 1,134,958 shares in 2006 and 1,102,309 shares in 2005	**(24,323)**	(23,298)
Stockholders equity	**180,786**	166,834
Total liabilities and stockholders equity	**$ 546,055**	$ 516,159

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Stepan Company

Consolidated Statements of Cash Flows

For the years ended December 31, 2006, 2005 and 2004

(Dollars in thousands)	*2006*	*2005*	*2004*
Cash Flows From Operating Activities			
Net income	**$ 6,670**	$ 13,159	$ 10,324
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect of accounting change		370	
Depreciation and amortization	**38,384**	38,769	39,169
Deferred compensation	**3,672**	2,094	693
Deferred income taxes	**(10,143)**	(5,406)	(4,310)
Other non-cash items	**802**	(93)	(1,420)
Changes in assets and liabilities:			
Receivables, net	**(8,000)**	(19,145)	(15,949)
Inventories	**(4,613)**	(1,516)	(4,009)
Other current assets	**(1,091)**	1,438	(1,019)
Accounts payable and accrued liabilities	**7,759**	8,884	20,677
Pension liabilities	**(2,554)**	4,057	698
Environmental and legal liabilities	**3,610**	(607)	(1,398)
Deferred revenues	**5,017**	38	503
Excess tax benefit from stock options	**(685)**		
Net Cash Provided By Operating Activities	**38,828**	42,042	43,959
Cash Flows From Investing Activities			
Expenditures for property, plant and equipment	**(45,970)**	(41,519)	(33,766)
Dividend from Philippine joint venture, net of tax withholdings			1,700
Formation of China joint venture			945
Other, net	**(2,524)**	13	2,939
Net Cash Used In Investing Activities	**(48,494)**	(41,506)	(28,182)
Cash Flows From Financing Activities			
Revolving debt and notes payable to banks, net	**12,934**	(11,399)	(481)
Other debt borrowings	**2,271**	43,154	17,680
Other debt repayments	**(12,474)**	(14,230)	(23,908)
Purchases of treasury stock, net			(30)
Dividends paid	**(8,149)**	(7,869)	(7,731)
Stock option exercises	**3,297**	534	718
Excess tax benefit from stock options	**685**		
Other, net	**(315)**	(408)	(335)
Net Cash Provided By (Used In) Financing Activities	**(1,751)**	9,782	(14,087)
Effect of Exchange Rate Changes on Cash	**145**	62	336
Net Increase (Decrease) in Cash and Cash Equivalents	**(11,272)**	10,380	2,026
Cash and Cash Equivalents at Beginning of Year	**16,641**	6,261	4,235
Cash and Cash Equivalents at End of Year	**$ 5,369**	$ 16,641	$ 6,261

Supplemental Cash Flow Information			
Cash payments of income taxes, net of refunds	**$ 7,037**	$ 10,639	$ 8,359
Cash payments of interest	**$ 9,004**	$ 7,670	$ 7,673

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Stepan Company

Consolidated Statements of Stockholders Equity

For the years ended December 31, 2006, 2005 and 2004

(Dollars in thousands)	*Convertible Preferred Stock*	*Common Stock*	*Additional Paid-in Capital*	*Treasury Stock*	*Accumulated Other Comprehensive Loss*	*Retained Earnings*	*Comprehensive Income*
Balance January 1, 2004	$ 14,552	$ 9,900	$ 22,277	$ (19,882)	$ (19,560)	$ 154,780	
Sale of 131,605 shares of common stock under stock option plan		131	1,949				
Purchase of 72,774 shares of common stock, net of sales				(1,729)			
Conversion of preferred stock to common stock	(15)	1	14				
Net income						10,324	$ 10,324
Other comprehensive income/(loss):							
Foreign currency translation adjustments					4,974		4,974
Unrealized gain on securities (net of income taxes of $161)					242		242
Minimum pension liability adjustment (net of income taxes of $1,515)					(2,195)		(2,195)
Comprehensive income							$ 13,345
Cash dividends paid:							
Preferred stock ($1.375 per share)						(800)	
Common stock (77.25¢ per share)						(6,931)	
Non-qualified stock option income tax benefit			209				
Balance, December 31, 2004	14,537	10,032	24,449	(21,611)	(16,539)	157,373	
Sale of 103,194 shares of common stock under stock option plan		103	1,937				
Purchase of 62,864 shares of common stock, net of sales				(1,687)			
Conversion of preferred stock to common stock	(156)	8	148				
Net income						13,159	$ 13,159
Other comprehensive income/(loss):							
Foreign currency translation adjustments					(4,024)		(4,024)
Unrealized gain on securities (net of income taxes of $38)					60		60
Minimum pension liability adjustment (net of income taxes of $1,920)					(3,364)		(3,364)
Comprehensive income							$ 5,831
Cash dividends paid:							
Preferred stock ($1.375 per share)						(796)	
Common stock (78.50¢ per share)						(7,073)	
Non-qualified stock option income tax benefit			278				
Balance, December 31, 2005	14,381	10,143	26,812	(23,298)	(23,867)	162,663	
Sale of 197,171 shares of common stock under stock option plan		197	3,973				
Purchase of 33,220 shares of common stock, net of sales				(1,037)			

Conversion of preferred stock to common stock	(60)	3	57				
Equity based compensation			420				
Deferred compensation			1,606	12			
Net income						6,670	$ 6,670
Other comprehensive income:							
Foreign currency translation adjustments					5,805		5,805
Unrealized gain on securities (net of income taxes of $78)					124		124
Minimum pension liability adjustment (net of income taxes of $3,035)					4,199		4,199
Comprehensive income							$ 16,798
Defined benefit pension liability transition adjustment (net of income taxes of $351)					(553)		
Cash dividends paid:							
Preferred stock ($1.375 per share)						(789)	
Common stock (80.50¢ per share)						(7,360)	
Non-qualified stock option income tax benefit			685				
Balance, December 31, 2006	$ 14,321	$ 10,343	$ 33,553	$ (24,323)	$ (14,292)	$ 161,184	

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements

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Notes to Consolidated Financial Statements

For the years ended December 31, 2006, 2005 and 2004

1. Summary of Significant Accounting Policies

Nature of Operations

Stepan Company (the Company) operations consist predominantly of the production and sale of specialty and intermediate chemicals, which are sold to other manufacturers for use in a variety of end products. Principal markets for all products are manufacturers of cleaning and washing compounds (including detergents, shampoos, fabric softeners, toothpastes and household cleaners), paints, cosmetics, food and beverages, agricultural products, plastics, furniture, automotive equipment, insulation and refrigeration.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. The Company consolidates all wholly and majority-owned subsidiaries in which the Company exercises controlling influence. The equity method is used to account for investments in which the Company exercises significant but non-controlling influence. See Joint Ventures below. All significant intercompany balances and transactions have been eliminated in consolidation.

