

STEPAN CO
Form 10-Q
October 29, 2009

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

1-4462

Commission File Number

STEPAN COMPANY

(Exact name of registrant as specified in its charter)

Edgar Filing: STEPAN CO - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)
Edens and Winnetka Road, Northfield, Illinois 60093
(Address of principal executive offices)
Registrant's telephone number (847) 446-7500

36-1823834
(I.R.S. Employer
Identification Number)

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding at October 27, 2009 |
|-----------------------------|---------------------------------|
| Common Stock, \$1 par value | 9,902,810 Shares |

Part I FINANCIAL INFORMATION

Item 1 Financial Statements

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

| <i>(In thousands, except per share amounts)</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|-----------------------------------------------------------------------|------------------------------------|------------|-----------------------------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| Net Sales | \$ 326,225 | \$ 432,947 | \$ 965,567 | \$ 1,234,797 |
| Cost of Sales | 257,294 | 390,162 | 782,283 | 1,096,153 |
| Gross Profit | 68,931 | 42,785 | 183,284 | 138,644 |
| Operating Expenses: | | | | |
| Marketing | 10,179 | 11,290 | 29,242 | 31,470 |
| Administrative | 16,449 | 11,776 | 36,683 | 35,716 |
| Research, development and technical services | 8,650 | 9,293 | 26,349 | 26,567 |
| Sale of land (Note 15) | | (8,469) | | (8,469) |
| Sale of product line (Note 14) | | (9,929) | | (9,929) |
| | 35,278 | 13,961 | 92,274 | 75,355 |
| Operating Income | 33,653 | 28,824 | 91,010 | 63,289 |
| Other Income (Expense): | | | | |
| Interest, net | (1,508) | (2,447) | (4,935) | (7,367) |
| Loss from equity in joint ventures | (2,398) | (1,368) | (3,491) | (2,245) |
| Other, net (Note 13) | 684 | (599) | 1,725 | (1,960) |
| | (3,222) | (4,414) | (6,701) | (11,572) |
| Income Before Provision for Income Taxes | 30,431 | 24,410 | 84,309 | 51,717 |
| Provision for Income Taxes | 10,843 | 7,379 | 30,003 | 16,205 |
| Net Income | 19,588 | 17,031 | 54,306 | 35,512 |
| Less: Net Income Attributable to the Noncontrolling Interest (Note 2) | (43) | (31) | (24) | (4) |
| Net Income Attributable to Stepan Company | \$ 19,545 | \$ 17,000 | \$ 54,282 | \$ 35,508 |
| Net Income Per Common Share Attributable to Stepan Company (Note 9): | | | | |
| Basic | \$ 1.96 | \$ 1.75 | \$ 5.47 | \$ 3.67 |
| Diluted | \$ 1.80 | \$ 1.59 | \$ 5.06 | \$ 3.39 |

Edgar Filing: STEPAN CO - Form 10-Q

Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9):

| | | | | |
|----------------------------|-----------|-----------|-----------|-----------|
| Basic | 9,880 | 9,628 | 9,815 | 9,521 |
| Diluted | 10,871 | 10,694 | 10,718 | 10,468 |
| Dividends per Common Share | \$ 0.2200 | \$ 0.2100 | \$ 0.6600 | \$ 0.6300 |

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

STEPAN COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

| <i>(Dollars in thousands)</i> | September 30, 2009 | December 31, 2008 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|--------------------------|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 72,929 | \$ 8,258 |
| Restricted cash (Note 15) | | 8,477 |
| Receivables, net | 182,537 | 188,444 |
| Inventories (Note 6) | 82,193 | 103,243 |
| Deferred income taxes | 11,059 | 10,552 |
| Other current assets | 10,654 | 9,449 |
| Total current assets | 359,372 | 328,423 |
| Property, Plant and Equipment: | | |
| Cost | 922,256 | 911,251 |
| Less: Accumulated depreciation | (679,437) | (673,085) |
| Property, plant and equipment, net | 242,819 | 238,166 |
| Goodwill, net | 4,494 | 4,410 |
| Other intangible assets, net | 5,302 | 6,307 |
| Long-term investments (Note 4) | 9,712 | 11,351 |
| Other non-current assets | 15,812 | 23,240 |
| Total assets | \$ 637,511 | \$ 611,897 |
| Liabilities and Stockholders Equity | | |
| Current Liabilities: | | |
| Current maturities of long-term debt (Note 12) | \$ 10,791 | \$ 38,264 |
| Accounts payable | 100,436 | 117,247 |
| Accrued liabilities | 60,216 | 56,624 |
| Total current liabilities | 171,443 | 212,135 |
| Deferred income taxes | 1,244 | 2,137 |
| Long-term debt, less current maturities (Note 12) | 99,475 | 104,725 |
| Other non-current liabilities | 85,533 | 83,667 |
| Commitments and Contingencies (Note 7) | | |
| Stockholders Equity: | | |
| 5 1/2% convertible preferred stock, cumulative, voting, without par value; authorized 2,000,000 shares; issued and outstanding 546,396 shares in 2009 and 550,448 shares in 2008 | 13,660 | 13,761 |
| Common stock, \$1 par value; authorized 30,000,000 shares; issued 11,159,819 shares in 2009 and 10,840,946 shares in 2008 | 11,160 | 10,841 |

Edgar Filing: STEPAN CO - Form 10-Q

| | | |
|--------------------------------------------------------------------------------------|------------|------------|
| Additional paid-in capital | 67,484 | 54,712 |
| Accumulated other comprehensive loss | (27,167) | (40,525) |
| Retained earnings (unrestricted approximately \$91,417 in 2009 and \$59,433 in 2008) | 244,776 | 197,481 |
| Less: Treasury stock, at cost, 1,268,645 shares in 2009 and 1,208,857 shares in 2008 | (31,208) | (28,126) |
| Total Stepan Company stockholders' equity | 278,705 | 208,144 |
| Noncontrolling interest | 1,111 | 1,089 |
| Total stockholders' equity | 279,816 | 209,233 |
| Total liabilities and stockholders' equity | \$ 637,511 | \$ 611,897 |

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

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

| <i>(Dollars in thousands)</i> | Nine Months Ended September 30 | |
|-----------------------------------------------------------------------------------|--------------------------------|-----------------|
| | 2009 | 2008 |
| Cash Flows From Operating Activities | | |
| Net income | \$ 54,306 | \$ 35,512 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 27,296 | 28,039 |
| Deferred compensation | 5,145 | 4,385 |
| Realized / unrealized (gain) loss on long-term investments | (1,423) | 2,703 |
| Stock-based compensation | 3,503 | 3,856 |
| Deferred income taxes | 3,656 | 4,683 |
| Gain on sale of product line | | (9,929) |
| Sale of land | | (8,469) |
| Other non-cash items | 5,527 | 2,243 |
| Changes in assets and liabilities: | | |
| Receivables, net | 11,477 | (62,308) |
| Inventories | 24,364 | (22,218) |
| Other current assets | (569) | (945) |
| Accounts payable and accrued liabilities | (7,566) | 30,143 |
| Pension liabilities | (2,843) | 141 |
| Environmental and legal liabilities | (54) | (571) |
| Deferred revenues | (726) | (1,145) |
| Excess tax benefit from stock options and awards | (2,179) | (2,843) |
| Net Cash Provided By Operating Activities | 119,914 | 3,277 |
| Cash Flows From Investing Activities | | |
| Expenditures for property, plant and equipment | (30,885) | (35,591) |
| Proceeds from sale of product line | | 9,929 |
| Change in restricted cash | 8,477 | (8,634) |
| Sale of mutual funds | 3,594 | 933 |
| Proceeds from sale of land | | 8,634 |
| Other, net | (2,086) | (2,503) |
| Net Cash Used In Investing Activities | (20,900) | (27,232) |
| Cash Flows From Financing Activities | | |
| Revolving debt and notes payable to banks, net | (23,748) | 483 |
| Term loan | | 30,000 |
| Other debt borrowings | 1,552 | 2,906 |
| Other debt repayments | (10,472) | (11,047) |
| Dividends paid | (6,987) | (6,554) |
| Purchase of treasury stock | (1,185) | |
| Stock option exercises | 5,160 | 6,708 |
| Excess tax benefit from stock options and awards | 2,179 | 2,843 |
| Other, net | (1,395) | (1,198) |
| Net Cash Provided By (Used in) Financing Activities | (34,896) | 24,141 |
| Effect of Exchange Rate Changes on Cash | 553 | (327) |

Edgar Filing: STEPAN CO - Form 10-Q

| | | |
|------------------------------------------------------|-----------|----------|
| Net Increase (Decrease) in Cash and Cash Equivalents | 64,671 | (141) |
| Cash and Cash Equivalents at Beginning of Period | 8,258 | 5,739 |
| Cash and Cash Equivalents at End of Period | \$ 72,929 | \$ 5,598 |
| Supplemental Cash Flow Information | | |
| Cash payments of income taxes, net of refunds | \$ 19,246 | \$ 6,632 |
| Cash payments of interest | \$ 5,033 | \$ 7,105 |

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2009

Unaudited

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by Stepan Company (Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate and make the information presented not misleading. In the opinion of management, all normal recurring adjustments necessary to present fairly the Company's financial position as of September 30, 2009, its results of operations for the three and nine months ended September 30, 2009 and 2008, and its cash flows for the nine months ended September 30, 2009 and 2008, have been included. These financial statements and related footnotes should be read in conjunction with the financial statements and related footnotes included in the Company's 2008 Form 10-K.

2. NONCONTROLLING INTERESTS IN CONSOLIDATED FINANCIAL STATEMENTS

On January 1, 2009, the Company adopted the new Financial Accounting Standards Board (FASB) requirements for noncontrolling interests in consolidated financial statements, which established accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This includes reporting noncontrolling interests in the balance sheet as a component of stockholders' equity, separate from the parent company's equity. In the statement of income, net income is to be reported on a consolidated basis that includes amounts attributable to the parent and the noncontrolling interest. The rules also require that noncontrolling interests are initially to be measured at fair value. The financial statement and disclosure provisions were applied retrospectively for all periods presented. Adoption of the new requirements did not have an effect on the Company's financial position, cash flows or results of operations.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

Below are reconciliations of total equity, Company equity and equity attributable to the noncontrolling interest for the nine months ended September 30, 2009 and 2008:

| <i>(In thousands)</i> | Total Equity | Stepan Company Equity | Noncontrolling Interest Equity |
|-----------------------------------------------------------|-----------------|-----------------------------|--------------------------------------|
| Balance at January 1, 2009 | \$ 209,233 | \$ 208,144 | \$ 1,089 |
| Net Income | 54,306 | 54,282 | 24 |
| Dividends | (6,987) | (6,987) | |
| Common Stock Purchases ⁽¹⁾ | (3,723) | (3,723) | |
| Stock Option Exercises | 6,304 | 6,304 | |
| 2008 Profit Sharing Distribution Settled in Company Stock | 981 | 981 | |
| Defined Benefit Pension Adjustments, net of tax | 614 | 614 | |
| Translation Adjustments | 12,742 | 12,744 | (2) |
| Other ⁽²⁾ | 6,346 | 6,346 | |
| Balance at September 30, 2009 | \$ 279,816 | \$ 278,705 | \$ 1,111 |
| Balance at January 1, 2008 | \$ 206,727 | \$ 206,051 | \$ 676 |
| Net Income | 35,512 | 35,508 | 4 |
| Dividends | (6,554) | (6,554) | |
| Common Stock Purchases ⁽³⁾ | (3,689) | (3,689) | |
| Stock Option Exercises | 9,399 | 9,399 | |
| Acquisition of additional interest in Stepan China | 231 | | 231 |
| 2007 Profit Sharing Distribution Settled in Company Stock | 541 | 541 | |
| Defined Benefit Pension Adjustments, net of tax | 276 | 276 | |
| Translation Adjustments | (8,234) | (8,321) | 87 |
| Other ⁽²⁾ | 7,375 | 7,375 | |
| Balance at September 30, 2008 | \$ 241,584 | \$ 240,586 | \$ 998 |

(1) Includes the value of Company shares purchased on the open market, the value of Company common shares tendered by employees to settle minimum statutory withholding taxes related to the receipt of performance awards and the value of Company common shares tendered in lieu of cash for stock option exercises.

(2) Primarily comprised of stock-based compensation, deferred compensation and excess tax benefit activities.

(3) Includes the value of Company common shares tendered in lieu of cash for stock option exercises.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

3. DERIVATIVE INSTRUMENTS

On January 1, 2009, the Company adopted the FASB's expanded disclosure requirements for derivatives and hedging instruments. The updated requirements include qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. Adoption of the new requirements did not have an effect on the Company's financial position, cash flows, or results of operations. The required disclosures, as they pertain to the Company, follow.

