

STEPAN CO  
Form 10-Q  
April 29, 2015

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 MARCH 31, 2015

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

Commission File Number 1-4462

STEPAN COMPANY

(Exact name of registrant as specified in its charter)

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

Edens and Winnetka Road, Northfield, Illinois 60093

(Address of principal executive offices)

Registrant's telephone number (847) 446-7500

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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 April 17, 2015
Common Stock, \$1 par value	22,281,254 Shares

## Part I FINANCIAL INFORMATION

## Item 1 - Financial Statements

## STEPAN COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

(In thousands, except per share amounts)	Three Months Ended March 31	
	2015	2014
Net Sales	\$460,451	\$477,442
Cost of Sales	384,009	414,418
Gross Profit	76,442	63,024
Operating Expenses:		
Selling	12,997	14,146
Administrative	19,339	14,431
Research, development and technical services	11,790	11,924
	44,126	40,501
Gain on sale of product line (Note 14)	2,862	—
Operating Income	35,178	22,523
Other Income (Expense):		
Interest, net	(4,054 )	(2,957 )
Loss from equity in joint ventures	(1,240 )	(1,451 )
Other, net (Note 13)	652	(26 )
	(4,642 )	(4,434 )
Income Before Provision for Income Taxes	30,536	18,089
Provision for Income Taxes	9,250	5,081
Net Income	21,286	13,008
Net (Income) Loss Attributable to Noncontrolling Interests (Note 2)	(16 )	10
Net Income Attributable to Stepan Company	\$21,270	\$13,018
Net Income Per Common Share Attributable to Stepan Company (Note 9):		
Basic	\$0.94	\$0.57
Diluted	\$0.93	\$0.57
Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9):		
Basic	22,718	22,773
Diluted	22,827	22,964
Dividends Declared Per Common Share	\$0.18	\$0.17

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

## STEPAN COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

(In thousands)	Three Months Ended March 31	
	2015	2014
Net income	\$21,286	\$13,008
Other comprehensive income (loss):		
Foreign currency translation adjustments (Note 10)	(25,152)	94
Pension liability adjustment, net of tax (Note 10)	749	410
Derivative instrument activity, net of tax (Note 10)	(42 )	3
Other comprehensive income (loss)	(24,445)	507
Comprehensive income (loss)	(3,159 )	13,515
Comprehensive (income) loss attributable to noncontrolling interests (Note 2)	(1 )	33
Comprehensive income (loss) attributable to Stepan Company	\$(3,160 )	\$13,548

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

## STEPAN COMPANY

## CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(In thousands)	March 31, 2015	December 31, 2014
<b>Assets</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$97,308	\$85,215
Receivables, net	271,510	270,436
Inventories (Note 6)	172,168	183,233
Deferred income taxes	15,548	15,364
Other current assets	22,397	21,308
Total current assets	578,931	575,556
<b>Property, Plant and Equipment:</b>		
Cost	1,379,839	1,385,851
Less: accumulated depreciation	(861,706 )	(861,656 )
Property, plant and equipment, net	518,133	524,195
Goodwill, net	11,390	11,502
Other intangible assets, net	20,092	20,803
Long-term investments (Note 3)	20,134	20,217
Other non-current assets	9,669	9,741
Total assets	\$1,158,349	\$1,162,014
<b>Liabilities and Equity</b>		
<b>Current Liabilities:</b>		
Current maturities of long-term debt (Note 12)	\$27,799	\$27,034
Accounts payable	142,101	156,983
Accrued liabilities	74,903	65,496
Total current liabilities	244,803	249,513
Deferred income taxes	15,754	15,804
Long-term debt, less current maturities (Note 12)	255,937	246,897
Other non-current liabilities	111,377	112,856
<b>Commitments and Contingencies (Note 7)</b>		
<b>Equity:</b>		
Common stock, \$1 par value; authorized 30,000,000 shares; issued 25,666,380 shares in 2015 and 25,640,090 shares in 2014	25,666	25,640
Additional paid-in capital	140,471	139,573
Accumulated other comprehensive loss (Note 10)	(108,375 )	(83,945 )
Retained earnings	537,763	520,540
Less: Common treasury stock, at cost, 3,386,626 shares in 2015 and 3,238,321 shares in 2014	(66,446 )	(66,262 )
Total Stepan Company stockholders' equity	529,079	535,546
Noncontrolling interests (Note 2)	1,399	1,398
Total equity	530,478	536,944
Total liabilities and equity	\$1,158,349	\$1,162,014