Joint Ventures

The Company is a partner in two joint ventures: Nanjing Stepan Jinling Chemical Limited Liability Company (Stepan China) in Nanjing, China, and Stepan Philippines Inc. in Bauan, Batangas, Philippines. Stepan China was formed to manufacture the Company s aromatic polyester polyols for China s domestic market. The Company and its partner own 55 percent and 45 percent, respectively, of the joint venture. The Company includes Stepan China s accounts in its consolidated financial statements, and the joint venture partner s interests in Stepan China s income and net assets are reported in the Minority Interest lines of the Consolidated Statements of Income and the Consolidated Balance Sheets, respectively. In 2004, Stepan China s financial statements were included in the Company s consolidated financial statements on a three-month lag basis. The reporting lag was reduced to one month in the third quarter of 2005 and was eliminated as of December 31, 2005. The impact of the additional months of activity on the Company s 2005 quarterly and annual consolidated financial statements was not significant.

Stepan Philippines Inc. owns and operates a manufacturing facility, which produces surfactants that are sold in the Philippines and Southeast Asia. The Company and its partner each hold a 50 percent interest in the joint venture. The Company s investment in Stepan Philippines Inc. is accounted for under the equity method and is included in the Other non-current assets caption on the Consolidated Balance Sheets. The Company s share of Stepan Philippines Inc. s net earnings is included in the Income from Equity in Joint Venture line of the Consolidated Statements of Income.

Cash and Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less from the date of purchase to be cash equivalents.

Concentration of Credit Risks

The Company grants credit to its customers who are widely distributed across the Americas, Europe and Asia. The Company does not have any one customer whose business represents more than 10 percent of the Company s consolidated revenue. There is no material concentration of credit risk.

Inventories

Inventories are valued at cost, which is not in excess of market value, and include material, labor and plant overhead costs. The last-in, first-out (LIFO) method is used to determine the cost of the Company s domestic inventories. The first-in, first-out (FIFO) method is used for all other inventories. Inventories priced at LIFO as of December 31, 2006 and 2005, amounted to 77 and 78 percent of total inventories, respectively.

Property, Plant and Equipment

Depreciation of physical properties is provided on a straight-line basis over the estimated useful lives of various assets. Lives used for calculating depreciation are generally 30 years for buildings and 15 years for building improvements. For assets classified as machinery and equipment, lives generally used for calculating depreciation expense are from ten to 15 years for manufacturing equipment, from five to ten years for furniture and fixtures, from three to five years for vehicles and from three to ten years for computer equipment and software. Manufacturing of chemicals is capital intensive with over 90 percent of the assets included in machinery and equipment representing manufacturing equipment. Major renewals and betterments are capitalized in the property accounts, while maintenance and repairs ($27,940,000, $28,114,000, and $24,444,000 in 2006, 2005 and 2004, respectively), which do not renew or extend the life of the respective assets, are charged to operations currently. The cost of property retired or sold and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in income.

Included in the computer equipment and software component of machinery and equipment within property, plant and equipment are costs related to the acquisition and development of internal-use software. Capitalized costs include external direct costs of materials and services consumed in obtaining and developing the software. For development projects where major internal resources are committed, payroll and payroll-related costs incurred during the application development phase of the project are also capitalized. The capitalized costs are amortized over the useful lives of the software, which are generally three to ten years. Costs incurred in the preliminary project phase are expensed.

Interest charges on borrowings applicable to major construction projects are capitalized.

Operating assets are written down to fair value whenever an impairment review indicates that the carrying value cannot be recovered on an undiscounted cash flow basis.

Revenue Recognition

Revenue is recognized upon shipment of goods to customers, at which time title and risk of loss pass to the customer. For arrangements where the Company consigns product to a customer location, revenue is recognized when the customer uses the inventory. The Company records shipping and handling billed to a customer in a sales transaction as revenue. Costs incurred for shipping and handling are recorded in cost of sales. Volume discounts due to customers are estimated and recorded in the same period as the sales to which the discounts relate and reported as reductions of revenue in the Consolidated Statements of Income.

Cost of sales comprises raw material costs, including inbound freight expense to deliver the raw materials, manufacturing plant labor expenses and various manufacturing overhead expenses, which include utility, maintenance, operating supply, amortization and manufacturing asset depreciation expenses. Cost of sales also includes outbound freight expenses, purchasing and receiving costs, quality assurance expenses, inter-plant transfer costs and warehouse expenses.

Marketing expense comprises salary and the related fringe benefit expenses for marketing and sales personnel and operating costs, such as outside agent commissions, automobile rental and travel-related expenses, which support the sales and marketing functions. Bad debt charges and any depreciation expenses related to marketing assets (e.g. computers) are also classified as marketing expense.

Administrative expense comprises salary and the related fringe benefit expenses and operating costs for the Company s various administrative functions, which include information services, finance, legal, and human resources. Compensation expense related to the Company s deferred compensation plans and legal and environmental remediation expenses are also classified as administrative expense.

Environmental Expenditures

Environmental expenditures that relate to current operations are expensed in cost of sales or capitalized as appropriate. Expenditures that mitigate or prevent environmental contamination and that benefit future operations are capitalized. Capitalized expenditures are depreciated generally utilizing a 10 year life. Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when environmental assessments and/or remedial efforts are probable and the cost or range of possible costs can be reasonably estimated. When no amount within the range is a better estimate than any other amount, the minimum is accrued. Some of the factors on which the Company bases its estimates include information provided by feasibility studies, potentially responsible party negotiations and the development of remedial action plans. Because reported liabilities are recorded based on estimates, actual amounts could differ from those estimates. Legal costs related to environmental matters are expensed as incurred. See Note 14.

Goodwill and Other Intangible Assets

Intangible assets include patents, agreements not to compete, trademarks, customer lists and goodwill, all of which were acquired as part of business acquisitions. The Company separately identifies intangible assets other than goodwill and amortizes them in accordance with their useful lives, generally ranging from five to 15 years. Goodwill is not amortized. Goodwill is subject to annual tests for impairment. Intangible assets are tested for impairment when events indicate that an impairment may have occurred. At December 31, 2006, there was no impairment of goodwill or other intangible assets. For more details see Note 3.

Research and Development Costs

The Company s research and development costs are expensed as incurred. These expenses are aimed at discovery and commercialization of new knowledge with the intent that such effort will be useful in developing a new product or in bringing about a significant improvement to an existing product or process. Total expenses were $18,850,000, $18,292,000 and $16,005,000 in 2006, 2005 and 2004, respectively. The balance of expenses reflected on the Consolidated Statements of Income relates to technical services, which include routine product testing, quality control and sales support service.