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by the use of derivative instruments is foreign exchange risk. Specifically, the Company currently holds forward foreign currency exchange contracts that are not designated as any type of accounting hedge, as defined by generally accepted accounting principles. The Company uses these contracts to manage its exposure to exchange rate fluctuations on certain accounts payable and accounts receivable balances recorded on the books of Company subsidiaries that are denominated in currencies other than the entities' functional currencies. The forward foreign exchange contracts are recognized on the balance sheet as either an asset or a liability measured at fair value. Gains and losses arising from recording the foreign exchange contracts at fair value are reported in earnings as offsets to the losses and gains reported in earnings arising from the remeasurement of the accounts payable and accounts receivable balances into the applicable functional currencies. At September 30, 2009, the Company had open forward foreign currency exchange contracts, all with expiration dates of three months or less, to buy or sell foreign currencies with a U.S. dollar equivalent of \$29,692,000. The fair values and line item presentations of derivative instruments reported in the September 30, 2009, and December 31, 2008, consolidated balance sheets are displayed below:

| <i>(Dollars in thousands)</i> | Balance Sheet Line Item | Fair Value | |
|-------------------------------|-------------------------|--------------------|-------------------|
| | | September 30, 2009 | December 31, 2008 |
| <u>Asset Derivatives</u> | | | |
| Foreign Currency Contracts | Receivables, net | \$ 548 | \$ 455 |
| <u>Liability Derivatives</u> | | | |
| Foreign Currency Contracts | Accounts Payable | \$ 44 | \$ 271 |

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

Derivative instrument gains and losses reported in the consolidated income statements for the three and nine month periods ending September 30, 2009 and 2008, are displayed below:

(Dollars in thousands)

| Derivative Instrument | Income Statement Line Item | Gain / (Loss) | | | |
|----------------------------|----------------------------|----------------------|--------|----------------------|--------|
| | | Three Months Ended | | Nine Months Ended | |
| | | September 30 2009 | 2008 | September 30 2009 | 2008 |
| Foreign Currency Contracts | Other, net | \$ 1,977 | \$ 460 | \$ 1,840 | \$ 382 |

4. FAIR VALUE DISCLOSURES

In April 2009, the FASB issued new rules requiring that disclosures about the fair values of financial instruments be made in interim reporting periods as well as in annual financial statements. These disclosure requirements were effective for interim reporting periods ending after June 15, 2009. The following are the financial instruments held by the Company at September 30, 2009, and descriptions of the methods and assumptions used to estimate the instruments' fair values:

Cash and cash equivalents

Carrying value approximates fair value because of the short maturity of the instruments.

Derivative assets and liabilities

Derivative assets and liabilities relate to the foreign currency exchange contracts discussed in Note 3. Fair value and carrying value are the same because the foreign currency contracts are recorded at fair value. The fair value of the foreign currency contracts was calculated as the difference between the present value of the forward foreign exchange rate at the reporting date and the contracted foreign exchange rate multiplied by the contracted notional amount. See the table that follows these financial instrument descriptions for the reported fair values of derivative assets and liabilities.

Long-term investments

Long-term investments are the mutual fund assets the Company holds to fund a portion of its deferred compensation liabilities. Fair value and carrying value are the same because the mutual fund assets are recorded at fair value in accordance with the fair value election the Company made in 2008 under the FASB's fair value option rules. Fair values for the mutual funds were calculated using the published market price per unit at the reporting date multiplied by the number of units held at the reporting date. See the table that follows these financial instrument descriptions for the reported fair value of long-term investments.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

Debt obligations

The Company's primary source of long-term debt financing is unsecured private placement notes with fixed interest rates and maturities. The fair value of fixed interest rate debt comprises the combined present values of scheduled principal and interest payments for each of the various loans, individually discounted at rates equivalent to those which could be obtained by the Company for new debt issues with durations equal to the average life to maturity of each loan. The discount rates are based on applicable duration U.S. Treasury rates plus market interest rate spreads to borrowers with credit ratings equivalent to those of the Company. The fair value of the Company's fixed-rate debt at September 30, 2009, including current maturities, was estimated to be \$82,161,000 compared to a carrying value of \$79,283,000.

Debt also includes \$28,500,000 for an unsecured term loan that carries a variable interest rate of LIBOR plus a spread of 125 basis points as of September 30, 2009. The current market spread over LIBOR for entities with credit ratings similar to the Company's is approximately 275 basis points. Using the current market spread to discount the scheduled principal and interest payment outflows calculated under the contractual spread, the Company estimates the fair value of the variable interest unsecured term loan at approximately \$27,023,000.

Because of the short-term nature of the remaining Company debt, the fair values for such debt approximate the carrying values.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

Below are the financial assets and liabilities the Company records at fair value and the level within fair value hierarchy used to estimate the fair value of these instruments:

(Dollars in thousands)

| September 30, 2009 | Fair Value | Level 1 | Level 2 | Level 3 |
|----------------------------------------|------------------|------------------|---------------|-----------|
| Mutual fund assets | \$ 9,712 | \$ 9,712 | \$ | \$ |
| Derivative assets | 548 | | 548 | |
| Total assets at fair value | \$ 10,260 | \$ 9,712 | \$ 548 | \$ |
| Derivative liabilities | \$ 44 | \$ | \$ 44 | \$ |
| Total liabilities at fair value | \$ 44 | \$ | \$ 44 | \$ |
| December 31, 2008 | | | | |
| Mutual fund assets | \$ 11,351 | \$ 11,351 | \$ | \$ |
| Derivative assets | 455 | | 455 | |
| Total assets at fair value | \$ 11,806 | \$ 11,351 | \$ 455 | \$ |
| Derivative liabilities | \$ 271 | \$ | \$ 271 | \$ |
| Total liabilities at fair value | \$ 271 | \$ | \$ 271 | \$ |

The FASB's fair value measurements and disclosure requirements became effective for the Company's nonrecurring fair value measurements of nonfinancial assets and liabilities on January 1, 2009. Adoption of the new requirements had no immediate effect on the Company's financial position, cash flows or results of operations, but may affect future determinations of goodwill, intangible assets and other long-lived assets' fair values recorded in conjunction with business combinations and as part of impairment reviews for goodwill and long-lived assets.

5. STOCK-BASED COMPENSATION

The Company has stock options outstanding under its 1992 Stock Option Plan and stock options and performance stock awards outstanding under its 2000 Stock Option Plan and its 2006 Incentive Compensation Plan. Compensation expense charged against income for all plans was \$1,102,000 and \$3,503,000 for the three and nine months ended September 30, 2009, compared to \$1,202,000 and \$3,856,000, respectively, for the three and nine months ended September 30, 2008. Unrecognized compensation cost for stock options and stock awards was \$1,221,000 and \$3,119,000, respectively, at September 30, 2009, compared to \$584,000 and \$1,705,000, respectively, at December 31, 2008. A portion of the increase in unrecognized compensation cost resulted from management's assessment that the probable levels of profitability on which the vesting of performance stock awards are based would be higher than originally projected, which led to an increase in the number of performance stock awards that are ultimately expected to vest. Also contributing to the increase were 2009 grants of 145,560 stock options and 74,300 performance stock awards. The unrecognized compensation cost at September 30, 2009, is expected to be recognized over weighted average periods of 1.2

years and 1.8 years for stock options and performance stock awards, respectively.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

6. INVENTORIES

The composition of inventories was as follows:

| <i>(Dollars in thousands)</i> | September 30, 2009 | December 31, 2008 |
|-------------------------------|--------------------|-------------------|
| Finished products | \$ 51,057 | \$ 69,152 |
| Raw materials | 31,136 | 34,091 |
| Total inventories | \$ 82,193 | \$ 103,243 |

Inventories are primarily priced using the last-in, first-out inventory valuation method. If the first-in, first-out inventory valuation method had been used for all inventories, inventory balances would have been approximately \$28,145,000 and \$38,669,000 higher than reported at September 30, 2009, and December 31, 2008, respectively.

7. CONTINGENCIES

There are a variety of legal proceedings pending or threatened against the Company. Some of these proceedings may result in fines, penalties, judgments or costs being assessed against the Company at some future time. The Company's operations are subject to extensive local, state and federal regulations, including the U. S. Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund Amendments of 1986 (Superfund). Over the years, the Company has received requests for information related to or has been named by the government as a PRP at 23 waste disposal sites where clean up costs have been or may be incurred under CERCLA and similar state statutes. In addition, damages are being claimed against the Company in general liability actions for alleged personal injury or property damage in the case of some disposal and plant sites. The Company believes that it has made adequate provisions for the costs it may incur with respect to these sites.

The Company has estimated a range of possible environmental and legal losses from \$7.5 million to \$31.4 million at September 30, 2009. At September 30, 2009, the Company's accrued liability for such losses, which represents the Company's best estimate within the estimated range of possible environmental and legal losses, was \$16.5 million, compared to \$16.7 million at December 31, 2008. During the first nine months of 2009, non-capital cash outlays related to legal and environmental matters approximated \$2.2 million compared to \$2.0 million in the first nine months of 2008.

For certain sites, estimates cannot be made of the total costs of compliance, or the Company's share of such costs; consequently, the Company is unable to predict the effect thereof on the Company's financial position, cash flows and results of operations.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

Management believes that in the event of one or more adverse determinations in any annual or interim period, the impact on the Company's cash flows and results of operations for those periods could be material. However, based upon the Company's present belief as to its relative involvement at these sites, other viable entities' responsibilities for cleanup, and the extended period over which any costs would be incurred, the Company believes that these matters, individually and in the aggregate, will not have a material effect on the Company's financial position.

Following are summaries of the material contingencies at September 30, 2009:

Maywood, New Jersey Site

The Company's property in Maywood, New Jersey and property formerly owned by the Company adjacent to its current site and other nearby properties (Maywood site) were listed on the National Priorities List in September 1993 pursuant to the provisions of CERCLA because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between USEPA and the Company for property formerly owned by the Company, and the issuance of an order by USEPA to the Company for property currently owned by the Company, the Company completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. The Company also submitted documentation and information as requested by USEPA, including the submission of a Draft Feasibility Study for Soil and Groundwater (Operable Units 1 and 2) in March 2009. The Company is awaiting the issuance of a Record of Decision from USEPA. In the first quarter of 2009, after considering available information, including the draft feasibility study, the Company revised its estimated range of possible losses for the site but made no change to its recorded liability.

Also, the New Jersey Department of Environmental Protection (NJDEP) filed a complaint against the Company and other entities on February 6, 2006, alleging that the defendants discharged hazardous substances at the Maywood site and at neighboring properties not part of the Maywood site resulting in damage to natural resources and the incurrence of response costs. The Consent Judgment was entered by the court and the Company's liability was resolved. Payment was made in the second quarter of 2009. The resolution of the Company's liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company.

The Company believes it has adequate reserves for claims associated with the Maywood site, and has recorded a liability for the estimated probable costs it expects to incur at the Maywood site related to remediation of chemical contamination. However, depending on the results of the ongoing discussions with USEPA, the final cost of such remediation could differ from the current estimates.

In addition, under the terms of a settlement agreement reached on November 12, 2004, the United States Department of Justice and the Company agreed to fulfill the terms of a Cooperative Agreement reached in 1985 under which the United States will take title to and responsibility for radioactive waste removal at the Maywood site, including past and future remediation costs incurred by the United States.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

D Imperio Property Site

During the mid-1970 s, Jerome Lightman and the Lightman Drum Company disposed of hazardous substances at several sites in New Jersey. The Company was named as a potentially responsible party (PRP) in the case *United States v. Lightman* (1:92-cv-4710 D.N.J.), which involved the D Imperio Property Site located in New Jersey. In the second quarter of 2007, the Company reached an agreement with respect to the past costs and future allocation percentage in said litigation for costs related to the D Imperio site, including costs to comply with USEPA s Unilateral Administrative Orders. The Company paid the settlement amount in the third quarter of 2007. The resolution of the Company s liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company. In December 2007, the Company received updated remediation cost estimates, which were considered in the Company s determination of its range of estimated possible losses and reserve balance.

Remediation work is continuing at this site. Based on current information, the Company believes that it has adequate reserves for claims associated with the D Imperio site. However, actual costs could differ from current estimates.

Ewan Property Site

The case *United States v. Lightman* (1:92-cv-4710 D.N.J.), described above for the D Imperio site, also involved the Ewan Property Site located in New Jersey. The agreement described above also included a settlement with respect to the past costs and future allocation percentage in said litigation for costs related to the past costs and allocation percentage at the Ewan site. The Company paid the settlement amount in the third quarter of 2007. The resolution of the Company s liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company.

In addition, the NJDEP filed a natural resource damages complaint in June 2007 against the Company and other entities regarding the Ewan site. The Company was served with the complaint in May 2008. The parties, including the Company, are engaged in discussions with NJDEP to resolve this litigation.

There is some monitoring and operational work continuing at the Ewan site. Based on current information, the Company believes that it has adequate reserves for claims associated with the Ewan site. However, actual costs could differ from current estimates.

