STEPAN CO
Form 10-Q
August 03, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2012

¨ **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)

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

Edens and Winnetka Road, Northfield, Illinois 60093

(Address of principal executive offices)

Registrant s telephone number (847) 446-7500

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 x 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 x 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	x
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 x

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 July 31, 2012**
Common Stock, $1 par value	10,369,660 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 June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Net Sales	$ 470,231	$ 476,989	$ 935,500	$ 899,587
Cost of Sales	396,835	407,404	785,320	768,216
Gross Profit	73,396	69,585	150,180	131,371
Operating Expenses:				
Selling	12,985	12,171	26,636	23,001
Administrative	14,086	12,680	31,038	23,554
Research, development and technical services	11,504	10,656	22,285	20,887
	38,575	35,507	79,959	67,442
Operating Income	34,821	34,078	70,221	63,929
Other Income (Expense):				
Interest, net	(2,086)	(2,194)	(4,690)	(4,257)
Loss from equity in joint ventures	(1,300)	(805)	(2,441)	(1,770)
Other, net (Note 12)	83	253	1,148	565
	(3,303)	(2,746)	(5,983)	(5,462)
Income Before Provision for Income Taxes	31,518	31,332	64,238	58,467
Provision for Income Taxes	10,007	10,326	20,363	18,645
Net Income	21,511	21,006	43,875	39,822
Net Income Attributable to Noncontrolling Interests (Note 2)	(86)	(139)	(148)	(194)
Net Income Attributable to Stepan Company	$ 21,425	$ 20,867	$ 43,727	$ 39,628
Net Income Per Common Share Attributable to Stepan Company (Note 9):				
Basic	$ 2.01	$ 2.00	$ 4.12	$ 3.80
Diluted	$ 1.89	$ 1.87	$ 3.85	$ 3.55
Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9):				
Basic	10,550	10,345	10,537	10,335

Diluted		11,357		11,178		11,345		11,175
Dividends Declared Per Common Share	$	0.28	$	0.26	$	0.56	$	0.52

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 June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Net income	$ 21,511	$ 21,006	$ 43,875	$ 39,822
Other comprehensive income (loss):				
Foreign currency translation adjustments	(10,554)	3,964	(2,020)	10,081
Pension liability adjustment, net of tax	582	521	1,164	1,044
Derivative instrument activity, net of tax	(43)	315	64	389
Other comprehensive income (loss)	(10,015)	4,800	(792)	11,514
Comprehensive income	11,496	25,806	43,083	51,336
Less: Comprehensive income attributable to noncontrolling interests	(65)	(167)	(202)	(236)
Comprehensive income attributable to Stepan Company	$ 11,431	$ 25,639	$ 42,881	$ 51,100

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)	June 30, 2012	December 31, 2011
Assets		
Current Assets:		
Cash and cash equivalents	$ 69,523	$ 84,099
Receivables, net	278,184	260,784
Inventories (Note 6)	137,852	111,175
Deferred income taxes	9,055	8,769
Other current assets	16,183	14,915
Total current assets	510,797	479,742
Property, Plant and Equipment:		
Cost	1,152,600	1,119,897
Less: accumulated depreciation	756,661	735,914
Property, plant and equipment, net	395,939	383,983
Goodwill, net	7,038	7,000
Other intangible assets, net	9,940	11,181
Long-term investments (Note 3)	13,445	12,464
Other non-current assets	6,138	6,748
Total assets	$ 943,297	$ 901,118
Liabilities and Equity		
Current Liabilities:		
Current maturities of long-term debt (Note 11)	$ 33,294	$ 34,487
Accounts payable	140,604	137,764
Accrued liabilities	61,615	60,975
Total current liabilities	235,513	233,226
Deferred income taxes	9,990	8,644
Long-term debt, less current maturities (Note 11)	162,049	164,967
Other non-current liabilities	90,878	88,816
Commitments and Contingencies (Note 7)		
Equity:		
5-1/2% convertible preferred stock, cumulative, voting, without par value; authorized 2,000,000 shares; issued and outstanding 518,293 shares in 2012 and in 2011	12,957	12,957
Common stock, $1 par value; authorized 30,000,000 shares; Issued 11,831,942 shares in 2012 and 11,709,312 shares in 2011	11,832	11,709
Additional paid-in capital	101,564	94,932
Accumulated other comprehensive loss	(42,134)	(41,485)

Retained earnings	403,872	366,293
Less: Common treasury stock, at cost, 1,482,657 shares in 2012 and 1,462,980 shares in 2011	(44,932)	(43,195)
Total Stepan Company stockholders equity	443,159	401,211
Noncontrolling interests (Note 2)	1,708	4,254
Total equity	444,867	405,465
Total liabilities and equity	$ 943,297	$ 901,118