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

(In thousands)	Three Months Ended March 31	
	2015	2014
<b>Cash Flows From Operating Activities</b>		
Net income	\$21,286	\$13,008
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,127	16,098
Deferred compensation	1,577	(248 )
Realized and unrealized gain on long-term investments	(531 )	(23 )
Stock-based compensation	798	226
Deferred income taxes	(1,261 )	(1,851 )
Other non-cash items	(1,397 )	1,573
Changes in assets and liabilities:		
Receivables, net	(11,546)	(30,013 )
Inventories	4,969	(13,245 )
Other current assets	(1,703 )	646
Accounts payable and accrued liabilities	5,647	6,291
Pension liabilities	111	(466 )
Environmental and legal liabilities	90	(357 )
Deferred revenues	(195 )	(183 )
Excess tax benefit from stock options and awards	(120 )	(414 )
<b>Net Cash Provided By (Used) In Operating Activities</b>	<b>33,852</b>	<b>(8,958 )</b>
<b>Cash Flows From Investing Activities</b>		
Expenditures for property, plant and equipment	(28,295)	(20,503 )
Proceeds from sale of product line (Note 14)	3,262	—
Sale of mutual funds	782	738
Other, net	(855 )	(3,362 )
<b>Net Cash Used In Investing Activities</b>	<b>(25,106)</b>	<b>(23,127 )</b>
<b>Cash Flows From Financing Activities</b>		
Revolving debt and bank overdrafts, net	14,241	(311 )
Other debt repayments	(2,063 )	(688 )
Dividends paid	(4,047 )	(3,800 )
Company stock repurchased	—	(430 )
Stock option exercises	167	904
Excess tax benefit from stock options and awards	120	414
Other, net	(275 )	(100 )
<b>Net Cash Provided By (Used In) Financing Activities</b>	<b>8,143</b>	<b>(4,011 )</b>
Effect of Exchange Rate Changes on Cash	(4,796 )	(531 )
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>12,093</b>	<b>(36,627 )</b>
Cash and Cash Equivalents at Beginning of Period	85,215	133,347
Cash and Cash Equivalents at End of Period	\$97,308	\$96,720



Supplemental Cash Flow Information

Cash (refunds) payments of income taxes, net	\$(2,920 )	\$2,790
Cash payments of interest	\$435	\$463

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

## STEPAN COMPANY

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2015

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 (US GAAP) 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 adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company's financial position as of March 31, 2015, and its results of operations and cash flows for the three months ended March 31, 2015 and 2014, 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 2014 Form 10-K.

## 2. RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to noncontrolling interests for the three months ended March 31, 2015 and 2014:

	Total	Stepan Company	Noncontrolling Interest
(In thousands)	Equity	Equity	Equity <sup>(3)</sup>
Balance at January 1, 2015	\$536,944	\$535,546	\$ 1,398
Net income	21,286	21,270	16
Dividends	(4,047 )	(4,047 )	—
Common stock purchases <sup>(1)</sup>	(273 )	(273 )	—
Stock option exercises	167	167	—
Defined benefit pension adjustments, net of tax	749	749	—
Translation adjustments	(25,152 )	(25,137 )	(15 )
Derivative instrument activity, net of tax	(42 )	(42 )	—
Other <sup>(2)</sup>	846	846	—
Balance at March 31, 2015	\$530,478	\$529,079	\$ 1,399

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	Total	Stepan Company	Noncontrolling Interest
(In thousands)	Equity	Equity	Equity <sup>(3)</sup>
Balance at January 1, 2014	\$553,741	\$552,286	\$ 1,455
Net income	13,008	13,018	(10 )
Dividends	(3,800 )	(3,800 )	—
Common stock purchases <sup>(1)</sup>	(531 )	(531 )	—
Stock option exercises	904	904	—
Defined benefit pension adjustments, net of tax	410	410	—
Translation adjustments	94	117	(23 )
Derivative instrument activity, net of tax	3	3	—
Other <sup>(2)</sup>	466	466	—
Balance at March 31, 2014	\$564,295	\$562,873	\$ 1,422

<sup>(1)</sup>Includes the value of Company shares purchased in the open market and the value of Company common shares tendered by employees to settle minimum statutory withholding taxes related to the receipt of performance awards and deferred compensation distributions.