Income Taxes

The provision for income taxes includes federal, foreign, state and local income taxes currently payable and those deferred because of temporary differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using enacted marginal tax rates. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. Deferred income tax expenses or credits are based on the changes in the asset or liability from period to period. See Note 7.

Translation of Foreign Currencies

Assets and liabilities of consolidated foreign subsidiaries are translated into U.S. dollars at exchange rates in effect at year end. The resulting translation adjustments are included in stockholders equity. Revenues and expenses for the consolidated foreign subsidiaries and equity income or losses for the Company s unconsolidated Philippines joint venture are translated at average exchange rates prevailing during the year. Gains or losses on foreign currency transactions are reflected in the Other, net caption of the Consolidated Statements of Income. The foreign exchange gains and losses recognized by year were $64,000 gain in 2006, $76,000 gain in 2005 and $103,000 loss in 2004.

Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), *Share-Based Payment*, which replaced SFAS No. 123, *Accounting for Stock-Based Compensation*, and superseded Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. The accounting standard applies to new awards and to awards modified, repurchased or cancelled after the adoption date and to the unvested portion of awards outstanding as of the adoption date. SFAS No. 123(R) requires the fair value of all share-based payment transactions to be recognized in the financial statements. Prior to January 1, 2006, the Company used the intrinsic value method of APB Opinion No. 25, which resulted in the recognition of no stock-based compensation expense. The Company elected to adopt the new accounting standard using the modified prospective application method. Because prior period financial statements are not restated, financial results are not comparable as reported. The following table reconciles the actual net income and earnings per share results for the years ended December 31, 2005 and 2004, to pro forma results for the same periods, as if the Company had applied the fair value recognition provisions of SFAS No. 123 for periods prior to January 1, 2006. In December 2004, the Company s Board of Directors approved the immediate acceleration of the vesting periods for most of the stock options that were unvested at that time. As a result, there were very few unvested stock options outstanding throughout 2005, which accounts for the large decline in pro forma compensation expense from 2004 to 2005.

(In thousands, except per share amounts)	**For the Years Ended December 31**	
	2005	**2004**
Net income, as reported	**$ 13,159**	$ 10,324
Deduct: Total stock-based employee compensation expense determined under		
fair value based method for all awards,		
net of related tax effects	**30**	1,517
Net income, pro forma	**$ 13,129**	$ 8,807
Earnings per share:		
Basic as reported	**$ 1.37**	$ 1.06
Basic pro forma	**$ 1.37**	$ 0.89
Diluted as reported	**$ 1.35**	$ 1.05
Diluted pro forma	**$ 1.35**	$ 0.89

See Note 9 for detailed information about the Company's stock-based compensation.

Earnings Per Share

Basic earnings per share amounts are computed based on the weighted-average number of common shares outstanding. Net income used in computing basic earnings per share has been reduced by dividends paid to preferred stockholders. Diluted earnings per share amounts are based on the increased number of common shares that would be outstanding assuming the exercise of certain outstanding stock options (under the treasury stock method), the conversion of the convertible preferred stock, when such conversion would have the effect of reducing earnings per share, and directors stock awards. See Note 16.

Comprehensive Income

Comprehensive income includes net income and all other non-owner changes in equity that are not reported in net income. For the years ended December 31, 2006, 2005 and 2004, the Company s comprehensive income included net income, foreign currency translation gains and losses, unrealized gains and losses on investment securities and defined benefit pension liability adjustments. Comprehensive income is disclosed in the Consolidated Statements of Stockholders Equity.

Accumulated other comprehensive loss as reported in the Consolidated Balance Sheets at December 31, 2006 and 2005, comprised the following:

(Dollars in thousands)	**December 31**	
	2006	**2005**
Foreign currency translation gains/(losses)	**$ 966**	($ 4,839)
Unrealized gains on securities (net of income taxes of $360 in 2006 and $282 in 2005)	**550**	426
Defined benefit pension liability adjustments (net of income taxes of $9,751 in 2006 and $12,435 in 2005)	**(15,808)**	(19,454)
Total accumulated other comprehensive loss	**($ 14,292)**	($ 23,867)

Segment Reporting

The Company reports financial and descriptive information about its reportable operating segments. Operating segments are components of the Company that have separate financial information that is regularly evaluated by the chief operating decision maker to assess segment performance and allocate resources. The Company discloses segment revenue, operating income, assets, capital expenditures and depreciation and amortization expenses. Enterprise-wide financial information about the revenues derived from the Company s products, the geographic locations in which the Company earns revenues and holds assets is also disclosed. See Note 15.

Derivative Instruments

Derivative instruments are recognized on the balance sheet as either an asset or a liability measured at fair value. Changes in fair value are recognized currently in earnings or in other comprehensive income if specific hedge criteria are met. Special accounting for qualifying hedges allows a derivative instrument s gains and losses to offset related results on the hedged item in the statement of income, to the extent effective. If a transaction is designated to receive hedge accounting, the Company establishes at the inception of the hedge the method it will use for assessing the effectiveness of the hedge and the measurement approach for determining the ineffective aspect of the hedge.

The Company has limited derivative transactions. Company policy prohibits the use of financial instruments for trading or speculative purposes. The Company does, however, enter into forward contracts to minimize exposure related to rising natural gas prices. The Company may contract up to 100 percent of its forecasted natural gas requirements. Because the Company anticipates taking delivery of the gas for use in its manufacturing operations, the forward contracts qualify for the normal purchase exception of SFAS No. 133, as amended. As a result, the contracts are not accounted for as derivative instruments. The cost of the natural gas is charged to expense at the time the gas is delivered and used. To the extent forecasts are adjusted resulting in contracted volume exceeding forecasted volume, which is generally insignificant, the excess contracted volume is accounted for as a derivative instrument and, accordingly, marked to market through earnings at the applicable measurement date. At December 31, 2006, the Company had open forward contracts for the purchase of 0.7 million dekatherms of natural gas in 2007 at a cost of $5,988,000.

The Company s foreign subsidiaries periodically use short-term forward exchange contracts to limit the exposure of certain foreign currency transactions and balances to fluctuating exchange rates. At December 31, 2006, the Company s French subsidiary had one forward contract for the January 2007 purchase of $500,000.

Recent Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, *Accounting for Income Taxes.* The interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken, in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties accounting in interim periods, disclosure and transition. The interpretation is effective for fiscal years beginning after December 15, 2006. The Company continues to evaluate the impact of adopting FIN 48. At this point, the Company does not believe that the adoption of FIN 48 will have a material effect on its financial position, cash flows and results of operations.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, provides a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. The guidance in the new standard is applicable in circumstances where other accounting pronouncements mandate or permit fair value measurements. SFAS No. 157, which is effective for financial statements issued for fiscal years beginning after November 15, 2007, does not require any new fair value measurements. The Company is in the process of determining the effect that adoption of SFAS No. 157 will have on its financial position, cash flows and results of operations.