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)	Six Months Ended June 30 2012	2011
Cash Flows From Operating Activities		
Net income	$ 43,875	$ 39,822
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,217	23,007
Deferred compensation	4,957	(709)
Realized and unrealized gain on long-term investments	(1,010)	(438)
Stock-based compensation	1,591	1,777
Deferred income taxes	538	4,846
Other non-cash items	2,669	1,083
Changes in assets and liabilities:		
Receivables, net	(19,725)	(83,875)
Inventories	(27,978)	(55,088)
Other current assets	(1,150)	(3,586)
Accounts payable and accrued liabilities	12,303	55,151
Pension liabilities	(1,646)	(895)
Environmental and legal liabilities	(143)	(412)
Deferred revenues	(662)	(890)
Excess tax benefit from stock options and awards	(2,070)	(1,113)
Net Cash Provided By (Used In) Operating Activities	36,766	(21,320)
Cash Flows From Investing Activities		
Expenditures for property, plant and equipment	(40,798)	(40,400)
Business acquisition		(13,562)
Sale of mutual funds	537	1,613
Other, net	(1,662)	(2,136)
Net Cash Used In Investing Activities	(41,923)	(54,485)
Cash Flows From Financing Activities		
Revolving debt and bank overdrafts, net	(810)	9,738
Build-to-suit obligation buyout		(12,206)
Other debt repayments	(2,827)	(2,291)
Dividends paid	(6,148)	(5,638)
Company stock repurchased	(500)	(1,000)
Stock option exercises	2,320	889
Payment to noncontrolling interest (Note 13)	(2,000)	
Excess tax benefit from stock options and awards	2,070	1,113
Other, net	(1,256)	(1,265)
Net Cash Used In Financing Activities	(9,151)	(10,660)
Effect of Exchange Rate Changes on Cash	(268)	866
Net Decrease in Cash and Cash Equivalents	(14,576)	(85,599)
Cash and Cash Equivalents at Beginning of Period	84,099	111,198

Cash and Cash Equivalents at End of Period	$ 69,523	$ 25,599
Supplemental Cash Flow Information		
Cash payments of income taxes, net of refunds	$ 15,121	$ 9,832
Cash payments of interest	$ 5,216	$ 4,122

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2012

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 adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company s financial position as of June 30, 2012 and its results of operations for the three and six months ended June 30, 2012 and 2011, and cash flows for the six months ended June 30, 2012 and 2011, 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 2011 Form 10-K.

2. RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to the noncontrolling interests for the six months ended June 30, 2012 and 2011:

(In thousands)	Total Equity	Stepan Company Equity	Noncontrolling Interests Equity (3)
Balance at January 1, 2012	$ 405,465	$ 401,211	$ 4,254
Net income	43,875	43,727	148
Purchase of remaining interest in Stepan Philippines, Inc. from noncontrolling interest	(2,000)	748	(2,748)
Dividends	(6,148)	(6,148)	
Common stock purchases (1)	(1,761)	(1,761)	
Stock option exercises	2,320	2,320	
Defined benefit pension adjustments, net of tax	1,164	1,164	
Translation adjustments	(2,020)	(2,074)	54
Derivative instrument activity, net of tax	64	64	
Other (2)	3,908	3,908	
Balance at June 30, 2012	$ 444,867	$ 443,159	$ 1,708

(In thousands)	Total Equity	Stepan Company Equity	Noncontrolling Interests Equity [3]
Balance at January 1, 2011	$ 353,071	$ 349,491	$ 3,580
Net income	39,822	39,628	194
Dividends	(5,638)	(5,638)	
Common stock purchases [1]	(2,274)	(2,274)	
Stock option exercises	889	889	
Defined benefit pension adjustments, net of tax	1,044	1,044	
Translation adjustments	10,081	10,039	42
Derivative instrument gain, net of tax	389	389	
Other [2]	3,603	3,603	
Balance at June 30, 2011	$ 400,987	$ 397,171	$ 3,816

(1) 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.
(2) Primarily comprised of activity related to stock-based compensation, deferred compensation and excess tax benefits.
(3) Includes partners noncontrolling interests in the Company s China and Philippines joint ventures. See Note 13 for information regarding the Company s purchase of the remaining ownership interest in the Philippine joint venture.

3. FINANCIAL INSTRUMENTS

The following are the financial instruments held by the Company at June 30, 2012 and December 31, 2011, 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 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 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 and all of its non-qualified supplemental executive defined contribution obligations (see the defined contribution plans section of Note 8). 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 set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 825, *Financial Instruments*. 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.