<sup>(2)</sup>Primarily comprised of activity related to stock-based compensation, deferred compensation and excess tax benefits.

<sup>(3)</sup>Reflects the noncontrolling interest in the Company's China joint venture.

### 3. FAIR VALUE MEASUREMENTS

The following describe the financial instruments held by the Company at March 31, 2015, and December 31, 2014, and 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 and interest rate contracts discussed in Note 4. Fair value and carrying value were the same because the contracts were recorded at fair value. The fair values of the foreign currency contracts were calculated as the difference between the applicable forward foreign exchange rates at the reporting date and the contracted foreign exchange rates multiplied by the contracted notional amounts. The fair values of the interest rate swaps were calculated as the difference between the contracted swap rate and the current market replacement swap rate multiplied by the present value of one basis point for the notional amount of the contract. See the table that follows the 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 and all of its non-qualified supplemental executive defined contribution obligations (see the defined contribution plans section of Note 9). Fair value and carrying value were the same because the mutual fund assets were recorded at fair value in accordance with the fair value option rules established by the Financial Accounting Standards Board (FASB). 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 the financial instrument descriptions for the reported fair value of long-term investments.

#### Debt obligations

The fair value of debt with original maturities greater than one year comprised 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 fair values of the remaining Company debt obligations approximated their carrying values due to the short-term nature of the debt. The Company's fair value measurements for debt fall in level 2 of the fair value hierarchy.

At March 31, 2015, and December 31, 2014, the fair value of debt and the related carrying values, including current maturities, were as follows:

	March	December
(In thousands)	31, 2015	31, 2014
Fair value	\$298,655	\$285,441
Carrying value	283,736	273,931

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The following tables present financial assets and liabilities measured on a recurring basis at fair value as of March 31, 2015, and December 31, 2014, and the level within the fair value hierarchy in which the fair value measurements fall:

(In thousands)	March		Level	Level
	2015	Level 1	2	3
Mutual fund assets	\$20,134	\$20,134	\$—	\$ —
Derivative assets:				
Foreign currency contracts	131	—	131	—
Total assets at fair value	\$20,265	\$20,134	\$131	\$ —
Derivative liabilities:				
Foreign currency contracts	142	—	142	—
Interest rate contracts	60	—	60	—
Total liabilities at fair value	\$202	\$—	\$202	\$ —

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(In thousands)	December		Level	Level
	2014	Level 1	2	3
Mutual fund assets	\$ 20,217	\$20,217	\$—	\$ —
Derivative assets:				
Foreign currency contracts	73	—	73	—
Total assets at fair value	\$ 20,290	\$20,217	\$73	\$ —
Derivative liabilities:				
Foreign currency contracts	\$ 628	\$—	\$628	\$ —

#### 4. DERIVATIVE INSTRUMENTS

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 currency exchange risk. The Company holds forward foreign currency exchange contracts that are not designated as any type of accounting hedge as defined by U.S. generally accepted accounting principles. The Company uses these contracts to manage its exposure to exchange rate fluctuations on certain Company subsidiary cash, accounts receivable, accounts payable and other obligation balances 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 re-measurement of the asset and liability balances into the applicable functional currencies. At March 31, 2015, and December 31, 2014, the Company had open forward foreign currency exchange contracts, with settlement dates of about one month, to buy or sell foreign currencies with U.S. dollar equivalent amounts of \$44,228,000 and \$51,623,000, respectively.

The Company is exposed to volatility in short-term interest rates and mitigates certain portions of that risk by using interest rate swaps. The interest rate swaps are recognized on the balance sheet as either an asset or a liability measured at fair value. The Company held interest rate swap contracts with notional values of \$4,139,000 at March 31, 2015, which are designated as cash flow hedges. At December 31, 2014, the Company held no significant interest rate swap contracts. Period-to-period changes in the fair value of interest rate swap contracts are recognized as gains or losses in other comprehensive income, to the extent effective. As each interest rate swap hedge contract is settled, the corresponding gain or loss is reclassified out of accumulated other comprehensive income (AOCI) into earnings in that settlement period. The latest date through which the Company expects to hedge its exposure to the volatility of short-term interest rates is December 1, 2021.

The fair values of the derivative instruments held by the Company on March 31, 2015, and December 31, 2014, and derivative instrument gains and losses for the three-month periods ending March 31, 2015 and 2014, were immaterial. For amounts reclassified out of AOCI into earnings for the three month periods ended March 31, 2015 and 2014, see Note 10.