Lightman Drum Company Superfund Site

The Company received a Section 104(e) Request for Information from USEPA dated March 21, 2000, regarding the Lightman Drum Company Superfund Site located in Winslow Township, New Jersey. The Company responded to this request on May 18, 2000. In addition, the Company received a Notice of Potential Liability and Request to Perform RI/FS dated June 30, 2000, from USEPA. The Company decided that it will participate in the performance of the RI/FS as a member of the Lightman Yard PRP Group. Due to the addition of other PRPs, the Company s allocation percentage decreased. However, the allocation has not yet been finalized by the Lightman Yard PRP Group.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

In the fourth quarter of 2007, the PRPs who agreed to conduct the interim remedial action entered into an Administrative Settlement Agreement and Order on Consent for Removal Action with USEPA, and these PRPs also entered into a Supplemental Lightman Yard Participation and Interim Funding Agreement to fund the agreed-upon removal action. The Company paid a soil removal assessment upon execution of the agreements which did not have a material impact on the financial position, results of operations or cash flows of the Company. The soil removal action was completed and USEPA approved it in October 2009. A final Feasibility Study was submitted to USEPA in February 2009 and was approved in March 2009. In June 2009, USEPA issued a Proposed Plan for Remediation. In the second quarter of 2009, after considering the Feasibility Study and Proposed Plan for Remediation, the Company revised its estimated range of possible losses for the site and increased its recorded liability. Recording the additional liability did not have a material effect on the Company's financial position, results of operations or cash flows. In September 2009, USEPA signed the Record of Decision. After considering the signed Record of Decision, the Company determined that no further adjustments to its liability or range of losses for the site were necessary.

The Company believes that based on current information it has adequate reserves for claims associated with the Lightman site. However, actual costs could differ from current estimates.

Wilmington Site

The Company is currently contractually obligated to contribute to the response costs associated with the Company's formerly-owned site at 51 Eames Street, Wilmington, Massachusetts. Remediation at this site is being managed by its current owner to whom the Company sold the property in 1980. Under the agreement, once total site remediation costs exceed certain levels, the Company is obligated to contribute up to five percent of future response costs associated with this site with no limitation on the ultimate amount of contributions. To date, the Company has paid the current owner \$1.6 million for the Company's portion of environmental response costs through the second quarter of 2009 (the current owner of the site bills the Company one calendar quarter in arrears). The Company has recorded a liability for its portion of the estimated remediation costs for the site. Depending on the ultimate cost of the remediation at this site, the amount for which the Company is liable could differ from the current estimates.

In addition, in response to the special notice letter received by the PRPs in June 2006 from USEPA seeking performance of an RI/FS at the site, certain PRPs, including the Company, signed an Administrative Settlement Agreement and Order on Consent for the RI/FS effective July 2007.

The Company and other prior owners also entered into an agreement in April 2004 waiving certain statute of limitations defenses for claims which may be filed by the Town of Wilmington, Massachusetts, in connection with this site. While the Company has denied any liability for any such claims, the Company agreed to this waiver while the parties continue to discuss the resolution of any potential claim which may be filed.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

The Company believes that based on current information it has adequate reserves for the claims related to this site.

8. POSTRETIREMENT BENEFIT PLANS*Defined Benefit Pension Plans**Components of Net Periodic Benefit Cost*

| <i>(Dollars in thousands)</i> | UNITED STATES | | | |
|--------------------------------|--------------------|----------|-------------------|----------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30 | | September 30 | |
| | 2009 | 2008 | 2009 | 2008 |
| Service cost | \$ | \$ | \$ | \$ 2 |
| Interest cost | 1,672 | 1,632 | 5,222 | 4,893 |
| Expected return on plan assets | (1,902) | (2,003) | (5,615) | (5,936) |
| Amortization of net loss | 200 | 149 | 933 | 449 |
| Net periodic (benefit) cost | \$ (30) | \$ (222) | \$ 540 | \$ (592) |

| <i>(Dollars in thousands)</i> | UNITED KINGDOM | | | |
|--------------------------------|--------------------|--------|-------------------|--------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30 | | September 30 | |
| | 2009 | 2008 | 2009 | 2008 |
| Interest cost | \$ 223 | \$ 251 | \$ 632 | \$ 778 |
| Expected return on plan assets | (148) | (234) | (419) | (725) |
| Amortization of net loss | 21 | | 60 | |
| Net periodic benefit cost | \$ 96 | \$ 17 | \$ 273 | \$ 53 |

*Employer Contributions**U.S. Plans*

The Company expects to contribute approximately \$3,217,000 to its U.S. qualified defined benefit pension plans in 2009 and to pay \$355,000 in 2009 related to its unfunded non-qualified plans. As of September 30, 2009, \$3,078,000 had been contributed to the qualified plans and \$163,000 had been paid related to the non-qualified plans.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

U.K. Plan

The Company's United Kingdom subsidiary expects to contribute approximately \$2,134,000 to its defined benefit pension plan in 2009. As of September 30, 2009, \$378,000 had been contributed to the plan.

Defined Contribution Plans

Defined contribution plan expense for the Company's retirement savings plans was \$1,174,000 and \$3,597,000, respectively, for the three and nine months ended September 30, 2009, compared to \$3,320,000 and \$6,094,000, respectively, for the three and nine months ended September 30, 2008. The declines in quarter-to-quarter and year-to-year defined contribution pension expenses resulted from the 2008 acceleration of certain discretionary transition contributions. When the Company froze its U.S. salaried defined benefit pension plan in 2006, a funded defined contribution plan was established that provided for fixed Company contributions and additional discretionary transition contributions to employee retirement accounts. The additional discretionary transition contributions were instituted to partially compensate certain U.S. employees for the loss in benefits resulting from freezing the defined benefit plan. In September 2008, the Company's Board of Directors approved an acceleration of a portion of the transition contributions. As a result, \$1,927,000 of additional transition contribution expense was recorded in the third quarter ended September 30, 2008. The contributions to the employees' retirement accounts were determined as of September 30, 2008, and were paid on October 7, 2008.

Expenses related to the Company's profit sharing plan were \$1,664,000 and \$3,947,000, respectively, for the three and nine months ended September 30, 2009, compared to \$416,000 and \$1,899,000, respectively, for the three and nine months ended September 30, 2008.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

9. EARNINGS PER SHARE

Below are the computations of basic and diluted earnings per share for the three and nine months ended September 30, 2009 and 2008.

| <i>(In thousands, except per share amounts)</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--------------------------------------------------------------------------------------------------------|--------------------------------------------|-------------|-------------------------------------------|-------------|
| | 2009 | 2008 | 2009 | 2008 |
| <u>Computation of Basic Earnings per Share</u> | | | | |
| Net income attributable to Stepan Company | \$ 19,545 | \$ 17,000 | \$ 54,282 | \$ 35,508 |
| Deduct dividends on preferred stock | (189) | (192) | (567) | (580) |
| Income applicable to common stock | \$ 19,356 | \$ 16,808 | \$ 53,715 | \$ 34,928 |
| Weighted-average number of common shares outstanding | 9,880 | 9,628 | 9,815 | 9,521 |
| Basic earnings per share | \$ 1.96 | \$ 1.75 | \$ 5.47 | \$ 3.67 |
| <u>Computation of Diluted Earnings per Share</u> | | | | |
| Net income attributable to Stepan Company | \$ 19,545 | \$ 17,000 | \$ 54,282 | \$ 35,508 |
| Weighted-average number of common shares outstanding | 9,880 | 9,628 | 9,815 | 9,521 |
| Add net shares issuable from assumed exercise of options (under treasury stock method) ⁽¹⁾ | 296 | 375 | 231 | 288 |
| Add contingently issuable net shares related to performance stock awards (under treasury stock method) | 68 | 54 | 44 | 18 |
| Add weighted-average shares issuable from assumed conversion of convertible preferred stock | 627 | 637 | 628 | 641 |
| Shares applicable to diluted earnings | 10,871 | 10,694 | 10,718 | 10,468 |
| Diluted earnings per share | \$ 1.80 | \$ 1.59 | \$ 5.06 | \$ 3.39 |

⁽¹⁾ Options to purchase 50,573 shares of common stock were not included in the computations of diluted earnings per share for the nine months ended September 30, 2009. Options to purchase 247,768 and 248,701 shares of common stock were not included in the computation of diluted earnings per share for the three and nine months ended September 30, 2008, respectively. The options exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

10. COMPREHENSIVE INCOME

Comprehensive income includes net income and all other non-owner changes in equity that are not reported in net income. Below is the Company's comprehensive income for the three and nine months ended September 30, 2009 and 2008:

| <i>(Dollars in thousands)</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|------------------------------------------------------------------|------------------------------------|-----------|-----------------------------------|-----------|
| | 2009 | 2008 | 2009 | 2008 |
| Net income | \$ 19,588 | \$ 17,031 | \$ 54,306 | \$ 35,512 |
| Other comprehensive income: | | | | |
| Foreign currency translation adjustments | 7,457 | (11,335) | 12,742 | (8,234) |
| Pension liability adjustments, net of tax | 137 | 92 | 614 | 276 |
| Derivative instruments revaluation, net of tax | | (2) | | |
| Comprehensive income | 27,182 | 5,786 | 67,662 | 27,554 |
| Comprehensive income attributable to the noncontrolling interest | (42) | (46) | (22) | (91) |
| Comprehensive income attributable to Stepan Company | \$ 27,140 | \$ 5,740 | \$ 67,640 | \$ 27,463 |

11. SEGMENT REPORTING

The Company has three reportable segments: surfactants, polymers and specialty products. Segment operating results for the three and nine months ended September 30, 2009 and 2008 are summarized below:

| <i>(Dollars in thousands)</i> | Surfactants | Polymers | Specialty Products | Segment Totals |
|------------------------------------------------------|-------------|-----------------------|-----------------------|-------------------|
| <u>For the three months ended September 30, 2009</u> | | | | |
| Net sales | \$ 240,083 | \$ 75,355 | \$ 10,787 | \$ 326,225 |
| Operating income | 27,384 | 15,096 | 4,211 | 46,691 |
| <u>For the three months ended September 30, 2008</u> | | | | |
| Net sales | \$ 318,388 | \$ 103,518 | \$ 11,041 | \$ 432,947 |
| Operating income | 12,986 | 14,231 ⁽¹⁾ | 1,392 | 28,609 |
| <u>For the nine months ended September 30, 2009</u> | | | | |
| Net sales | \$ 738,197 | \$ 195,198 | \$ 32,172 | \$ 965,567 |
| Operating income | 80,744 | 28,832 | 9,850 | 119,426 |
| <u>For the nine months ended September 30, 2008</u> | | | | |
| Net sales | \$ 916,724 | \$ 287,442 | \$ 30,631 | \$ 1,234,797 |
| Operating income | 45,649 | 30,780 ⁽¹⁾ | 4,677 | 81,106 |

⁽¹⁾ Includes \$9.9 million gain on sale of product line.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

Below are reconciliations of segment operating income to consolidated income before income taxes:

| <i>(Dollars in thousands)</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|-----------------------------------------|------------------------------------|--------------------|-----------------------------------|-------------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Operating income segment totals | \$ 46,691 | \$ 28,609 | \$ 119,426 | \$ 81,106 |
| Unallocated corporate expenses | (13,038) | 215 ⁽¹⁾ | (28,416) | (17,817) ⁽¹⁾ |
| Interest expense, net | (1,508) | (2,447) | (4,935) | (7,367) |
| Loss from equity in joint ventures | (2,398) | (1,368) | (3,491) | (2,245) |
| Other, net | 684 | (599) | 1,725 | (1,960) |
| Consolidated income before income taxes | \$ 30,431 | \$ 24,410 | \$ 84,309 | \$ 51,717 |

⁽¹⁾ Includes \$8.5 million gain on sale of land.

12. DEBT

At September 30, 2009, and December 31, 2008, debt comprised the following:

| <i>(Dollars in thousands)</i> | Maturity Dates | September 30 2009 | December 31 2008 |
|-------------------------------------------|-------------------|----------------------|---------------------|
| Unsecured private placement notes | | | |
| 5.69% | 2012-2018 | \$ 40,000 | \$ 40,000 |
| 6.86% | 2009-2015 | 25,714 | 30,000 |
| 6.59% | 2009-2012 | 10,909 | 10,909 |
| Unsecured bank term loan | 2009-2013 | 28,500 | 30,000 |
| Unsecured U.S. bank debt | 2011 | | 600 |
| Debt of foreign subsidiaries | | | |
| Secured bank term loans, foreign currency | 2009-2010 | 4,128 | 5,788 |
| Other, foreign currency | 2009-2015 | 1,015 | 25,692 |
| Total debt | | 110,266 | 142,989 |
| Less current maturities | | 10,791 | 38,264 |
| Long-term debt | | \$ 99,475 | \$ 104,725 |

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 loan agreements.