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 June 30, 2012, and December 31, 2011, the fair value of debt and the related carrying values, including current maturities, were as follows:

(In thousands)	June 30, 2012	December 31, 2011
Fair value	$ 206,391	$ 206,789
Carrying value	195,343	199,454

The following tables present financial assets and liabilities measured on a recurring basis at fair value as of June 30, 2012, and December 31, 2011, and the level within the fair value hierarchy in which the fair value measurements fall:

(In thousands)	June 2012	Level 1	Level 2	Level 3
Mutual fund assets	$ 13,445	$ 13,445	$	$
Derivative assets:				
Foreign currency contracts	30		30	
Total assets at fair value	$ 13,475	$ 13,445	$ 30	$
Derivative liabilities:				
Foreign currency contracts	$ 3	$	$ 3	$
Interest rate contracts	55		55	
Total liabilities at fair value	$ 58	$	$ 58	$

(In thousands)	December 2011	Level 1	Level 2	Level 3
Mutual fund assets	$ 12,464	$ 12,464	$	$
Derivative assets:				
Foreign currency contracts	100		100	
Total assets at fair value	$ 12,564	$ 12,464	$ 100	$
Derivative liabilities:				
Foreign currency contracts	$ 52	$	$ 52	$
Interest rate contracts	36		36	
Total liabilities at fair value	$ 88	$	$ 88	$

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 (although they are effectively economic hedges). The Company uses these contracts to manage its exposure to exchange rate fluctuations on certain Company subsidiary 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 receivable and payable balances into the applicable functional currencies. At June 30, 2012, the Company had open forward foreign currency exchange contracts, with settlement dates of about one month, to buy or sell foreign currencies with a U.S. dollar equivalent of $15,458,000. At

December 31, 2011, the Company had open forward foreign currency exchange contracts, all with settlement dates of about one month, to buy or sell foreign currencies with a U.S. dollar equivalent of $26,627,000.

The Company also holds forward foreign currency exchange contracts that are designated as a cash flow hedge. The Company uses these contracts to manage the risks and related cash flow variability resulting from exposure to exchange rate fluctuations on forecasted progress payments related to a construction project undertaken in Singapore. The progress payments are denominated in a currency other than the Singapore location s functional currency. The latest date through which the Company expects to hedge its exposure to the variability in cash flows for the progress payments is December 31, 2013. The forward foreign exchange contracts are recognized on the balance sheet as either an asset or a liability measured at fair value. Period-to-period changes in the fair value of the hedging instruments are recognized as gains or losses in other comprehensive income, to the extent effective. Once the constructed asset is complete and placed into service, the accumulated gains or losses will be reclassified out of accumulated other comprehensive income (AOCI) into earnings in the periods over which the asset is being depreciated. The amount in AOCI at June 30, 2012, that is expected to be reclassified into earnings in the next 12 months is insignificant. The Company had open forward foreign currency exchange contracts designated as cash flow hedges with U.S. dollar equivalent amounts of $1,508,000 and $5,266,000 at June 30, 2012, and December 31, 2011, 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 $3,229,000 at June 30, 2012, and $3,694,000 at December 31, 2011, which were designated as cash flow hedges. 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 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 June 30, 2014.

The fair values of the derivative instruments held by the Company on June 30, 2012, and December 31, 2011, and derivative instrument gains and losses and amounts reclassified out of AOCI into earnings for the three and six month periods ended June 30, 2012 and 2011, were immaterial.

5. STOCK-BASED COMPENSATION

On June 30, 2012, 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. SARs, which were granted for the first time in 2012, cliff vest after two years of continuous service, settle in cash and expire ten years from the grant date. Because SARs are cash-settled, they are accounted for as liabilities that must be re-measured at fair value at the end of every reporting period until settlement. The Company uses the Black-Scholes option pricing model for determining the fair value of SARs. Compensation expense for each reporting period is based on the period-to-period change (or portion of the change, depending on the proportion of the vesting period that has been completed at the reporting date) in the fair value of the SARs

Compensation expense charged against income for all stock options, stock awards and SARs was as follows:

(In thousands)

Three Months Ended June 30		Six Months Ended June 30	
2012	2011	2012	2011
$ 963	$ 928	$ 1,591	$ 1,777

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

(In thousands)

	June 30, 2012	December 31, 2011
Stock options	$ 1,269	$ 974
Stock awards	3,220	2,109
SARs	910	

The increase in unrecognized compensation costs for stock options, SARs and stock awards reflected the first quarter 2012 grants of 32,623 stock options, 29,729 stock awards and 32,623 SARs. The unrecognized compensation costs at June 30, 2012, are expected to be recognized over weighted-average periods of 1.2 years, 2.1 years and 1.6 years for stock options, stock awards and SARs, respectively.