#### 5. STOCK-BASED COMPENSATION

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On March 31, 2015 the Company had stock options outstanding under its 2000 Stock Option Plan, stock options and stock awards outstanding under its 2006 Incentive Compensation Plan and stock options, stock awards and stock appreciation rights (SARs) outstanding under its 2011 Incentive Compensation Plan.

Compensation expense recorded for all stock options, stock awards and SARs was as follows:

(In
thousands)
Three
Months
Ended
March 31
2015 2014
\$798 \$226

During the first quarter of 2014, management assessed that the profitability performance targets on which the compensation expenses for stock awards vesting on December 31, 2014, were based would not be achieved. Consequently, the resulting adjustment lowered the overall stock-based compensation expense for the three months ended March 31, 2014.

Unrecognized compensation costs for stock options, stock awards and SARs were as follows:

	March	
	31,	December
(In thousands)	2015	31, 2014
Stock options	\$ 1,668	\$ 774
Stock awards	3,728	1,365
SARs	3,015	693

The increases in unrecognized compensation costs for stock options, stock awards and SARs reflected the first quarter 2015 grants of:

	Shares
Stock options	82,969
Stock awards	73,028
SARs	182,417

The unrecognized compensation costs at March 31, 2015, are expected to be recognized over weighted-average periods of 1.6 years, 2.5 years and 1.7 years for stock options, stock awards and SARs, respectively.

## 6. INVENTORIES

The composition of inventories was as follows:

	March	December
(In thousands)	31, 2015	31, 2014
Finished products	\$ 120,166	\$ 126,157
Raw materials	52,002	57,076
Total inventories	\$ 172,168	\$ 183,233

Inventories are priced primarily 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 \$32,825,000 and \$34,340,000 higher than reported at March 31, 2015, and December 31, 2014, 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 potentially responsible party (PRP) at a number of 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 these sites.

As of March 31, 2015, the Company estimated a range of possible environmental and legal losses of \$22.1 million to \$41.4 million. At March 31, 2015, and December 31, 2014, the Company's accrued liability for such losses, which represented the Company's best estimate within the estimated range of possible environmental and legal losses, was \$22.1 million and \$22.0 million, respectively. During the first three months of 2015 and 2014, cash outlays related to legal and environmental matters approximated \$0.3 million.

For certain sites, the Company has responded to information requests made by federal, state or local government agencies but has received no response confirming or denying the Company's stated positions. As such, estimates of the total costs, or range of possible costs, of remediation, if any, or the Company's share of such costs, if any, cannot be determined with respect to these sites. Consequently, the Company is unable to predict the effect thereof on the Company's financial position, cash flows and results of operations. Given the information available, management believes the Company has no liability at these sites. However, in the event of one or more adverse determinations with respect to such sites in any annual or interim period, the effect on the Company's cash flows and results of operations for those periods could be material. Based upon the Company's present knowledge with respect to its involvement at these sites, the possibility of 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 March 31, 2015:

#### 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 has completed various Remedial Investigation Feasibility Studies (RI/FS), and on September 24, 2014, USEPA issued its Record of Decision ("ROD") for chemically-contaminated soil. Based on the most current information available, the Company recorded a \$0.6 million increase in its remediation liability for this site in the three months ended March 31, 2015. The Company believes its recorded liability represents its best estimate of the cost of remediation for the Maywood site. The best estimate of the cost of remediation for the Maywood site could change as the Company continues to hold discussions with USEPA, as the design of the remedial action progresses or if other PRPs are identified. The ultimate amount for which the Company is liable could differ from the Company's current recorded liability.

In April 2015, the Company agreed to enter into an Administrative Settlement Agreement and Administrative Order on Consent with USEPA for performance of certain investigative and design work for chemically-contaminated soil. Based on the Company's review and analysis of this order, no changes to the Company's current recorded liability for claims associated with soil remediation of chemical contamination were required.

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. As such, the Company recorded no liability related to this settlement agreement.

#### 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 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 2012, the PRPs approved certain changes to remediation cost estimates which were considered in the Company's determination of its range of estimated possible losses and liability balance. The changes in range of possible losses and liability balance were immaterial. Remediation work is continuing at this site. Based on current information, the Company believes that its recorded liability for claims associated with the D'Imperio site is adequate. 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 \$2.3 million for the Company's portion of environmental response costs through the fourth quarter of 2014 (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.

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 its recorded liability for the claims related to this site is adequate. However, 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.