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*. This statement amends certain requirements set forth in previous pension and postretirement accounting standards. SFAS No. 158 requires that the overfunded or underfunded status of a defined benefit postretirement plan be recognized as an asset or liability in the statement of financial position. Changes in the funded status are to be recognized in comprehensive income. This requirement is effective for fiscal years ending after December 15, 2006. Adoption of SFAS No. 158 did not have an effect on the Company s results of operations or cash flows. Furthermore, the adoption of the new standard did not have a significant effect on the Company s financial position. See Note 11. In addition to the foregoing requirement, SFAS No. 158 mandates, with limited exceptions, that the funded status of a defined benefit postretirement plan be measured as of the date of an entity s year-end statement of financial position. The Company already complies with this requirement.

In September 2006, the SEC released Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements.* SAB No. 108 provides guidance regarding the methodology for quantifying and evaluating the materiality of financial statement misstatements. SAB No. 108 is effective for fiscal years ending after November 15, 2006. Application of the guidance in SAB No. 108 did not have a material effect on the Company s financial position, cash flows or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 expands the scope of what entities may carry at fair value by offering an irrevocable option to record many types of financial assets and liabilities at fair value. Changes in fair value would be recorded in an entity s income statement. This accounting standard also establishes presentation and disclosure requirements that are intended to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for the Company on January 1, 2008. Earlier application is permitted under certain circumstances. The Company will begin to assess the impact, if any, that the adoption of SFAS No. 159 will have on its financial position, cash flows and results of operations.

2. Asset Retirement Obligations

The Company adopted FIN 47, *Accounting for Conditional Asset Retirement Obligations*, effective December 31, 2005. As a result, the Company recorded a liability for the eventual, future disposal of asbestos at the Company s various locations. The asset retirement obligation reflects the special handling and disposal of asbestos as set forth by the regulations of the various countries in which the Company operates. The asbestos is primarily used to insulate storage and processing tanks, reactors, boilers and infrastructure assets, such as flooring, walls and ceilings. The impact of adopting FIN 47 was a non-cash after-tax charge of $370,000 against income for 2005. In accordance with the guidance of FIN 47, the charge for the cumulative effect of initially applying the interpretation was reported as a change in accounting principle in the Consolidated

Statements of Income. The effect on 2005 operating income was not material. The asset retirement obligation was $539,000 and $604,000 at December 31, 2006 and 2005, respectively.

Below is a reconciliation of the January 1, 2006, and December 31, 2006, carrying values of the Company s asset retirement obligations:

(In thousands)	
Asset retirement obligation, January 1	$ 604
Liabilities incurred in 2006	
Liabilities settled in 2006	(88)
Accretion expense	23
Asset retirement obligation, December 31	$ 539

3. Goodwill and Other Intangible Assets

The Company s net carrying values of goodwill were $7,841,000 and $7,414,000 as of December 31, 2006 and December 31, 2005, respectively. The entire amount of goodwill relates to the surfactants reportable segment. The change in net carrying value resulted from the effects of currency translation.

The following table reflects the components of all other intangible assets, which all have finite lives, as of December 31, 2006 and 2005. The changes in the intangible assets carrying amounts, except non-compete agreements, were due to the effects of currency translation.

	Gross Carrying Amount		**Accumulated Amortization**	
(In thousands)	**December 31**		**December 31**	
	2006	**2005**	**2006**	**2005**
Other Intangible Assets:				
Patents	**$ 2,000**	$ 2,000	**$ 1,133**	$ 1,000
Trademarks	**5,510**	5,512	**3,279**	2,916
Customer lists	**4,806**	4,660	**4,155**	3,655
Know-how [(a)]	**8,484**	8,457	**4,873**	4,283
Non-compete agreements		2,381		2,381
Total	**$ 20,800**	$ 23,010	**$ 13,440**	$ 14,235

(a) Know-how includes intellectual property rights covering proprietary information, written formulae, trade secrets or secret processes, inventions and developmental products (whether patentable or not), discoveries, improvements, compositions, manufacturing processes, manuals, specifications and technical data.

Aggregate amortization expense for the years ended December 31, 2006 and 2005, was $1,509,000 and $1,696,000, respectively. Estimated amortization expense for identifiable intangibles assets for each of the five succeeding fiscal years is as follows:

(In thousands)	
For year ended 12/31/07	$ 1,243
For year ended 12/31/08	$ 1,139
For year ended 12/31/09	$ 1,116
For year ended 12/31/10	$ 1,111
For year ended 12/31/11	$ 1,111

4. Inventories

The composition of inventories is as follows:

	December 31	
(Dollars in thousands)	**2006**	**2005**
Finished products	**$ 56,128**	$ 48,154
Raw materials	**26,709**	28,245
Total inventories	**$ 82,837**	$ 76,399

If the first-in, first-out (FIFO) inventory valuation method had been used for all inventories, inventory balances would have been approximately $24,555,000 and $21,259,000 higher than reported at December 31, 2006, and December 31, 2005, respectively.

5. Debt

Debt comprises the following:

		December 31	
(Dollars in thousands)	**Maturity Dates**	**2006**	**2005**
Unsecured private placement notes			
5.69%	2012-2018	**$ 40,000**	$ 40,000
6.86%	2009-2015	**30,000**	30,000
6.59%	2007-2012	**16,364**	19,091
7.77%	2007-2008	**5,455**	8,182
Unsecured U.S. bank debt	2011	**9,400**	
Debt of foreign subsidiaries			
Secured bank term loans, foreign Currency	2007-2010	**18,737**	22,315
Other, foreign currency	2007-2015	**11,208**	6,134
Total Debt		**131,164**	125,722
Less current maturities		**23,761**	16,777
Long-term debt		**$ 107,403**	$ 108,945

During 2006, the Company negotiated a new, committed $60,000,000 revolving credit agreement, with a term of five years, and simultaneously cancelled a similar agreement that would have expired in 2007. As of December 31, 2006, the Company had borrowings totaling $9,400,000 on this new loan agreement. During 2006, the Company borrowed under this agreement at varying rates, which averaged 5.91 percent. The revolving credit agreement requires a facility fee on the total commitment that is based on the Company s leverage ratio. Periodically, the company had other borrowings under notes payable to U.S. banks for which there were no outstanding balances at December 31, 2006 or 2005.