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

13. OTHER, NET

Other, net in the consolidated statements of income included the following:

| <i>(Dollars in thousands)</i> | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--------------------------------------------------|---------------------------------------|----------|--------------------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| Foreign exchange gain (loss) | \$ (306) | \$ 918 | \$ 251 | \$ 558 |
| Investment related income | 20 | 50 | 51 | 185 |
| Realized / unrealized gain (loss) on investments | 970 | (1,567) | 1,423 | (2,703) |
| Other, net | \$ 684 | \$ (599) | \$ 1,725 | \$ (1,960) |

14. SALE OF PRODUCT LINE

On July 31, 2008, the Company sold select polyurethane system product lines to Bayer MaterialScience LLC (Bayer). The product lines that were sold comprised products used as insulation materials for appliances, water heaters, doors, roofs, picnic coolers and other similar applications, and represented approximately \$16,000,000 in Company annual net sales. The sale consisted primarily of Company-developed customer lists and product formulations related to the product lines. No manufacturing or other physical assets were included in the sale, and no personnel reductions were made. Manufacturing assets used in the production of the sold product lines are currently being utilized to produce other Company products. As consideration for the sale, the Company received \$9,929,000 of cash, all of which was recorded as a pretax gain in the third quarter ended September 30, 2008. The gain was attributed to the polymer segment. In addition to the sale of the product lines, the Company and Bayer entered into a separate manufacturing agreement whereby the Company would produce the divested products on Bayer's behalf and at Bayer's option for a period of up to two years to allow Bayer time to transition the manufacture of the products to its own facilities. No take-or-pay or minimum purchase requirements were included in the agreement. Other than acting as a contract manufacturer for Bayer during the term of the manufacturing agreement, the Company has no continuing involvement with the divested product lines.

15. LAND SALE AND OFFICE BUILDING PURCHASE

In September 2008, the Company sold 88 acres of land at its Millsdale manufacturing facility in Elwood, Illinois, to an industrial park developer for \$8,634,000. The land had a cost basis of \$165,000, so the Company recorded a pretax gain of \$8,469,000. The gain was not attributed to any reportable segment. Also in September 2008, the Company purchased a 64,000 square foot office building along with 3.25 acres of land near its corporate headquarters for \$6,442,000. For income tax purposes, the Millsdale land sale and the office building purchase were structured as a tax-deferred, like-kind exchange pursuant to section 1031 of the U.S. Internal Revenue Code. To accomplish the tax deferred exchange, the Company directed that the land sale proceeds (\$8,634,000) be deposited with and

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September 30, 2009

Unaudited

held by a qualified intermediary until consummation of the exchange, which occurred when renovations to the office building were finalized in March 2009. The proceeds held by the intermediary were classified as restricted cash until completion of the tax-free exchange, at which time the restricted designation was lifted.

16. INVESTMENT IN CHINA JOINT VENTURE

On May 15, 2008, the Company increased its controlling ownership interest in the Stepan China joint venture (a reporting unit within the Company's polymer reportable segment) from 55 percent to 80 percent. The Company achieved the increase in ownership by contributing an additional \$3,109,000 of capital (all cash) to Stepan China. By agreement, the minority joint venture partner made no additional capital contribution, thereby reducing its noncontrolling interest in the Stepan China joint venture from 45 percent to 20 percent. The Company accounted for this transaction as a step acquisition, applying purchase accounting treatment in accordance with the acquisition accounting rules in effect at that time. No intangible assets or goodwill were acquired as a result of the step acquisition. Stepan China's accounts have been included in the Company's consolidated financial statements since the formation of the joint venture, when the Company first obtained controlling interest.

17. SUBSEQUENT EVENTS DISCLOSURE

The Company adopted the FASB's requirements for subsequent events which were effective for interim or annual financial periods ending after June 15, 2009. Subsequent events are events or transactions that occur after the balance sheet date, but before financial statements are issued. The Company evaluated subsequent events through October 29, 2009, which was the issue date of the Company's financial statements for the period ended September 30, 2009. No events requiring financial statement recognition or disclosure were noted.

18. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the FASB established the FASB Accounting Standards Codification (ASC) as the single authoritative source of U.S. generally accepted accounting principles for nongovernmental entities. The codification, which reorganizes existing U.S. generally accepted accounting principles issued by the FASB and other related private sector standard setters, was effective for interim and annual periods ending after September 15, 2009. The adoption of the ASC did not have an impact on the Company's financial position, results of operations or cash flows.

In June 2009, the FASB issued amendments to the accounting rules for variable interest entities (VIEs) accounting, which are intended to improve financial reporting by providing additional guidance to companies involved with VIEs and by requiring additional disclosures about a company's involvement in VIEs. These amendments are effective for interim and annual periods beginning after November 15, 2009. The Company is evaluating the effect, if any, that the adoption of these amendments will have on its financial position, results of operations or cash flows.

Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is Management's Discussion and Analysis of certain significant factors that have affected the Company's financial condition and results of operations during the interim period included in the accompanying condensed consolidated financial statements.

Overview

The Company produces and sells intermediate chemicals that are used in a wide variety of applications worldwide. The overall business comprises three reportable segments:

Surfactants Surfactants, which accounted for 77 percent of consolidated net sales for the first three quarters of 2009, are principal ingredients in consumer and industrial cleaning products such as detergents for washing clothes, dishes, carpets, floors and walls, as well as shampoos, body washes, toothpastes and fabric softeners. Other applications include germicidal quaternary compounds, lubricating ingredients, emulsifiers (for spreading agricultural products), plastics and composites and biodiesel. Surfactants are manufactured at six North American sites (five in the U.S. and one in Canada), three European sites (United Kingdom, France and Germany) and three Latin American sites (Mexico, Brazil and Colombia). The Company holds a 50 percent ownership interest in two joint ventures, Stepan Philippines and TIORCO, LLC, that are excluded from surfactant segment operating results. The joint ventures are accounted for under the equity method. TIORCO, LLC was formed in September 2008.

Polymers Polymers, which accounted for 20 percent of consolidated net sales for the first three quarters of 2009, include two primary product lines: polyols and phthalic anhydride. Polyols are used in the manufacture of laminate insulation board for the construction industry and are also sold to the appliance, flexible foam and coatings, adhesives, sealants and elastomers (C.A.S.E.) industries. Phthalic anhydride is used in unsaturated polyester resins, alkyd resins and plasticizers for applications in construction materials and components of automotive, boating and other consumer products. In the U.S., polymer product lines are manufactured at the Company's Millsdale, Illinois, site. Polyols are also manufactured at the Company's Wesseling (Cologne), Germany facility, as well as at its 80-percent owned joint venture in Nanjing, China (which is included in consolidated results). The Company also has a polymer sales office in Brazil; no polymer manufacturing facilities are located in Brazil.

Specialty Products Specialty products, which accounted for three percent of consolidated net sales for the first three quarters of 2009, include flavors, emulsifiers and solubilizers used in the food and pharmaceutical industries. Specialty products are manufactured primarily at the Company's Maywood, New Jersey, site.

Despite the continued challenges of the global economic recession, the Company achieved record net income for the three and nine months ended September 30, 2009. The economic slowdown continued to negatively affect sales volume, which was down seven percent quarter over quarter and 10 percent year over year. Sales volume for the Company's polymers segment lags behind last year's

levels, as activity in the industries into which the segment sells (roofing insulation, construction materials, automotive and recreational vehicles, etc.) remained down. Management expects polymer volume recovery to be slow. The recession has had a lesser effect on sales volume for the surfactants segment, as surfactants used in cleaning compounds have historically been more recession resistant. Sales volume for the Company's largest product lines, consumer laundry and personal care, improved slightly over the prior year. Surfactant sales volume declines have primarily been for biodiesel and construction and oilfield applications. Lower year-over-year raw material costs, which came as a result of the economic recession, have benefited all segments, as the effect of lower costs has more than offset the effect of lower sales volume. While declines in raw material costs resulted in lower selling prices throughout the first half of 2009, the costs of crude oil, petroleum-based and other products have begun to rise in the second half of the year, which has led to price increases for many of the Company's surfactant and polymer products. The Company has also implemented cost savings initiatives to reduce discretionary spending for items such as overtime, travel and entertainment, outside consulting and temporary help.

Deferred Compensation Plans

The accounting for the Company's deferred compensation plans can cause period-to-period fluctuations in Company expenses and profits. For the third quarter of 2009, expense related to the Company's deferred compensation plans was \$1.5 million higher than that reported for the same quarter of 2008. However, deferred compensation-related expenses for the first three quarters of 2009 were \$3.2 million lower than expenses for the first three quarters of 2008. The pretax and after tax effects of all deferred compensation-related activities and the income statement line items in which the effects were recorded are displayed below (see the "Corporate Expenses" section of this management discussion and analysis for further details):

| <i>(Dollars in millions)</i> | (Income) / Expense | | | |
|------------------------------------------------------------------|---------------------------|---------------------|--------------------------|---------------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30 | September 30 | September 30 | September 30 |
| | 2009 | 2008 | 2009 | 2008 |
| Deferred Compensation (Administrative Expense) | \$ 5.3 | \$ 1.2 | \$ 5.1 | \$ 4.4 |
| Investment Income (Other, net) | | | | (0.2) |
| Realized/Unrealized (Gains) / Losses on Investments (Other, net) | (1.0) | 1.6 | (1.4) | 2.7 |
| Net Pretax Income Effect | \$ 4.3 | \$ 2.8 | \$ 3.7 | \$ 6.9 |
| After Tax Effect | \$ 2.7 | \$ 1.7 | \$ 2.3 | \$ 4.3 |

Effects of Foreign Currency Translation

The Company's foreign subsidiaries transact business and report financial results in their respective local currencies. As a result, foreign subsidiary income statements are translated into U.S. dollars at average foreign exchange rates appropriate for the reporting period. Because foreign exchange rates fluctuate against the U.S. dollar over time, foreign currency translation affects period-to-period comparisons of financial statement items (i.e. because foreign exchange rates fluctuate, similar period-to-period local currency results for a foreign subsidiary may translate into different U.S. dollar results). For the three and nine month periods ending September 30, 2009, the U.S. dollar strengthened against nearly all the foreign currencies in the locations where the Company does business, when compared to the exchange rates for the three and nine month periods ending September 30, 2008. Consequently, reported net sales, expense and income amounts for the three and nine month periods ending September 30, 2009, were lower than they would have been had the foreign currency exchange rates remained constant with the rates for the same periods of 2008. Below is a table that presents the impact that foreign currency translation had on the changes in consolidated net sales and various income line items for the three and nine month periods ending September 30, 2009 and 2008:

| <i>(In millions)</i> | Three Months Ended September 30 | | Increase (Decrease) | Inc (Dec) Due to Foreign Translation |
|----------------------|--------------------------------------------|-------------|--------------------------------|-----------------------------------------------------|
| | 2009 | 2008 | | |
| Net Sales | \$ 326.2 | \$ 432.9 | \$ (106.7) | \$ (12.5) |
| Gross Profit | 68.9 | 42.8 | 26.1 | (1.8) |
| Operating Income | 33.7 | 28.8 | 4.9 | (1.2) |
| Pretax Income | 30.4 | 24.4 | 6.0 | (1.0) |

| <i>(In millions)</i> | Nine Months Ended September 30 | | Increase (Decrease) | Inc (Dec) Due to Foreign Translation |
|----------------------|-------------------------------------------|-------------|--------------------------------|---------------------------------------------------------|
| | 2009 | 2008 | | |
| Net Sales | \$ 965.6 | \$ 1,234.8 | \$ (269.2) | \$ (61.6) |
| Gross Profit | 183.3 | 138.6 | 44.7 | (9.5) |
| Operating Income | 91.0 | 63.3 | 27.7 | (6.2) |
| Pretax Income | 84.3 | 51.7 | 32.6 | (6.3) |

Sale of Commodity Polyurethane Systems Product Lines

On July 31, 2008, the Company sold select polyurethane system product lines, which were a part of the polymer segment, to Bayer MaterialScience LLC (Bayer). No manufacturing assets were included in the sale and no employees were terminated. The sold product lines were insulation materials used in appliances, water heaters, doors, roofs, picnic coolers and other similar applications,

and represented approximately \$16.0 million in Company annual net sales. The products, which are manufactured at the Company's Millsdale, Illinois, facility, continue to be produced for Bayer during a transition period of up to two years. The sale was for \$9.9 million of cash, which the Company reported as a pretax gain in the third quarter ended September 30, 2008. The Company continues to produce and sell polyurethane systems for specialty applications. See Note 14 in the Notes to Condensed Consolidated Financial Statements for additional information.