### Unclaimed Property Examination

The Company is undergoing an unclaimed property examination by the state of Delaware (the Company's state of incorporation) and seven other states for the period covering 1981 through 2010. The types of unclaimed property under examination include certain un-cashed payroll and accounts payable checks and certain accounts receivable credits. Generally, unclaimed property must be reported and remitted to the state of the rightful owner. In cases where the rightful owner cannot be identified, the property must be reported and remitted to the unclaimed property holder's state of incorporation. The examination of un-cashed payroll and accounts payable checks has been completed, and no significant adjustments to the Company's unclaimed property liability were required. The examination of accounts receivable credits is ongoing. On the basis of currently available information, the Company believes its liability for unclaimed property is adequate. Because the audit is not final, the Company's ultimate actual obligation could differ from the recorded liability.

### Customer Claims

From time to time in the normal course of business, customers make claims against the Company for issues such as product performance and liability, contract disputes, delivery errors and other various concerns. Frequently, such claims are subject to extensive investigation, discussion and negotiation prior to settlement or resolution. On the basis of the most current information available, the Company's liability for such claims was \$4,016,000 at March 31, 2015, compared to \$3,475,000 at December 31, 2014. Investigations and discussions with the affected customers are ongoing. Therefore, the actual amounts ultimately paid, if any, to settle the claims could differ significantly from the amounts currently recorded.

### Mexico Value-Added Tax

During an examination of the Company's 2009 and 2010 Mexico subsidiary financial records, local tax authority auditors determined that the Company's treatment of value-added tax (VAT) for purchase transactions with a certain vendor was incorrect. As a result, the tax authorities concluded that the Company owed past VAT from 2009 -2010 along with assessed inflation, penalty and interest charges. Consequently, the Company recorded a liability and corresponding income statement charge for the VAT inflation, penalty and interest charges. The liability included the 2009 – 2010 assessment of inflation, penalty and interest charges plus an estimated amount for the potential exposure for 2011 – 2014. The amount recorded was not material to the Company's results of operations. No charge was recorded for the past unpaid VAT because the Company believes the amount will be recoverable through the normal VAT process. Depending on negotiations with Mexico's tax authorities, the accuracy of the estimates for 2011 - 2014 and the actual amount of the past VAT that is recovered by the Company, the actual settlement could differ from the current recorded liability.

## 8. POSTRETIREMENT BENEFIT PLANS

### Defined Benefit Pension Plans

The Company sponsors various funded qualified and unfunded non-qualified defined benefit pension plans, the most significant of which cover employees in the U.S. and U.K. locations. The U.S. and U.K. defined benefit pension plans are frozen and service benefits are no longer being accrued.

### Components of Net Periodic Benefit Cost

	UNITED STATES		UNITED KINGDOM	
	Three Months Ended		Three Months Ended	
	March 31		March 31	
(In thousands)	2015	2014	2015	2014
Interest cost	\$1,701	\$1,723	\$195	\$243
Expected return on plan assets	(2,393)	(2,378)	(262)	(328)
Amortization of net actuarial loss	1,149	662	45	—
Net periodic benefit cost (income)	\$457	\$7	\$(22 )	\$(85 )

### Employer Contributions

#### U.S. Plans

As a result of pension funding relief provisions included in the Highway and Transportation Funding Act of 2014, the Company expects to make no 2015 contributions to the funded U.S. qualified defined benefit plans. Approximately, \$185,000 is expected to be paid related to the unfunded unqualified plans. As of March 31, 2015, \$141,000 had been paid related to the non-qualified plans.

## U.K. Plan

The Company's United Kingdom subsidiary expects to contribute approximately \$551,000 to its defined benefit pension plan in 2015. As of March 31, 2015, \$216,000 had been contributed to the plan.

## Defined Contribution Plans

The Company sponsors retirement savings defined contribution plans that cover U.S. and U.K. employees. The Company also sponsors a qualified profit sharing plan for its U.S. employees. The retirement savings and profit sharing defined contribution plans include a qualified plan and a non-qualified supplemental executive plan.