The debt of foreign subsidiaries consists mostly of bank term loans to Stepan Europe, Stepan Mexico and to the Company s China joint venture, all in local currencies. The European bank term loans have scheduled maturities through 2010 and bear interest at 90-day EURIBOR plus 1.8 percent. The Mexican bank term loan has scheduled maturities through 2009, and bears interest at 10.35 percent. The China joint venture has bank term loans totaling $2,562,000 that mature through 2008 and short-term loans totaling $1,793,000, both in local currency, with interest averaging 5.79 percent. The Company guarantees its pro rata share (55 percent) of the China joint venture s bank debt. Other foreign currency debt is composed primarily of borrowings under uncommitted lines of credit to the Company s European subsidiaries. Except for the debt of the Company s China joint venture, the foreign debt that is currently outstanding is secured by the assets of the respective entities but is not guaranteed by the U.S. parent.

The various loan agreements contain provisions, which, among others, require maintenance of certain financial ratios and place limitations on additional debt, investments and payment of dividends. The Company is in compliance with its U.S. loan agreements as of December 31, 2006. Unrestricted retained earnings were $32,219,000 and $32,520,000 at December 31, 2006 and 2005, respectively.

Due to European severance costs and changes to French pension accounting standards, the Company s French subsidiary was out of compliance with its loan agreements as of December 31, 2006. The Company obtained a compliance waiver from its French banks.

Debt at December 31, 2006, matures as follows: $23,761,000 in 2007; $12,615,000 in 2008; $10,744,000 in 2009; $7,733,000 in 2010; $16,420,000 in 2011 and $59,891,000 after 2011.

The fair value of the Company s fixed-rate debt at December 31, 2006, including current maturities, was estimated to be $94,162,000 compared to a carrying value of $92,801,000.

Net interest expense for the years ended December 31 was composed of the following:

(Dollars in Thousands)	**2006**	**2005**	**2004**
Interest Expense	**$ 9,063**	$ 8,065	$ 7,567
Interest Income	**(178)**	(115)	(157)
	8,885	7,950	7,410
Capitalized Interest		(149)	(173)
Interest, Net	**$ 8,885**	$ 7,801	$ 7,237

The Company maintains standby letters of credit under its workers compensation insurance agreements and for other purposes as needed from time to time. The insurance letters of credit are renewed annually and amended to the amounts required by the insurance agreements. As of December 31, 2006, the Company had a total of $1,411,000 in outstanding standby letters of credit.

6. Leased Properties

The Company leases certain property and equipment (primarily transportation equipment, buildings and land) under operating leases, which are denominated in local currencies. Total rental expense was $4,545,000, $3,987,000, and $3,936,000 in 2006, 2005 and 2004, respectively.

Consolidated Company minimum future rental payments under operating leases with terms in excess of one year as of December 31, 2006, are:

(Dollars in thousands)	*Year*	*Amount*
	2007	$ 3,117
	2008	2,863
	2009	2,165
	2010	1,950
	2011	1,456
	Subsequent to 2011	7,893
Total minimum future rental payments		$ 19,444

In January 2005, the Company s Brazilian subsidiary entered into an agreement to purchase a subsidiary of a multinational cleaning products company for a minimal purchase price. The purchase contract included a 10-year capital lease agreement under which $463,000 was paid for the first 24 months with gross remaining payments due of $2,136,000. At the end of the lease agreement, all of the relevant assets will be transferred and assigned to the Company. The assets and liabilities under the capital lease were recorded at the present value of the minimum lease payments. The leased assets are recorded under the property, plant and equipment caption of the Condensed Consolidated Balance Sheet. The capital lease liability is recorded under the other non-current liabilities caption of the Condensed Consolidated Balance Sheet. The amortization of the assets held under the capital lease is included in depreciation expense for 2006. Following is a summary of property held under the capital lease:

(Dollars in thousands)	**December 31, 2006**
Machinery and equipment	$ 961
Building	301
Land	99
	1,361
Less: Accumulated depreciation	(217)
Total property, net	$ 1,144

The minimum future lease payments under the capital lease as of December 31, 2006, for each of the next five years and in the aggregate are:

(Dollars in thousands)	*Year*	*Amount*
	2007	$ 267
	2008	267
	2009	267
	2010	267
	2011	267
	Subsequent to 2011	801
Total minimum lease payments		$ 2,136
Less: Amount representing interest		(976)
Capital lease liability at December 31, 2006		$ 1,160

7. Income Taxes

The provisions for taxes on income and the related income before taxes are as follows:

(Dollars in thousands)	*2006*	*2005*	*2004*
Taxes on Income			
Federal			
Current	**$ 4,765**	$ 6,153	$ 5,912
Deferred	**(4,931)**	(4,483)	(2,477)
State			
Current	**1,175**	821	707
Deferred	**(1,325)**	(543)	(558)
Foreign			
Current	**5,789**	2,602	2,011
Deferred	**(4,573)**	(380)	(1,275)
Total	**$ 900**	$ 4,170	$ 4,320
Income before Taxes and Minority Interest			
Domestic	**$ 353**	$ 7,673	$ 12,212
Foreign	**7,036**	9,973	2,421
Total	**$ 7,389**	$ 17,646	$ 14,633

The variations between the effective and statutory U.S. federal income tax rates are summarized as follows:

(Dollars in thousands)	***2006*** *Amount*	*%*	***2005*** *Amount*	*%*	***2004*** *Amount*	*%*
Federal income tax provision at statutory tax rate	**$ 2,586**	**35.0**	$ 6,176	35.0	$ 5,122	35.0
State tax provision (benefit) on income less applicable federal tax benefit	**(98)**	**(1.3)**	181	1.0	97	0.7
Foreign income taxed at different rates [(a)]	**(1,246)**	**(16.9)**	(1,270)	(7.2)	(112)	(0.8)
Effect of equity in foreign joint venture	**452**	**6.1**	440	2.5	(555)	(3.8)
Domestic production activities deduction	**(134)**	**(1.8)**	(223)	(1.3)		
Repatriation of foreign earnings			485	2.7	700	4.8
Charitable contribution of intellectual property					(980)	(6.7)
U.S. tax credits [(b)]	**(1,964)**	**(26.6)**	(1,899)	(10.8)	(265)	(1.8)
Non-deductible expenses and other items, net [(c)]	**1,304**	**17.7**	280	1.7	313	2.1
Total income tax provision	**$ 900**	**12.2**	$ 4,170	23.6	$ 4,320	29.5

(a) Includes the effect of changes in valuation allowances for foreign entities of $885,000, or 11.5 percent, in 2006.

(b) During 2006, the Company generated biodiesel credits of $1,601,000 compared to $1,430,000 in 2005. There were no biodiesel credits in 2004.

(c) 2006 includes $560,000 for the tax effect on the gross up of pre-tax earnings due to biodiesel credits, $398,000 in adjustments for federal income tax contingencies and $346,000 for the tax effects on various non-deductible expenses.