Sale of Land

In September 2008, the Company sold 88 acres of land at its Millsdale manufacturing facility in Elwood, Illinois, to an industrial park developer for \$8.6 million. The land had a cost basis of \$0.1 million, so the Company recorded a pretax gain of \$8.5 million in the third quarter ended September 30, 2008. The gain was not attributed to any reportable segment. For income tax purposes, the land disposition and the acquisition of an office building near the Company's corporate headquarters were structured as a tax-deferred like-kind exchange, pursuant to Section 1031 of the Internal Revenue Code. See Note 15 in the Notes to Condensed Consolidated Financial Statements for additional information.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2009 and 2008

Summary

Net income for the third quarter of 2009 improved 15 percent to \$19.5 million, or \$1.80 per diluted share, compared to \$17.0 million, or \$1.59 per diluted share, for the third quarter of 2008. Prior year net income benefited from \$11.3 million (net of tax) of gains on the above-noted sales of the polyurethane systems product lines and Millsdale land. Below is a summary discussion of the major factors leading to the quarter-to-quarter changes in net sales, profits and expenses. A detailed discussion of segment operating performance for the third quarter of 2009 follows the summary.

Consolidated net sales declined \$106.7 million, or 25 percent, between quarters. Lower average selling prices, a seven percent decline in sales volume and the effects of foreign currency translation accounted for approximately \$64.3 million, \$29.9 million and \$12.5 million, respectively, of the net sales reduction. Lower raw material costs drove the drop in average selling prices. The sales volume declines were largely due to the impact of the slow economy. Sales volume for the polymers segment was down 13 percent, due to weak demand for roofing insulation in commercial construction. Sales volume was down six percent for the surfactants segment, primarily due to a decline in demand for biodiesel, oilfield chemicals and surfactants used in construction materials for housing. Consumer laundry and personal care volume grew.

Third quarter 2009 operating income was \$4.8 million, or 17 percent, greater than third quarter 2008 operating income despite the 2008 \$9.9 million and \$8.5 million gains reported on the sales of the polyurethane product lines and Millsdale land, respectively.

Gross profit improved \$26.1 million, or 61 percent. All segments reported quarter-over-quarter gross profit growth: surfactants gross profit was up \$13.1 million, or 41 percent; polymers gross profit was up \$10.7 million, or 120 percent; and specialty products was up \$2.7 million, or 122 percent. Lower raw material costs contributed to each segment's improvement. The effects of foreign currency translation reduced the quarter-to-quarter consolidated gross profit growth by approximately \$1.8 million.

Operating expenses for the third quarter of 2009 were \$21.3 million, or 153 percent, greater than operating expenses for the same quarter of last year. Major items accounting for the increase in expenses were as follows:

| <i>(Dollars in millions)</i> | Increase / (Decrease) |
|-------------------------------|----------------------------------|
| Gain on Sale of Product Lines | \$ 9.9 |
| Gain on Sale of Land | 8.5 |
| Deferred Compensation Expense | 4.0 |
| Foreign Currency Translation | (0.7) |
| Legal/Environmental Expense | 0.5 |
| Other | (0.9) |
| Total | \$ 21.3 |

The gains on sales of product lines and land are explained in the Overview section of this management discussion and analysis (MD&A). The increase in deferred compensation expense reflected increases in the values of Company common stock and mutual funds to which the deferred compensation liabilities are tied (see the Corporate Expenses section of this MD&A for further details). The increase in legal/environmental expense was mainly due to a favorable adjustment made to the environmental reserve in the third quarter of 2008. The other caption primarily reflects declines in discretionary spending (e.g. travel and entertainment, dues, consulting fees, etc.) resulting from a Company-wide cost savings initiative.

Interest expense for the third quarter of 2009 was \$0.9 million, or 38 percent, lower than interest expense for the third quarter of 2008. Lower average debt levels, resulting from a decrease in working capital requirements, led to the decline. Lower raw material costs drove the decline in working capital.

The loss from equity joint ventures, which includes results for the 50-percent owned Stepan Philippines Inc. (SPI) and TIORCO, LLC (TIORCO) joint ventures, increased \$1.0 million between quarters. SPI reported an equity loss of \$1.8 million, which was \$0.4 million greater than the loss reported in last year's third quarter. The current quarter included \$1.2 million of expense for the reserve of value added tax receivable balances that are in dispute with Philippine tax authorities. TIORCO, which was formed in September 2008, reported \$0.6 million of equity loss. Start-up expenses coupled with the economy's negative effect on demand for the oil recovery services the venture provides drove the TIORCO result.

Other, net was income of \$0.7 million for the third quarter of 2009 compared to \$0.6 million of expense for the same period of 2008, a favorable swing of \$1.3 million. A \$2.5 million increase in investment related income and a \$1.2 million unfavorable swing in foreign exchange gains and losses accounted for the other, net income change. Unrealized and realized gains related to the mutual

Edgar Filing: STEPAN CO - Form 10-Q

funds held for the Company's deferred compensation plans accounted for the quarter-to-quarter change in investment related income as \$1.0 million of gains were posted in the third quarter of 2009 compared to losses of \$1.6 million for the third quarter of 2008. Foreign exchange activity resulted in \$0.3 million of losses for the third quarter of 2009 compared to \$0.9 million of gains for the same period of 2008.

The effective tax rate was 35.6 percent for the third quarter ended September 30, 2009, compared to 30.2 percent for the third quarter ended September 30, 2008. The increase in the effective tax rate was primarily attributable to a lower tax benefit realized on foreign joint venture equity income and a greater percentage of consolidated income being generated in the U.S. where the effective tax rate is higher.

Segment Results

| <i>(Dollars in thousands)</i> | Surfactants | Polymers | Specialty Products | Segment Results | Corporate | Total |
|------------------------------------------------------|-------------|------------|--------------------|-----------------|-----------|------------|
| For the three months ended September 30, 2009 | | | | | | |
| Net sales | \$ 240,083 | \$ 75,355 | \$ 10,787 | \$ 326,225 | | \$ 326,225 |
| Operating income | 27,384 | 15,096 | 4,211 | 46,691 | (13,038) | 33,653 |
| For the three months ended September 30, 2008 | | | | | | |
| Net sales | \$ 318,388 | \$ 103,518 | \$ 11,041 | \$ 432,947 | | \$ 432,947 |
| Operating income | 12,986 | 14,231 | 1,392 | 28,609 | 215 | 28,824 |

Surfactants

Surfactants net sales for the third quarter of 2009 declined \$78.3 million, or 25 percent, from net sales for the third quarter of 2008. A 16 percent drop in average selling prices, a six percent decrease in sales volume and the effects of foreign currency translation accounted for approximately \$49.3 million, \$17.6 million and \$11.4 million, respectively, of the net sales change. A quarter-to-quarter comparison of net sales by region follows:

| <i>(Dollars in thousands)</i> | For the Three Months Ended | | Increase / | Percent |
|-------------------------------|----------------------------|--------------------|-------------|---------|
| | September 30, 2009 | September 30, 2008 | (Decrease) | Change |
| North America | \$ 157,084 | \$ 213,986 | \$ (56,902) | -27 |
| Europe | 58,072 | 71,721 | (13,649) | -19 |
| Latin America | 24,927 | 32,681 | (7,754) | -24 |
| Total Surfactants Segment | \$ 240,083 | \$ 318,388 | \$ (78,305) | -25 |

The 27 percent decline in net sales for North American operations was attributable to a 19 percent decline in average selling prices and a nine percent decrease in sales volume, which accounted for \$37.1 million and \$19.0 million, respectively, of the reduction. The effects of foreign currency translation contributed \$0.8 million to the drop in net sales. The decrease in average selling

prices reflected lower quarter-over-quarter raw material costs. A significant drop in biodiesel sales volume accounted for 57 percent of the total decrease in North American volume. Because of the current unprofitable environment for biodiesel, the Company continued to focus its manufacturing resources on more profitable opportunities. The economic downturn has had a minimal impact on the Company's largest surfactant product lines, consumer laundry and cleaning and personal care, as sales volume was slightly ahead of the prior year quarter. Sales of functional surfactants with industrial or construction applications continued to be adversely affected by the economy.

Net sales for European operations declined 19 percent due to an 11 percent decrease in average selling prices and the effects of foreign currency translation, which accounted for \$7.8 million and \$6.1 million, respectively, of the decline. Lower raw material costs drove the reduction in average selling prices. Sales volume was essentially unchanged from quarter to quarter.

Net sales for Latin American operations declined 24 percent due to a 15 percent decline in average selling prices and the effects of foreign currency translation, which accounted for \$5.1 million and \$4.6 million, respectively, of the decrease. The lower average selling prices reflected falling raw material costs. Sales volume increased six percent from quarter to quarter, which reduced the net sales decline by about \$1.9 million. Additional business at the Company's Brazil subsidiary drove the sales volume improvement, which was partially offset by sales volume declines at the Company's Mexico and Colombia subsidiaries.

Surfactants operating income for the third quarter of 2009 was \$14.4 million higher than operating income for the third quarter of 2008. Gross profit increased \$13.1 million, or 41 percent. Lower raw material costs drove the gross profit improvement. Reduced freight costs, combined with purchasing-led cost saving initiatives also contributed to the quarter-to-quarter profit growth. The six percent drop in sales volume and the effects of foreign currency translation (approximately \$1.5 million) tempered the improvement. Operating expenses declined \$1.3 million, or seven percent. Quarter-to-quarter comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(Dollars in thousands)</i> | For the Three Months Ended | | Increase / (Decrease) | Percent Change |
|----------------------------------|-------------------------------|-----------------------|--------------------------|-------------------|
| | September 30, 2009 | September 30, 2008 | | |
| Gross Profit | | | | |
| North America | \$ 33,238 | \$ 23,113 | \$ 10,125 | +44 |
| Europe | 8,540 | 4,201 | 4,339 | +103 |
| Latin America | 3,508 | 4,881 | (1,373) | -28 |
| Total Surfactants Segment | \$ 45,286 | \$ 32,195 | \$ 13,091 | +41 |
| Operating Expenses | 17,902 | 19,209 | (1,307) | -7 |
| Operating Income | \$ 27,384 | \$ 12,986 | \$ 14,398 | +111 |

Gross profit for North American operations increased between quarters despite a nine percent decline in sales volume. The effect of lower quarter-over-quarter raw material costs drove the gross profit improvement. Lower freight expenses, precipitated by reduced fuel costs, and the impact of cost saving initiatives also contributed.

Gross profit for European operations increased due principally to lower raw material costs combined with cost saving efforts. A more favorable customer mix also contributed. The unfavorable effects of foreign currency translation reduced Europe's quarter-to-quarter profit improvement by approximately \$0.8 million.

Latin American operations' gross profit declined due principally to a less profitable sales mix and the effects of foreign currency translation (approximately \$0.6 million). The unfavorable impact of lower sales volume at the Company's Mexico and Colombia subsidiaries more than offset the effect of additional business at the Brazil subsidiary.

Operating expenses for the surfactants segment were down \$1.3 million, or seven percent, between quarters due largely to declines of \$1.0 million and \$0.6 million in research and development and marketing expenses, respectively, for North American operations and to a \$0.6 million favorable effect of foreign currency translation. The expense reductions were partially offset by a \$1.0 million increase in operating expenses for European operations. Lower discretionary expenses for consulting, outside services and travel and entertainment accounted for the declines in both research and development and marketing expenses for North American operations. The increase in operating expenses for European operations was primarily attributable to an increased provision for potential bad debts and higher product registration expenses.

Polymers

Third quarter 2009 net sales for the polymers segment declined \$28.2 million, or 27 percent, from third quarter 2008 net sales. A 13 percent drop in sales volume, driven by the economic recession, accounted for \$13.6 million of the drop in net sales, while lower average selling prices and the unfavorable effects of foreign currency translation contributed \$13.5 million and \$1.1 million, respectively, to the decline. A quarter-to-quarter comparison of net sales by region is displayed below:

| <i>(Dollars in thousands)</i> | For the Three Months Ended | | | |
|-------------------------------|----------------------------|--------------------|-----------------------|----------------|
| | September 30, 2009 | September 30, 2008 | Increase / (Decrease) | Percent Change |
| North America | \$ 51,354 | \$ 74,350 | \$ (22,996) | -31 |
| Europe | 20,771 | 25,318 | (4,547) | -18 |
| Asia and Other | 3,230 | 3,850 | (620) | -16 |
| Total Polymers Segment | \$ 75,355 | \$ 103,518 | \$ (28,163) | -27 |

Net sales for North American operations fell 31 percent due to a 19 percent decline in sales volume and a 14 percent decline in average selling prices, which accounted for \$14.4 million and \$8.6 million, respectively, of the decrease in net sales. Sales volumes for polyols and phthalic anhydride fell 25 percent and five percent, respectively, due to the negative impact of the economic slowdown on the industries into which the segment sells. The decrease in average selling prices reflected lower raw material costs, particularly for phthalic anhydride.