Defined contribution plan expenses for the Company's retirement savings and profit sharing plans were as follows:

(In thousands)	Three Months Ended March 31	
	2015	2014
Retirement savings plans	\$1,184	\$1,131
Profit sharing plan	980	764
Total defined contribution expense	\$2,164	\$1,895

The Company funds the obligations of its non-qualified supplemental executive defined contribution plans (supplemental plans) through a rabbi trust. The trust comprises various mutual fund investments selected by the participants of the supplemental plans. In accordance with the accounting guidance for rabbi trust arrangements, the assets of the trust and the obligations of the supplemental plans are reported on the Company's consolidated balance sheets. The Company elected the fair value option for the mutual fund investment assets so that offsetting changes in the mutual fund values and defined contribution plan obligations would be recorded in earnings in the same period. Therefore, the mutual funds are reported at fair value with any subsequent changes in fair value recorded in the consolidated statements of income. The liabilities related to the supplemental plans increase (i.e., supplemental plan expense is recognized) when the value of the trust assets appreciates and decrease when the value of the trust assets declines (i.e., supplemental plan income is recognized). At March 31, 2015, the balance of the trust assets was \$1,813,000, which equaled the balance of the supplemental plan liabilities (see the long-term investments section in Note 3 for further information regarding the Company's mutual fund assets).

## 9. EARNINGS PER SHARE

Below are the computations of basic and diluted earnings per share for the three months ended March 31, 2015 and 2014:

Three Months  
Ended

(In thousands, except per share amounts)	March 31	
	2015	2014
<b>Computation of Basic Earnings per Share</b>		
Net income attributable to Stepan Company	\$21,270	\$13,018
Weighted-average number of shares outstanding	22,718	22,773
Basic earnings per share	\$0.94	\$0.57
<b>Computation of Diluted Earnings per Share</b>		
Net income attributable to Stepan Company	\$21,270	\$13,018
Weighted-average number of shares outstanding	22,718	22,773
Add weighted-average net shares issuable from assumed exercise of options (under treasury stock method) <sup>(1)</sup>	104	182
Add weighted-average net shares related to unvested stock awards (under treasury stock method)	5	9
Weighted-average shares applicable to diluted earnings	22,827	22,964
Diluted earnings per share	\$0.93	\$0.57

<sup>(1)</sup>Options to purchase 226,098 and 47,639 shares of Company common stock were excluded from the computation of diluted earnings per share for the three months ended March 31, 2015 and March 31, 2014, respectively. The options' exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

## 10. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in the Company's accumulated other comprehensive income (loss) (AOCI) by component (net of income taxes) for the three-month periods ended March 31, 2014 and 2015, are presented below:

(In thousands)	Foreign	Defined	Cash Flow	Total
	Currency	Benefit		
	Translation	Plan	Hedge	
	Adjustments	Adjustments	Adjustments	
Balance at December 31, 2013	\$ (10,971 )	\$ (18,672 )	\$ 115	\$(29,528 )
Other comprehensive income before reclassifications	117	—	—	117
Amounts reclassified from AOCI	—	410	3	413
Net current-period other comprehensive income	117	410	3	530
Balance at March 31, 2014	\$ (10,854 )	\$ (18,262 )	\$ 118	\$(28,998 )
Balance at December 31, 2014	\$ (42,914 )	\$ (41,149 )	\$ 118	\$(83,945 )
Other comprehensive income before reclassifications	(25,137 )	—	(43 )	(25,180 )
Amounts reclassified from AOCI	—	749	1	750
Net current-period other comprehensive income	(25,137 )	749	(42 )	(24,430 )
Balance at March 31, 2015	\$ (68,051 )	\$ (40,400 )	\$ 76	\$(108,375)

Information regarding the reclassifications out of AOCI for the three month periods ended March 31, 2015 and 2014, is displayed below:

(In thousands)	Amount		Affected Line Item in Consolidated Statements of Income
	Reclassified from AOCI (a)	2015 2014	
AOCI Components	2015	2014	
Amortization of defined benefit pension actuarial losses	\$ (1,194)	\$ (662)	(b)
	445	252	Tax benefit
	\$(749 )	\$(410)	Net of tax
Gains and losses on cash flow hedges:			
Interest rate contracts	\$ (5 )	\$ (7 )	Interest, net
Foreign exchange contracts	2	2	Cost of sales
	(3 )	(5 )	Total before tax
	2	2	Tax benefit
	\$(1 )	\$(3 )	Net of tax
Total reclassifications for the period	\$(750 )	\$(413)	Net of tax

(a) Amounts in parentheses denote expense to statement of income.

(b) This component of accumulated other comprehensive income is included in the computation of net periodic benefit cost (see Note 8 for additional details).





11. SEGMENT REPORTING