At December 31, the tax effect of significant temporary differences representing deferred tax assets and liabilities is as follows:

(Dollars in thousands)	*2006*	*2005*
Deferred Tax Liabilities:		
Depreciation	**$ (25,754)**	$ (29,460)
Safe harbor leases		(235)
Deferred Tax Liabilities	**$ (25,754)**	$ (29,695)
Deferred Tax Assets:		
Pensions	**$ 10,098**	$ 12,445
State income tax accrual	**(40)**	(114)
Deferred revenue	**2,490**	1,085
Other accruals and reserves	**4,508**	3,325
Amortization of intangibles	**342**	430
Inventories	**1,445**	672
Legal and environmental accruals	**10,090**	8,805
Deferred compensation	**10,365**	9,020
Bad debt and rebate reserves	**1,699**	1,686
Subsidiaries net operating loss carryforwards	**2,846**	3,154
Tax credits	**746**	596
Other	**4**	4
Deferred Tax Assets	**$ 44,593**	$ 41,108
Valuation Allowance	**$ (1,458)**	$ (2,459)
Net Deferred Tax Assets	**$ 17,381**	$ 8,954
Reconciliation to Consolidated Balance Sheet:		
Current deferred tax assets	**$ 10,362**	$ 8,239
Non-current deferred tax assets (in other non-current assets)	**9,065**	3,222
Current deferred tax liabilities (in accrued liabilities)		(297)
Non-current deferred tax liabilities	**(2,046)**	(2,210)
Net Deferred Tax Assets	**$ 17,381**	$ 8,954

Undistributed earnings of foreign subsidiaries and related companies that are deemed to be permanently reinvested amounted to $51,226,000 at December 31, 2006 compared to $45,226,000 at December 31, 2005. In general, the Company reinvests earnings of foreign subsidiaries in their operations indefinitely. However, the Company will repatriate earnings from a subsidiary where excess cash has accumulated and it is advantageous for tax or foreign exchange reasons. Because of the probable availability of foreign tax credits, it is not practicable to estimate the amount, if any, of the deferred tax liability on earnings reinvested indefinitely.

Tax loss carryforwards at December 31, 2006, amounted to $7,800,000 compared with $8,329,000 at the end of 2005. All of the tax loss carryforwards have an indefinite carryforward period. Tax credit carryforwards at December 31, 2006, amounted to $746,000 compared to $596,000. Of the tax credit carryforwards, $746,000 expires in 2015.

At December 31, 2006, the Company had valuation allowances of $1,458,000, which were attributable to the tax loss carryforwards in Germany and Brazil. At December 31, 2005, the Company had valuation allowances of $2,459,000, which were attributable to the tax loss carryforwards in Germany and Brazil.

The Company's wholly owned subsidiary in Germany recorded sufficient earnings during 2006, to allow the Company to utilize tax loss carryforwards in the amount of $410,000 for which a valuation allowance had previously been recorded. In addition, $475,000 of Germany s valuation allowance was released due to anticipated increased future earnings. This adjustment more accurately reflects the Company s estimate using the more likely than not test for the valuation allowance.

Due to a favorable tax law change in Mexico the Company benefited from a tax reduction of $635,000 during 2006. A transitional tax rule and election available under the law change impacts how inventories and cost of goods sold are recognized for tax purposes. In order to utilize the benefit of the law change in Mexico, the favorable election was made during 2006.

The reserve for tax contingencies related to issues in the U.S. and foreign locations was $1,857,000 at December 31, 2006 compared to $870,000 at December 31, 2005. This balance is the Company's best estimate of the potential liability for tax contingencies. The increase in the tax contingency reserve was primarily due to revised estimates of possible tax exposures in state and foreign jurisdictions. Inherent uncertainties exist in estimates of tax contingencies due to changes in tax law; both legislated and concluded through the various jurisdictions' tax court systems. It is the opinion of the Company's management that the possibility is remote that costs ultimately incurred in excess of those accrued, if any, will have a material adverse impact on the Company's financial statements.

In June of 2006, the FASB issued FIN 48, *Accounting for Uncertainty in Income Taxes*, effective for fiscal years beginning after December 15, 2006. This Interpretation is intended to clarify the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with SFAS No. 109, *Accounting of Income Taxes*, by prescribing a more-likely-than-not threshold to recognize any benefit of a tax position taken or expected to be taken in a tax return. Tax positions that meet the recognition threshold are reported at the largest amount that is more-likely-than-not to be realized. FIN 48 revised disclosure requirements and introduces a prescriptive, annual, tabular roll-forward of the unrecognized tax benefits. Companies are required to assess all material open positions in all tax jurisdictions and determine the appropriate amount of tax benefits that are recognizable under FIN 48. The Company continues to evaluate the impact of adopting FIN 48. At this point, the Company does not believe that the adoption of FIN 48 will have a material effect on its financial position, cash flows and results of operations.

8. Stockholders Equity

The Company s preferred stock is convertible at the option of the holder at any time (unless previously redeemed) into shares of common stock at a conversion of 1.14175 shares of common stock for each share of preferred stock. Dividends on preferred stock accrue at a rate of $1.375 per share per annum, which are cumulative from the date of original issue. The Company may not declare and pay any dividend or make any distribution of assets (other than dividends or other distribution payable in shares of common stock) or redeem, purchase or otherwise acquire, shares of common stock, unless all accumulated and unpaid preferred dividends have been paid or are contemporaneously declared and paid. The preferred stock is subject to optional redemption by the Company, in whole or in part, at any time, at a redemption price of $25 per share plus accrued and unpaid dividends thereon to the date fixed for redemption. Preferred stock is entitled to 1.14175 votes per share on all matters submitted to stockholders for action and votes together with the common stock as a single class, except as otherwise provided by law or the Certificate of Incorporation of the Company. There is no mandatory redemption or sinking fund obligation with respect to the preferred stock.

At December 31, 2006 and 2005, treasury stock consisted of 1,134,958 and 1,102,309 shares of common stock, respectively.

9. Stock-based Compensation

On December 31, 2006, the Company had stock options outstanding under its 1992 Stock Option Plan (1992 Plan) and stock options and stock awards outstanding under its 2000 Stock Option Plan (2000 Plan) and its 2006 Incentive Compensation Plan (2006 Plan). The 2006 Plan was approved by shareholders at the Company s annual shareholder meeting held on April 25, 2006. Stock options and stock awards are granted to executives, key employees and outside directors. No further options or awards may be granted under the 1992 Plan or the 2000 Plan. The 2006 Plan authorizes the award of 1,000,000 shares of the Company s common stock for stock options, stock appreciation rights and stock awards. The compensation cost that was charged against income for all plans was $420,000 for the year ended December 31, 2006. No stock-based compensation was charged against income for the years ended December 31, 2005 and 2004, as the Company did not begin recognizing fair value stock-based compensation expense in its financial statements until January 1, 2006, with the adoption of SFAS No. 123(R). The total income tax benefit recognized in the income statement for share-based compensation arrangements was $93,000 for the same period. The following provides information regarding the stock option and stock award grants.