Net sales for European operations declined 18 percent due to an 18 percent drop in average selling prices and the unfavorable effects of foreign currency translation, which accounted for \$4.7 million and \$1.1 million, respectively, of the reduction in net sales. Lower raw material costs led to the decline in average selling prices. Sales volume increased five percent between quarters as business began to improve for a number of major customers.

Net sales for Asia and Other regions were down 16 percent from quarter to quarter due to a 20 percent decline in average selling prices. Sales volume improved four percent as a result of improvement from the Company's China subsidiary.

Polymer operating income for the third quarter of 2009 increased \$0.9 million, or six percent, from operating income for the third quarter of 2008. Gross profit improved \$10.7 million, or 120 percent, due primarily to lower raw material costs combined with reduced freight expense and the positive effects of cost containment efforts. Operating expenses increased \$9.8 million, as the prior year benefited from the \$9.9 million gain on the sale of the commodity polyurethane systems product lines. Below are quarter-to-quarter comparisons of gross profit by region and total segment operating expenses and operating income:

| <i>(Dollars in thousands)</i> | For the Three Months Ended | | Increase / (Decrease) | Percent Change |
|-----------------------------------|----------------------------|--------------------|-----------------------|----------------|
| | September 30, 2009 | September 30, 2008 | | |
| Gross Profit | | | | |
| North America | \$ 14,451 | \$ 5,521 | \$ 8,930 | +162 |
| Europe | 4,499 | 2,961 | 1,538 | +52 |
| Asia and Other | 597 | 387 | 210 | +54 |
| Total Polymers Segment | \$ 19,547 | \$ 8,869 | \$ 10,678 | +120 |
| Operating Expenses ⁽¹⁾ | 4,451 | (5,362) | 9,813 | NM |
| Operating Income | \$ 15,096 | \$ 14,231 | \$ 865 | +6 |

⁽¹⁾ 2008 includes the \$9.9 million gain on the sale of the commodity polyurethane systems product lines.

The increase in gross profit for North American operations was attributable to lower raw material costs, resulting primarily from the recession-driven drop in prices for crude oil and oil-derived products. Raw material costs rose significantly throughout the first three quarters of 2008, resulting in profit margin erosion. Margin recovery commenced when raw material prices dropped precipitously in the fourth quarter of 2008 as the economic slowdown took hold, causing commodity prices to move downward. Reduced freight expense, resulting from lower fuel costs, also contributed to the improved profit. Gross profit was negatively affected by the 19 percent decline in sales volume.

Gross profit for European operations increased largely due to the significant quarter-over-quarter decline in raw material costs that resulted from the global economic recession. Higher sales volume also contributed to the profit improvement.

Gross profit for Asia and Other operations increased \$0.2 million as a result of lower raw material costs coupled with the four percent growth in sales volume.

As noted earlier, the \$9.8 million increase in operating expenses was due to the positive effect that the prior year gain on the product line sale had on third quarter 2008 expenses.

Specialty Products

Net sales for the third quarter of 2009 were \$0.3 million, or two percent, lower than net sales for the same period of 2008. Sales volume was flat quarter over quarter. Operating income was up \$2.8 million between quarters due principally to the favorable effects of lower raw material costs. A more favorable mix of sales also contributed.

Corporate Expenses

Corporate expenses increased \$13.3 million to \$13.0 million for the third quarter of 2009 from \$0.2 million of income for the third quarter of 2008. Corporate expenses for the third quarter of 2008 included, and were reduced by, the \$8.5 million gain on the sale of land at the Company's Millsdale facility. Deferred compensation expense was up \$4.0 million quarter over quarter due primarily to the increase in the price of Company common stock, to which a large portion of the deferred compensation liability is tied. The price of Company common stock increased \$15.92 per share from June 30, 2009, to September 30, 2009, compared to an \$8.95 per share increase for the same period of 2008. Third quarter 2009 increases in the values of the mutual fund investment assets held for the deferred compensation plan compared to third quarter 2008 value declines also contributed to the higher deferred compensation expense. Legal expense was up \$0.5 million from quarter-to-quarter due mainly to a favorable adjustment made to the environmental reserve in the third quarter of 2008.

Nine Months Ended September 30, 2009 and 2008

Summary

Net income for the three quarters ended September 30, 2009, improved 53 percent to \$54.3 million, or \$5.06 per diluted share, compared to \$35.5 million, or \$3.39 per diluted share, for the same period of 2008. Prior year net income benefited from \$11.3 million (net of tax) of gains on the previously discussed sales of the polyurethane systems product lines and Millsdale land. Below is a summary discussion of the major factors leading to the year-to-year changes in net sales, profits and expenses. A detailed discussion of segment operating performance for the first three quarters of 2009 follows the summary.

Consolidated net sales declined \$269.2 million, or 22 percent, between years. Lower sales volume, a decline in average selling prices and the effects of foreign currency translation accounted for approximately \$119.1 million, \$88.5 million and \$61.6 million, respectively, of the year-to-year decrease in net sales. Sales volumes fell 10 percent, due mainly to the slowdown in the world economy. Sales volume for the polymers segment dropped 21 percent, and sales volume declined seven percent for the surfactants segment. The decline in average selling prices was principally the result of falling raw material costs.

Operating income for the first three quarters of 2009 was \$27.7 million, or 44 percent, greater than operating income for the first three quarters of 2008 despite the 2008 \$9.9 million and \$8.5 million gains reported on the sales of the polyurethane product lines and

Millsdale land, respectively. Gross profit was up \$44.6 million, or 32 percent. All three segments contributed to the improvement in gross profit. Surfactants segment gross profit was up \$32.8 million, or 33 percent; polymers segment gross profit increased \$7.2 million, or 21 percent; and gross profit for the specialty products segment was up \$5.2 million, or 73 percent. Lower raw material and freight costs coupled with Company cost saving initiatives benefited all segments. The effects of foreign currency translation reduced the year-to-year consolidated gross profit improvement by approximately \$9.5 million.

Operating expenses increased \$16.9 million, or 22 percent, between years. Major items accounting for the expense increase were as follows:

| <i>(Dollars in millions)</i> | Increase / (Decrease) |
|-------------------------------|----------------------------------|
| Gain on Sale of Product Lines | \$ 9.9 |
| Gain on Sale of Land | 8.5 |
| Foreign Currency Translation | (3.3) |
| Provision for Bad Debts | 1.5 |
| Legal/Environmental Expense | 1.0 |
| Deferred Compensation Expense | 0.8 |
| Other | (1.5) |
| Total | \$ 16.9 |

The gains on sales of product lines and land are explained in the Overview section of this MD&A. The increase in bad debt provision reflected reserve increases for specific customers and for non-specific balances. Legal/environmental expenses were up mainly due to increased environmental reserve requirements recorded in 2009 compared to a favorable adjustment made to the reserve in 2008. The increase in deferred compensation expense is discussed in detail in the Corporate Expenses section of this MD&A. The other caption primarily reflects declines in discretionary spending (e.g. travel and entertainment, dues, consulting fees, etc.) resulting from a Company-wide cost savings initiative.

Interest expense for the first three quarters of 2009 was \$2.4 million, or 33 percent, less than interest expense for the first three quarters a year ago. Lower average debt levels, resulting from a decrease in working capital requirements, led to the decline. A decline in raw material costs drove the reduction in working capital requirements.

The loss from equity joint ventures, which includes results for the 50-percent owned SPI and TIORCO joint ventures, increased \$1.2 million between years. SPI reported an equity loss of \$1.6 million for the first three quarters of 2009, which was \$0.7 million less than the loss reported in the same period of 2008. The current year included \$1.2 million of expense to reserve for value added tax receivable balances that are in dispute with Philippine tax authorities. TIORCO, which was formed in September 2008, reported \$1.9 million of equity loss. Start-up expenses coupled with the economy's negative effect on demand for the oil recovery services the venture provides drove the TIORCO result.

Other, net was \$1.7 million of income for the first three quarters of 2009 compared to \$2.0 million of expense for the same period of 2008. A \$4.0 million increase in investment related income, partially offset by a \$0.3 million decline in foreign exchange

Edgar Filing: STEPAN CO - Form 10-Q

gains, accounted for the \$3.7 million year-to-year favorable other, net change. Unrealized and realized gains related to the mutual funds held for the Company's deferred compensation plans accounted for the year-to-year change in investment related income as \$1.4 million of gains were posted in the first three quarters of 2009 compared to losses of \$2.7 million for the first three quarters of 2008. Foreign exchange activity resulted in \$0.3 million of gains for the first three quarters of 2009 compared to \$0.6 million of gains for the same period of 2008.

The effective tax rate was 35.6 percent for the first nine months ended September 30, 2009, compared to 31.3 percent for the first nine months ended September 30, 2008. The increase in the effective tax rate was primarily attributable to a lower tax benefit realized on foreign joint venture equity income and a greater percentage of consolidated income being generated in the U.S. where the effective tax rate is higher. Lower U.S. tax credits also contributed to the higher effective tax rate.

Segment Results

| <i>(Dollars in thousands)</i> | Surfactants | Polymers | Specialty Products | Segment Results | Corporate | Total |
|-----------------------------------------------------|-------------|------------|--------------------|-----------------|-----------|--------------|
| For the nine months ended September 30, 2009 | | | | | | |
| Net sales | \$ 738,197 | \$ 195,198 | \$ 32,172 | \$ 965,567 | | \$ 965,567 |
| Operating income | 80,744 | 28,832 | 9,850 | 119,426 | (28,416) | 91,010 |
| For the nine months ended September 30, 2008 | | | | | | |
| Net sales | \$ 916,724 | \$ 287,442 | \$ 30,631 | \$ 1,234,797 | | \$ 1,234,797 |
| Operating income | 45,649 | 30,780 | 4,677 | 81,106 | (17,817) | 63,289 |

Surfactants

Surfactants net sales for the first three quarters of 2009 declined \$178.5 million, or 19 percent, from net sales for the same period of 2008. A seven percent decrease in sales volume, the effects of foreign currency translation and a seven percent decline in average selling prices accounted for approximately \$67.3 million, \$55.8 million and \$55.4 million, respectively, of the net sales change. A year-to-year comparison of net sales by region follows:

| <i>(Dollars in thousands)</i> | For the Nine Months Ended | | Increase / | Percent |
|-------------------------------|---------------------------|--------------------|--------------|---------|
| | September 30, 2009 | September 30, 2008 | (Decrease) | Change |
| North America | \$ 494,608 | \$ 615,006 | \$ (120,398) | -20 |
| Europe | 168,518 | 210,860 | (42,342) | -20 |
| Latin America | 75,071 | 90,858 | (15,787) | -17 |
| Total Surfactants Segment | \$ 738,197 | \$ 916,724 | \$ (178,527) | -19 |

The 20 percent decline in net sales for North American operations was primarily attributable to a 10 percent decrease in sales volume and a nine percent decline in average selling prices, which accounted for \$63.8 million and \$50.8 million, respectively, of the net sales change. In addition, the effects of foreign currency translation contributed \$5.8 million to the decline. The fall in sales volume reflected reduced sales of functional surfactants that have industrial or construction applications, which were negatively impacted by the poor economy. A significant drop in biodiesel sales volume accounted for 54 percent of the total decrease in North American volume. Because of the current unprofitable economic environment for biodiesel, the Company continued to focus its manufacturing resources on more profitable opportunities. Sales volumes for consumer laundry and cleaning and agricultural chemical products were slightly higher than last year despite the economy. The decrease in average selling prices reflected lower raw material costs.

Net sales for European operations declined 20 percent due to the effects of foreign currency translation (\$30.6 million) and a five percent decrease in average selling prices. The reduction of average selling prices, which was driven by lower raw material costs, accounted for \$11.3 million of the drop in net sales. Sales volume was essentially unchanged between years.

Net sales for Latin American operations declined 17 percent due primarily to the effects of foreign currency translation, as the currencies for all three Latin American locations weakened against the U.S. dollar. Sales volume dropped one percent between years. Sales volume declines at the Company's Mexico and Colombia subsidiaries were largely offset by sales gains at the Brazil subsidiary.

Surfactants operating income for the first three quarters of 2009 was \$35.1 million greater than operating income for the first three quarters of 2008. Gross profit increased \$32.8 million due principally to lower raw material costs. Reduced freight expenses coupled with purchasing-led saving initiatives also contributed to the profit improvement. Operating expenses declined \$2.3 million, or four percent. Year-to-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(Dollars in thousands)</i> | For the Nine Months Ended | | Increase / (Decrease) | Percent Change |
|----------------------------------|---------------------------|-----------------------|--------------------------|-------------------|
| | September 30, 2009 | September 30, 2008 | | |
| <u>Gross Profit</u> | | | | |
| North America | \$ 96,139 | \$ 71,057 | \$ 25,082 | +35 |
| Europe | 24,590 | 14,706 | 9,884 | +67 |
| Latin America | 11,102 | 13,232 | (2,130) | -16 |
| Total Surfactants Segment | \$ 131,831 | \$ 98,995 | \$ 32,836 | +33 |
| Operating Expenses | 51,087 | 53,346 | (2,259) | -4 |
| Operating Income | \$ 80,744 | \$ 45,649 | \$ 35,095 | +77 |

Gross profit for North American operations increased from year to year due largely to the effects of lower raw material and freight costs coupled with purchasing-led cost saving initiatives. The impact of the economic recession has moved raw material costs lower since the end of the third quarter of 2008 when costs were at their peak. The Company has seen a recent rise in some raw material costs as the economy slowly begins to recover. The 10 percent decline in sales volume partially offset the improvement in gross profit.

The improvement in gross profit for European operations was due to the positive impact of lower raw material and freight costs. A more favorable customer and product mix, particularly for the United Kingdom subsidiary, also contributed. The effects of foreign currency translation reduced Europe's year-to-year profit improvement by approximately \$4.2 million.

Gross profit for Latin American operations declined due to the effects of foreign currency translation (approximately \$2.9 million) and a one percent decline in sales volume. Lower raw material costs partially offset the impacts of foreign currency translation and reduced sales volume.

Operating expenses for the surfactants segment were down \$2.3 million between years. The decline was primarily attributable to a \$2.9 million favorable effect of foreign currency translation and to a \$0.5 million decline in research and development expenses, partially offset by increases in administrative and marketing expenses of \$0.6 million and \$0.5 million, respectively. Lower outside product safety testing services in the U.S., due primarily to fewer requests for and requirements to perform regulatory product testing, accounted for the decline in research and development expenses. Higher pension expense for the Company's U.K. subsidiary accounted for about \$0.3 million of the increase in surfactant administrative expenses. Higher bad debt provisions (\$1.5 million), partially offset by lower expenses for U.S. travel and entertainment, consulting fees and dues expenses (collectively about \$0.5 million) and by marketing service expenses charged out of U.S. marketing areas to the TIORCO joint venture, accounted for the increase in marketing expenses. The bad debt provision increases were attributable to all regions and reflected adjusting reserves for identified risky accounts. The offsetting travel and entertainment, consulting fees and dues expenses reflected the effects of the Company's initiative to reduce discretionary spending.

Polymers

Polymers net sales for the first three quarters of 2009 declined \$92.2 million, or 32 percent, from net sales for the first three quarters of 2008. A 21 percent drop in sales volume, driven by the global economic recession, lower average selling prices and the effects of foreign currency translation accounted for \$59.1 million, \$27.3 million and \$5.8 million, respectively, of the net sales decline. A year-to-year comparison of net sales by region is displayed below:

| <i>(Dollars in thousands)</i> | For the Nine Months Ended | | Increase / (Decrease) | Percent Change |
|-------------------------------|----------------------------------|-------------------------------|----------------------------------|---------------------------|
| | September 30, 2009 | September 30, 2008 | | |
| North America | \$ 134,876 | \$ 201,372 | \$ (66,496) | -33 |
| Europe | 52,368 | 76,719 | (24,351) | -32 |
| Asia and Other | 7,954 | 9,351 | (1,397) | -15 |
| Total Polymers Segment | \$ 195,198 | \$ 287,442 | \$ (92,244) | -32 |

Net sales for North American operations decreased 33 percent due to declines of 24 percent and 11 percent in sales volume and average selling prices, respectively. The drop in sales volume accounted for \$49.2 million of the net sales decline, and the reduction in average selling prices accounted for \$17.3 million of the decline. Sales volume for polyols and phthalic anhydride fell 28 percent and 14 percent, respectively, as a result of the negative impact of the slow economy on the industries into which the products are sold. Sales volume for polyurethane systems fell 61 percent as a result of the July 2008 sale of the Company's commodity system product lines. The 11 percent decrease in average selling prices for North American operations reflected lower raw material costs, particularly for phthalic anhydride.

Net sales for European operations declined 32 percent due to a 14 percent drop in average selling prices, a 12 percent decrease in polyol sales volume and the effects of foreign currency translation, which accounted for \$9.8 million, \$8.9 million and \$5.7 million, respectively, of the reduction in net sales. Lower raw material costs led to the drop in average selling prices. The decrease in sales volume reflected the negative effects that the global recession has had on rigid insulation board end-users, although business improved slightly in the third quarter.

Asia and Other operations' net sales were down 15 percent from year-to-year due primarily to a 17 percent decline in average selling prices brought on by lower raw material costs. Sales volume increased four percent.

Polymer operating income for the first three quarters of 2009 declined \$1.9 million, or six percent, from operating income for the first three quarters of 2008. Gross profit increased \$7.2 million, or 21 percent. The increase was attributable to improved third quarter profitability generated from raw material costs that fell from the historically high levels of a year ago. The effects of foreign currency translation reduced the improvement in gross profit by about \$1.6 million. Operating expenses increased \$9.1 million. The prior year expenses included, and were reduced by, the \$9.9 million gain on the sale of the polyurethane systems product lines. Below are year-to-year comparisons of gross profit by region and total segment operating expenses and operating income:

| <i>(Dollars in thousands)</i> | For the Nine Months Ended | | Increase / (Decrease) | Percent Change |
|-----------------------------------|---------------------------|-----------------------|-----------------------------|-------------------|
| | September 30, 2009 | September 30, 2008 | | |
| Gross Profit | | | | |
| North America | \$ 28,222 | \$ 21,710 | \$ 6,512 | +30 |
| Europe | 12,549 | 12,137 | 412 | +3 |
| Asia and Other | 944 | 705 | 239 | +34 |
| Total Polymers Segment | \$ 41,715 | \$ 34,552 | \$ 7,163 | +21 |
| Operating Expenses ⁽¹⁾ | 12,883 | 3,772 | 9,111 | +242 |
| Operating Income | \$ 28,832 | \$ 30,780 | \$ (1,948) | -6 |

⁽¹⁾ 2008 includes the \$9.9 million gain on the sale of the commodity polyurethane systems product lines.

The increase in gross profit for North American operations was attributable to the impact of lower raw material costs that more than offset the decline in sales volume. As noted in the quarter-to-quarter discussion, raw material costs rose significantly throughout the first three quarters of 2008, resulting in profit margin erosion. Raw material prices dropped significantly in the fourth quarter of 2008 as the effects of the economic recession moved commodity prices downward. Lower freight expenses, caused by lower fuel costs, also contributed to the year-over-year gross profit improvement.

Gross profit for European operations increased three percent due to the effects of decreased raw material costs brought on by the global recession. The negative effect of foreign currency translation tempered the gross profit improvement by \$1.5 million. The \$0.2 million, or 34 percent, increase in gross profit for Asia and Other operations reflected lower raw material costs coupled with the four percent increase in sales volume.

The \$9.1 million increase in operating expenses was due to the positive effect that the prior year gain on the product line sale had on third quarter 2008 expenses. The year-over-year effect of the 2008 non-recurring gain was offset by a \$0.5 million decline in operating expenses for North American operations and a \$0.4 million foreign currency translation impact. Lower marketing expenses, primarily travel and entertainment, accounted for the decrease in North American operations' operating expenses.

Specialty Products

Net sales for the first three quarters of 2009 were \$1.5 million, or five percent, higher than net sales for the first three quarters of 2008. Higher sales volumes for all product lines led to the improvement in net sales. Operating income was up \$5.2 million between years due to higher sales volumes, lower raw material costs and an improved sales mix.

Corporate Expenses

Corporate expenses increased \$10.6 million, or 60 percent, to \$28.4 million for the first three quarters of 2009 from \$17.8 million for the same period of 2008. Corporate expenses for 2008 included, and were reduced by, the \$8.5 million gain on the sale of land at the Company's Millsdale facility. Also contributing to the year-over-year change in corporate expenses were a \$1.0 million increase in environmental expenses resulting from adjustments to requirements for environmental remediation reserves and a \$0.8 million increase in deferred compensation expense. Current year increases in the values of the mutual fund investment assets held for the deferred compensation plan compared to prior year value declines led to the rise in deferred compensation expense. The increase in deferred compensation expense caused by the rise in mutual fund values was partially offset by a decrease in expense caused by the change in the price of Company common stock, as the price of Company common stock increased \$13.09 per share from December 31, 2008, to September 30, 2009, compared to a \$22.04 per share increase for the same period of 2008.

LIQUIDITY AND CAPITAL RESOURCES

Cash flow from operating activities for the first nine months of 2009 was an aggregate cash source of \$119.9 million compared to a source of \$3.3 million for the comparable period in 2008. Net income for the current year-to-date period increased by \$18.8 million and current year working capital changes were favorable by \$83.0 million compared to the same period in 2008.

For the current year to date, accounts receivable were a cash source of \$11.5 million compared to a cash use of \$62.3 million for the comparable period in 2008. Inventories were a cash source of \$24.4 million for the first nine months of 2009 versus a cash use of \$22.2 million for the same period in 2008. Accounts payable and accrued liabilities were a use of \$7.6 million for the first three quarters of 2009 compared to a source of \$30.1 million for the comparable prior year period.

During 2009, lower raw material costs have had a direct, favorable cash flow impact in comparison to 2008 by driving lower inventory carrying costs during the current year period. Accounts receivable have also been favorable to cash flow with decreases influenced by lower sales volumes as well as lower average selling prices. During 2008, an unprecedented increase in crude oil prices led to significantly higher costs for oil-derived commodity chemicals, which are used as raw materials. Raw material costs are a primary driver to the Company's working capital, with a direct impact on inventory carrying costs as well as an indirect impact on selling prices and accounts receivable. Despite the weakening economy, the Company has not experienced any significant change in the payment timing of its receivables and the Company has not changed its own payment practices related to its payables. It is management's opinion that raw material costs will continue to be lower than in 2008 and are, therefore, expected to decrease as a risk factor to the Company's cash flow.

Investing activities for the first nine months of 2009 included capital expenditures of \$30.9 million versus \$35.6 million for same period in 2008. In September 2008, the Company entered into an Internal Revenue Code 1031 tax deferred, like-kind exchange, which included the sale of land at the Company's Millsdale manufacturing site and the deposit of the land sale proceeds of \$8.6 million in a restricted cash investment fund. As of December 31, 2008, the restricted cash balance was \$8.5 million. During the first quarter of 2009, this exchange was consummated and the Company recovered the restricted cash balance as an investing source of funds. During 2009, some investments held for the deferred compensation plans were sold, resulting in a cash source of \$3.6 million. Management has projected that capital spending for full year 2009 will be approximately \$44.0 million to \$48.0 million.

As of September 30, 2009, the Company's cash and cash equivalents totaled \$72.9 million, including \$35.1 million in two different U.S. money market funds which were each rated AAA by Standard and Poor's and Aaa by Moody's. Cash in U.S. demand deposit accounts, fully covered by FDIC insurance, totaled \$24.5 million. Cash of the Company's non-U.S. subsidiaries held outside of the U.S. totaled \$13.3 million as of September 30, 2009.

Consolidated debt decreased by \$32.7 million for the first three quarters of 2009, from \$143.0 million to \$110.3 million. Over the same period, net debt, total debt minus cash, declined by \$89.0 million, from \$126.3 million to \$37.3 million. Since December 31, 2008, foreign debt decreased by \$26.3 million and U.S. debt decreased by \$6.4 million. As of September 30, 2009, the ratio of total debt to total debt plus Company shareholder equity was 28.3 percent, compared to 40.7 percent at December 31, 2008. The ratio of net debt to net debt plus Company shareholder equity was 11.8 percent at September 30, 2009, compared to 37.8 percent as of December 31, 2008.

At September 30, 2009, the Company's debt included \$76.6 million of unsecured private placement loans with maturities extending through 2018. These loans are the Company's primary source of long-term debt financing, and are supplemented by bank credit facilities to meet short and medium term needs. The Company's debt also included a \$28.5 million term loan with its U.S. banks, which has maturities through 2013.

The Company currently has \$58.4 million of credit available under its committed \$60.0 million revolving credit agreement, which will require renewal on April 20, 2011. While the current global credit shortage will restrain the general economy, the Company does not believe that this will adversely affect Company liquidity in 2009 due to its current cash position and the adequacy and quality of its credit facilities.

Certain foreign subsidiaries of the Company maintain bank term loans and short-term bank lines of credit in their respective local currencies to meet working capital requirements as well as to fund capital expenditure programs and acquisitions. As of September 30, 2009, the Company's European subsidiaries had term loans totaling \$1.6 million including current maturities. The European subsidiaries also had short-term bank debt totaling \$0.1 million with unborrowed capacity of approximately \$31.9 million at that date. The Company's Mexican subsidiary had debt totaling \$3.5 million. The Company's Brazilian subsidiary and its 80-percent owned Chinese joint venture had no debt as of September 30, 2009.