Stock Options

Under all plans, stock option awards are granted with an exercise price equal to the market price of the Company s stock at the date of grant. The market price is defined as the average of the opening and closing prices for Company common stock on the grant date as reported in the New York Stock Exchange Composite Transactions. The option awards generally vest based on two years of continuous service and have 8- to 10-year contractual terms. The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model incorporating the assumptions noted in the following table. Expected volatility is based on the historical volatility of the Company s stock. The Company also uses historical data to estimate the expected term of options granted. The risk-free rate is the U.S. Treasury note rate that corresponds to the expected option term at the date of grant.

	For the Years Ended December 31 2006	2005	2004
Expected dividend yield	3.00%	2.80%	2.80%
Expected volatility	23.15%	23.10%	22.70%
Expected life	7.9 years	7.5 years	7.5 years
Risk-free interest rate	4.77%	4.15%	3.95%

A summary of option activity under the Company s stock option plans for the year ended December 31, 2006, is presented below:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value ($000)
Options				
Outstanding at January 1, 2006	1,340,719	$ 23.89		
Granted	106,995	26.50		
Exercised	(197,171)	21.15		
Forfeited or expired	(32,727)	24.02		
Outstanding at December 31, 2006	1,217,816	24.57	4.91	$ 8,652
Vested or expected to vest at December 31, 2006	1,214,456	24.56	4.90	$ 8,634
Exercisable at December 31, 2006	1,114,321	24.38	4.53	$ 8,118

The weighted-average grant-date fair values of options granted during the years ended December 31, 2006, 2005 and 2004 were $6.45, $5.01 and $5.58, respectively. The total intrinsic values of options exercised during the years ended December 31, 2006, 2005, and 2004 were $1,805,000, $712,000, and $1,076,000, respectively.

As of December 31, 2006, there was $370,000 of total unrecognized compensation cost related to unvested stock options granted under the Company s stock option plans. That cost is expected to be recognized over a weighted-average period of 1.15 years.

Cash received from stock option exercises under the Company s stock option plans for the years ended December 31, 2006, 2005, and 2004 was $3,297,000, $534,000 and $718,000, respectively. The actual tax benefit realized for the tax deductions from stock option exercises totaled $685,000, $278,000, and $209,000 for the years ended December 31, 2006, 2005, and 2004, respectively.

Stock Awards

In February 2006, the Company granted, to employees, stock awards under the 2000 Stock Option Plan. These are the only such awards granted under the plan. The stock awards vest only upon the Company s achievement of certain levels of consolidated net income and return on invested capital by the end of the specified measurement period, in this case December 31, 2008. The number of Company shares of common stock ultimately distributed, if any, is contingent upon the level of consolidated net income and return on invested capital attained. The fair value of stock awards equals the grant-date market price of the Company s common stock, discounted for the estimated amount of dividends that would not be received during the measurement period. Compensation expense is recorded each reporting period based on the probable number of awards that will ultimately vest given the projected level of consolidated net income and return on invested capital. If at the end of the measurement period the performance objectives are not met, no compensation cost is recognized and any compensation expense recorded in prior periods will be reversed. Compensation cost is currently computed based on management s assessment that the minimum level of the performance objectives will be achieved by the end of the measurement period.

A summary of stock award activity for the year ended December 31, 2006, is presented below:

		Weighted-Average Grant Date	
	Shares	**Fair Value**	
Unvested Stock Awards			
Unvested at January 1, 2006			
Granted	84,000	$	23.97
Vested			
Forfeited	2,000	$	23.93
Unvested at December 31, 2006	82,000	$	23.97

As of December 31, 2006, under the current Company assumption as to the number of stock award shares that will probably vest at the measurement period ended December 31, 2008, there was $314,000 of unrecognized compensation cost related to unvested stock awards. That cost is expected to be recognized over a period of 2.0 years. No stock award shares vested during the year ended December 31, 2006.

In general, it is the Company s policy to issue new shares of its common stock upon the exercise of stock options or the vesting of stock awards.

10. Deferred Compensation and Related Investments

The Company sponsors deferred compensation plans that allow management to defer receipt of their bonuses and outside directors to defer receipt of their fees until retirement or departure from the Company or as elected. The deferred amounts are invested in mutual funds or Company common stock. The compensation expense and related deferred compensation obligation to the participants who elect deferral are recorded when the underlying compensation is earned. The deferred obligation may increase or decrease based on the performance results of investment options a limited selection of mutual funds or Company common stock chosen by the plan participants. The Company maintains at least enough Company common stock in treasury to cover the equivalent number of common stock shares resulting from participants electing the Company common stock investment option, which periodically requires the Company to purchase its common shares from the open market. When plan distributions are made to retired/departed participants, such distributions are made, in cash or shares of Stepan Company common stock at the option of the participant, in amounts equivalent to the payment date value of the investment choices made by the participant. Since the deferred compensation obligations may be settled in cash, each reporting period the Company must record any appreciation in the value of the participant s plan balances as additional compensation expense. Conversely, declines in the market value of the investment choices made by the participant reduce compensation expense in the periods that the market value declines. The resulting increases and reductions of compensation expense are recorded in the Administrative expense line of the Consolidated Statements of Income. The additional compensation expense resulting from the appreciation of the market value and earnings of the selected investment options was $3,672,000 in 2006, $2,094,000 in 2005 and $693,000 in 2004. The Company s deferred compensation liability was $24,069,000 and $22,118,000 at December 31, 2006 and 2005, respectively.

In December 2006, the Company, with prior Board of Director approval, adopted an amended and restated management incentive plan. The amendment provided participants with an irrevocable 2006 election to transfer all or a portion of their deferred compensation accounts that were attributable to pre-2007 bonuses to an alternate Company common stock investment option. The number of share equivalents credited to the participants accounts for this option was based on the December 31, 2006, closing price of the Company s common stock. The share equivalents transferred to the alternate investment option can be distributed (upon a participant s retirement or departure from the Company) only in shares of Stepan Company common stock (i.e., there can be no cash settlements of these amounts). Furthermore, such amounts cannot be transferred to the plan s other investment options. As a result of the irrevocable 2006 election, the share equivalent amounts transferred to the participants deferred compensation accounts were treated as equity instruments, and on December 31, 2006, $1,542,000 was reclassified from the deferred compensation liability to additional paid-in capital in the Stockholders Equity section of the Consolidated Balance Sheets. In addition to the irrevocable 2006 election noted above, the amended plan rules also mandate that all future deferrals of bonuses to the Company common stock investment option will all be directed to the alternate Company common stock investment option. The Company implemented this plan change to reduce some of the deferred compensation plan expense volatility as expense treatment is not required for future fluctuations in the value of these shares.

The Company purchases shares of mutual funds in accordance with the mutual fund investment selections made by the participants. Such investments are classified as available-for-sale and included in Other non-current assets in the Consolidated Balance Sheets. These investments are recorded at cost when purchased and adjusted to their fair market values at the end of each reporting period with unrealized gains and losses recorded as direct adjustments to stockholders equity in Accumulated other comprehensive loss . If the accumulated unrealized loss for a particular mutual fund is considered other-than-temporary, the loss is reclassified out of Accumulated other comprehensive loss and recorded as an impairment loss in the Consolidated Statements of Income. The fair value of the affected mutual fund would then become its new cost basis for future gain/loss computations. Impairment losses, realized gains and losses from sales of mutual funds, dividend income and capital gains distributions are recorded in the Other, net caption under the Other Income (Expense) section of the Consolidated Statements of Income. The Company uses the average cost method to determine investment gains and losses.

The aggregate fair value of the mutual fund investments and gross unrealized gains or losses related to such investments at December 31, 2006 and 2005, were as follows:

(Dollars in thousands)	*2006*	*2005*
Aggregate fair value	**$ 13,648**	$ 10,836
Gross unrealized gains	**911**	733
Gross unrealized losses	**1**	25

The following table displays additional information about the mutual fund investments with gross unrealized losses at December 31, 2006 and 2005:

	Length of Time in Loss Position					
	Less than 12 Months		**12 Months or Greater**		**Total**	
(Dollars in thousands)	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
December 31, 2006	$ 473	$ 1			$ 473	$ 1
December 31, 2005	$ 2,942	$ 17	$ 241	$ 8	$ 3,183	$ 25

Dividend income and realized gains and losses from sales of mutual fund investments recorded in the Consolidated Statements of Income and unrealized gains and losses recorded directly to stockholders equity for the years ended December 31, 2006, 2005 and 2004, were as follows:

(Dollars in thousands)	**For the Years Ended December 31**		
	2006	**2005**	**2004**
Dividend income	**$ 1,026**	$ 424	$ 471
Realized gains/(losses)	**143**	208	2
Unrealized gains (net of taxes)	**124**	60	242

There were no impairment losses recorded in 2006, 2005 or 2004.

11. Post Retirement Benefit Plans

Defined Benefit Plans

The Company has funded non-contributory defined benefit plans covering substantially all U.S. employees and two unfunded non-qualified defined benefit pension plans (a supplemental executive plan and an outside directors plan). There is also a funded defined benefit plan for the Company s United Kingdom subsidiary. The benefits under these plans are based primarily on years of service and compensation levels. The Company generally funds the qualified pension plans up to the maximum amount deductible for income tax purposes.

Throughout the first half of 2006, amendments were made to four of the Company s defined benefit pension plans: the U.S. funded salaried defined benefit pension plan, the non-qualified unfunded supplemental executive defined benefit pension plan, the Maywood, New

Jersey, hourly defined benefit pension plan and the Stepan United Kingdom (UK) defined benefit pension plan. The amendments, which were similar for all four plans, took effect on July 1, 2006. The Company froze the defined benefit pension plans at June 30, 2006, and, as a result, accruals for service benefits ceased as of that date. Benefits earned through June 30, 2006, are available to participants when they retire, in accordance with the terms of the plans. The noted defined benefit pension plans were replaced with Company contributions to participants defined contribution accounts equal to a fixed percent of base salary. This change had no impact on current retirees or former employees with vested benefits or employees who terminated or retired by June 30, 2006. The Company will continue to recognize pension expense and cash funding obligations for the frozen defined benefit plans over the remaining lives of the pension liabilities. The Company also continues to recognize pension expense for the frozen unfunded supplemental executive defined benefit plan. Details of the effects of the pension plan amendments follow.

U.S. Salaried and Supplemental Executive Defined Benefit Pension Plans

In February 2006, the Company s Board of Directors approved amendments to the Company s U.S. funded salaried defined benefit pension plan and its non-qualified unfunded supplemental executive defined benefit pension. As a result of the announced pension plan amendments, the Company remeasured the obligations and assets of the salaried and supplemental executive defined benefit pension plans at February 14, 2006. The assumptions used in the remeasurement of the pension plan obligations were the same as those used in the December 31, 2005, measurement. The effects of the plan amendments were reductions of $14,310,000 and $493,000 in the projected benefit obligations for the salaried and supplemental executive defined benefit pension plans, respectively. In addition, the amendments triggered an $111,000 curtailment loss that was recognized as a component of the net periodic benefit cost recorded for the three- month period ended March 31, 2006.

Maywood, New Jersey, Hourly Defined Benefit Pension Plan

In April 2006, the hourly workers at the Company s Maywood, New Jersey, plant ratified a new union contract, which resulted in amendments to the hourly defined benefit pension plan. The Company remeasured the obligations and assets of the Maywood hourly defined benefit pension plan at April 18, 2006. With the exception of the discount rate, which was increased from 5.75 percent to 6.25 percent, the assumptions used in the remeasurement of the pension plan obligations were the same as those used in the December 31, 2005, measurement. The amendment triggered a $281,000 curtailment loss that was recognized as a component of the net periodic benefit cost recorded for the three-month period ended June 30, 2006.

Stepan UK Defined Benefit Pension Plan

In June 2006, Stepan UK pension plan trustees approved amendments to the Stepan UK defined benefit pension plan. As a result, the plan obligations and assets were remeasured at June 5, 2006. The discount rate used to measure the plan obligations was updated to a current rate of 5.00 percent compared to 4.70 percent used to measure plan obligations at December 31, 2005. The effect of the plan amendments was a $1,816,000 reduction in the projected benefit obligations of the Stepan UK defined benefit pension plan. No curtailment gain or loss was triggered as a result of the remeasurement.

In December 2006, the Company adopted SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Post Retirement Plans.* The following table displays the incremental effect of applying the new accounting standard on the individual lines of the consolidated balance sheet at December 31, 2006:

(Dollars in thousands)	**Before Application of SFAS No. 158**	**Adjustments**	**After Application of SFAS No. 158**
Other non-current assets	$ 37,369	$ (588)	$ 36,781
Total assets	546,643	(588)	546,055
Accrued liabilities	53,262	(4,612)	48,650
Other non-current liabilities	69,997	4,577	74,574
Accumulated other comprehensive loss	(13,739)	(553)	(14,292)
Total stockholders equity	181,339		