The Company has material debt agreements that require the maintenance of minimum interest coverage and minimum net worth. These agreements also limit the incurrence of additional debt as well as the payment of dividends and repurchase of treasury shares. Testing for these agreements is based on the combined financial statements of the U.S. operations of Stepan Company and Stepan Canada Inc. (the Restricted Group). Under the most restrictive of these debt covenants:

1. The Restricted Group must maintain a minimum interest coverage ratio, as defined within the agreements, of 2.0 to 1.0, for the preceding four calendar quarters.
2. The Restricted Group must maintain net worth of at least \$113.7 million.
3. The Restricted Group must maintain a ratio of long-term debt to total capitalization, as defined in the agreements, not to exceed 55 percent.
4. The Restricted Group may pay dividends and purchase treasury shares in amounts of up to \$30.0 million plus 100 percent of net income and cash proceeds of stock option exercises, measured cumulatively beginning December 31, 2001. The maximum amount of dividends that could have been paid within this limitation is disclosed as unrestricted retained earnings on the Company's balance sheet.

The Company was in compliance with all of its loan agreements as of September 30, 2009. Based on current projections, the Company believes it will be in compliance with its loan agreements throughout 2009.

Compared to one year earlier, total Company debt was down by \$39.4 million and net debt was down by \$98.0 million. The Company has benefitted from lower levels of working capital driven by the impact of lower commodity raw material costs on inventory and receivables, and also from improved earnings. The Company anticipates that cash from operations, committed credit facilities and cash on hand, subject to the foregoing, will be sufficient to fund anticipated capital expenditures, dividends and other planned financial commitments for the foreseeable future.

ENVIRONMENTAL AND LEGAL MATTERS

The Company is subject to extensive federal, state and local environmental laws and regulations. Although the Company's environmental policies and practices are designed to ensure compliance with these laws and regulations, future developments and increasingly stringent environmental regulation could require the Company to make additional unforeseen environmental expenditures. The Company will continue to invest in the equipment and facilities necessary to comply with existing and future regulations. During the first nine months of 2009, the Company's expenditures for capital projects related to the environment were \$1.9 million. These projects are capitalized and depreciated over their estimated useful lives, which is typically 10 years. Recurring costs associated with the operation and maintenance of facilities for waste treatment and disposal and managing environmental compliance in ongoing operations at the Company's manufacturing locations were approximately \$11.1 million for the first nine months ended September 30, 2009 and 2008. While difficult to project, it is not anticipated that these recurring expenses will increase significantly in the future.

Over the years, the Company has received requests for information related to or has been named by the government as a potentially responsible party at 23 waste disposal sites where cleanup costs have been or may be incurred under CERCLA and similar state statutes. In addition, damages are being claimed against the Company in general liability actions for alleged personal injury or property damage in the case of some disposal and plant sites. The Company believes that it has made adequate provisions for the costs it may incur with respect to the sites. It is the Company's accounting policy to record liabilities 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. After partial remediation payments at certain sites, the Company has estimated a range of possible environmental and legal losses from \$7.5 million to \$31.4 million at September 30, 2009, compared to \$10.8 million to \$34.4 million at December 31, 2008. At September 30, 2009, the Company's accrued liability for such losses, which represents the Company's best estimate within the estimated range of possible environmental and legal losses, was \$16.5 million, compared to \$16.7 million at December 31, 2008. During the first nine months of 2009, non-capital cash outlays related to legal and environmental matters approximated \$2.2 million compared to \$2.0 million for the first nine months of 2008.

For certain sites, estimates cannot be made of the total costs of compliance or the Company's share of such costs; consequently, the Company is unable to predict the effect thereof on the Company's financial position, cash flows and results of operations.

Management believes that in the event of one or more adverse determinations in any annual or interim period, the impact on the Company's cash flows and results of operations for those periods could be material. However, based upon the Company's present belief as to its relative involvement at these sites, other viable entities' responsibilities for cleanup and the extended period over which any costs would be incurred, the Company believes that these matters will not have a material effect on the Company's financial position. Certain of these matters are discussed in Item 1, Part 2, Legal Proceedings, in this report and in other filings of the Company with the Securities and Exchange Commission, which are available upon request from the Company. See also Note 7 to the condensed consolidated financial statements for a summary of the environmental proceedings related to certain environmental sites.

OUTLOOK

Despite the economy, the Company began 2009 with the intent to drive results within each of its three business segments and improve performance. In each of the first three quarters, the Company delivered record net income, benefitting from the relative stability of the large laundry and personal care markets for the Company's surfactant products, falling commodity prices within all three segments and the ability to contain costs. In the fourth quarter, management expects that earnings will be lower than the previous three quarters due to seasonal volume declines and acceleration of planned maintenance items, including a planned 2010 shutdown of the Company's phthalic anhydride (PA) plant in order to complete the work while the PA market remains slow. The Company is on track to deliver a record year in 2009 and is now focused on driving business growth in 2010.

CRITICAL ACCOUNTING POLICIES

There have been no changes to the critical accounting policies disclosed in the Company's 2008 Annual Report on Form 10-K.

OTHER

Except for the historical information contained herein, the matters discussed in this document are forward looking statements that involve risks and uncertainties. The results achieved this quarter are not necessarily an indication of future prospects for the Company. Actual results in future quarters may differ materially. Potential risks and uncertainties include, among others, fluctuations in the volume and timing of product orders, changes in demand for the Company's products, the ability to pass on raw material price increases, changes in technology, continued competitive pressures in the marketplace, outcome of environmental contingencies, availability of raw materials, foreign currency fluctuations and the general economic conditions.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in the Company's market risks since December 31, 2008.

Item 4 Controls and Procedures

a. Evaluation of Disclosure Controls and Procedures

Based on their evaluation of our disclosure controls and procedures as of the end of the most recent fiscal quarter covered by this Form 10-Q, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934) were effective as of September 30, 2009.

b. Changes in Internal Control Over Financial Reporting

There were no changes in internal controls that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II OTHER INFORMATION

Item 1 Legal Proceedings

Maywood, New Jersey Site

The Company's property in Maywood, New Jersey and property formerly owned by the Company adjacent to its current site and other nearby properties (Maywood site) were listed on the National Priorities List in September 1993 pursuant to the provisions of CERCLA because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between USEPA and the Company for property formerly owned by the Company, and the issuance of an order by USEPA to the Company for property currently owned by the Company, the Company completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. The Company also submitted documentation and information as requested by USEPA, including the submission of a Draft Feasibility Study for Soil and Groundwater (Operable Units 1 and 2) in March 2009. The Company is awaiting the issuance of a Record of Decision from USEPA.

The Company believes it has adequate reserves for claims associated with the Maywood site, and has recorded a liability for the estimated probable costs it expects to incur at the Maywood site related to remediation of chemical contamination. However, depending on the results of the ongoing discussions with USEPA, the final cost of such remediation could differ from the current estimates.

In addition, under the terms of a settlement agreement reached on November 12, 2004, the United States Department of Justice and the Company agreed to fulfill the terms of a Cooperative Agreement reached in 1985 under which the United States will take title to and responsibility for radioactive waste removal at the Maywood site, including past and future remediation costs incurred by the United States.

D Imperio Property Site

During the mid-1970's, Jerome Lightman and the Lightman Drum Company disposed of hazardous substances at several sites in New Jersey. The Company was named as a potentially responsible party (PRP) in the case *United States v. Lightman* (1:92-cv-4710 D.N.J.), which involved the D Imperio Property Site located in New Jersey. In the second quarter of 2007, the Company reached an agreement with respect to the past costs and future allocation percentage in said litigation for costs related to the D Imperio site, including costs to comply with USEPA's Unilateral Administrative Orders. The Company paid the settlement amount in the third quarter of 2007. The resolution of the Company's liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company. In December 2007, the Company received updated remediation cost estimates, which were considered in the Company's determination of its range of estimated possible losses and reserve balance.

Remediation work is continuing at this site. Based on current information, the Company believes that it has adequate reserves for claims associated with the D Imperio site. However, actual costs could differ from current estimates.

Ewan Property Site

The case *United States v. Lightman* (1:92-cv-4710 D.N.J.), described above for the D Imperio site, also involved the Ewan Property Site located in New Jersey. The agreement described above also included a settlement with respect to the past costs and future allocation percentage in said litigation for costs related to the past costs and allocation percentage at the Ewan site. The Company paid the settlement amount in the third quarter of 2007. The resolution of the Company's liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company.

In addition, the NJDEP filed a natural resource damages complaint in June 2007 against the Company and other entities regarding the Ewan site. The Company was served with the complaint in May 2008. The parties, including the Company, are engaged in discussions with NJDEP to resolve this litigation.

There is some monitoring and operational work continuing at the Ewan site. Based on current information, the Company believes that it has adequate reserves for claims associated with the Ewan site. However, actual costs could differ from current estimates.

Lightman Drum Company Superfund Site

The Company received a Section 104(e) Request for Information from USEPA dated March 21, 2000, regarding the Lightman Drum Company Superfund Site located in Winslow Township, New Jersey. The Company responded to this request on May 18, 2000. In addition, the Company received a Notice of Potential Liability and Request to Perform RI/FS dated June 30, 2000, from USEPA. The Company decided that it will participate in the performance of the RI/FS as a member of the Lightman Yard PRP Group. Due to the addition of other PRPs, the Company's allocation percentage decreased. However, the allocation has not yet been finalized by the Lightman Yard PRP Group.

In the fourth quarter of 2007, the PRPs who agreed to conduct the interim remedial action entered into an Administrative Settlement Agreement and Order on Consent for Removal Action with USEPA, and these PRPs also entered into a Supplemental Lightman Yard Participation and Interim Funding Agreement to fund the agreed-upon removal action. The Company paid a soil removal assessment upon execution of the agreements which did not have a material impact on the financial position, results of operations or cash flows of the Company. The soil removal action was completed and USEPA approved it in October 2009. A final Feasibility Study was submitted to USEPA in February 2009 and was approved in March 2009. In June 2009, USEPA issued a Proposed Plan for Remediation. In September 2009, USEPA signed the Record of Decision.

The Company believes that based on current information it has adequate reserves for claims associated with the Lightman site. However, actual costs could differ from current estimates.

Wilmington Site

The Company is currently contractually obligated to contribute to the response costs associated with the Company's formerly-owned site at 51 Eames Street, Wilmington, Massachusetts. Remediation at this site is being managed by its current owner to whom

the Company sold the property in 1980. Under the agreement, once total site remediation costs exceed certain levels, the Company is obligated to contribute up to five percent of future response costs associated with this site with no limitation on the ultimate amount of contributions. To date, the Company has paid the current owner \$1.6 million for the Company's portion of environmental response costs through the second quarter of 2009 (the current owner of the site bills the Company one calendar quarter in arrears). The Company has recorded a liability for its portion of the estimated remediation costs for the site. Depending on the ultimate cost of the remediation at this site, the amount for which the Company is liable could differ from the current estimates.

In addition, in response to the special notice letter received by the PRPs in June 2006 from USEPA seeking performance of an RI/FS at the site, certain PRPs, including the Company, signed an Administrative Settlement Agreement and Order on Consent for the RI/FS effective July 2007.

The Company and other prior owners also entered into an agreement in April 2004 waiving certain statute of limitations defenses for claims which may be filed by the Town of Wilmington, Massachusetts, in connection with this site. While the Company has denied any liability for any such claims, the Company agreed to this waiver while the parties continue to discuss the resolution of any potential claim which may be filed.

The Company believes that based on current information it has adequate reserves for the claims related to this site.

Other Sites

The Company has been named as a de minimis PRP at other sites, and as such the Company believes that a resolution of its liability will not have a material impact on the financial position, results of operations or cash flows of the Company.

Item 1A Risk Factors

There have been no material changes from the risk factors disclosed in the Company's 2008 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Below is a summary by month of share purchases by the Company during the third quarter of 2009:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|-----------|----------------------------------|------------------------------|----------------------------------------------------------------------------------|--------------------------------------------------------------------------------|
| July | | | | |
| August | 7,184 ^(a) | \$ 48.78 | | |
| September | 32,024 ^(b) | \$ 59.63 | | |

^(a) Includes 3,973 shares purchased on the open market and 3,211 shares tendered in lieu of cash for stock option exercises. The shares tendered were held by the individuals exercising the options for more than six months.

^(b) Includes 32,024 shares tendered in lieu of cash for stock option exercises. The shares tendered were held by the individuals exercising the options for more than six months.

Item 3 Defaults Upon Senior Securities

None

Item 4 Submission of Matters to a Vote of Security Holders

None

Item 5 Other Information

None

Item 6 Exhibits

- (a) Exhibit 31.1 Certification of President and Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
- (b) Exhibit 31.2 Certification of Vice President and Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
- (c) Exhibit 32 Certification pursuant to 18 U.S.C. Section 1350

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 29, 2009

STEPAN COMPANY

/s/ J. E. HURLBUTT
J. E. Hurlbutt
Vice President and Chief Financial Officer