6. INVENTORIES

The composition of inventories was as follows:

(In thousands)	June 30, 2012	December 31, 2011
Finished products	$ 88,586	$ 73,076
Raw materials	49,266	38,099
Total inventories	$ 137,852	$ 111,175

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 $42,614,000 and $43,954,000 higher than reported at June 30, 2012, and December 31, 2011, 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 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.

At June 30, 2012, the Company has estimated a range of possible environmental and legal losses of $9.1 million to $28.9 million. At June 30, 2012, and December 31, 2011, 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 $14.9 million and $14.6 million, respectively. During the first six months of 2012 cash outlays related to legal and environmental matters approximated $1.5 million compared to $2.7 million in the first six months of 2011.

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 June 30, 2012:

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 is awaiting the issuance of a Record of Decision (ROD) from USEPA.

The Company believes its recorded liability for claims associated with the remediation of chemical contamination at the Maywood site is adequate. 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. 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 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 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 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 the first quarter of 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 $2.0 million for the Company s portion of environmental response costs through the first quarter of 2012 (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, actual costs could differ from current estimates.

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			
(In thousands)	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Interest cost	$ 1,735	$ 1,761	$ 3,471	$ 3,523
Expected return on plan assets	(2,103)	(2,013)	(4,205)	(4,025)
Amortization of net loss	932	786	1,863	1,571
Net periodic benefit cost	$ 564	$ 534	$ 1,129	$ 1,069

	UNITED KINGDOM			
(In thousands)	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Interest cost	$ 210	$ 279	$ 419	$ 555
Expected return on plan assets	(221)	(264)	(441)	(525)
Amortization of net loss	11	52	22	103
Net periodic benefit cost	$	$ 67	$	$ 133

Employer Contributions

U.S. Plans

The Company expects to contribute approximately $6,698,000 to its U.S. qualified defined benefit pension plans in 2012 and to pay $268,000 in 2012 related to its unfunded non-qualified plans. As of June 30, 2012, $2,120,000 had been contributed to the qualified plans and $152,000 had been paid related to the non-qualified plans.

U.K. Plan

The Company s United Kingdom subsidiary expects to contribute approximately $940,000 to its defined benefit pension plan in 2012. As of June 30, 2012, $507,000 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 plan were $1,058,000 and $2,112,000, respectively, for the three and six months ended June 30, 2012, compared to $1,005,000 and $1,955,000, respectively, for three and six months ended June 30, 2011.

Expenses related to the Company s profit sharing plan were $1,352,000 and $2,881,000, respectively, for the three and six months ended June 30, 20112 compared to $1,510,000 and $2,660,000, respectively, for the three and six months ended June 30, 2011.

In July 2011, the Company established a rabbi trust to fund the obligations of its previously unfunded non-qualified supplemental executive defined contribution plans (supplemental plans). 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 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 June 30, 2012, the balance of the trust assets was $1,429,000, 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 is the computation of basic and diluted earnings per share for the three and six months ended June 30, 2012 and 2011.

(In thousands, except per share amounts)	Three Months Ended June 30 2012	Three Months Ended June 30 2011	Six Months Ended June 30 2012	Six Months Ended June 30 2011
Computation of Basic Earnings per Share				
Net income attributable to Stepan Company	$ 21,425	$ 20,867	$ 43,727	$ 39,628
Deduct dividends on preferred stock	177	179	355	358
Income applicable to common stock	$ 21,248	$ 20,688	$ 43,372	$ 39,270
Weighted-average number of common shares outstanding	10,550	10,345	10,537	10,335
Basic earnings per share	$ 2.01	$ 2.00	$ 4.12	$ 3.80
Computation of Diluted Earnings per Share				
Net income attributable to Stepan Company	$ 21,425	$ 20,867	$ 43,727	$ 39,628
Weighted-average number of shares outstanding	10,550	10,345	10,537	10,335
Add weighted-average net shares issuable from assumed exercise of options (under treasury stock method) [1]	212	237	213	244
Add weighted-average net shares related to unvested stock awards (under treasury stock method)	3	2	3	2
Add weighted-average shares issuable from assumed conversion of convertible preferred stock	592	594	592	594
Weighted-average shares applicable to diluted earnings	11,357	11,178	11,345	11,175
Diluted earnings per share	$ 1.89	$ 1.87	$ 3.85	$ 3.55

(1) Options to purchase 255 and 16,444 shares of common stock were not included in the computations of diluted earnings per share for the three and six months ended June 30, 2012, respectively. Options to purchase 63,167 and 61,516 shares of common stock were not included in the computations of diluted earnings per share for the three and six months ended June 30, 2011, respectively. The options exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

10. SEGMENT REPORTING

The Company has three reportable segments: surfactants, polymers and specialty products. Segment operating results for the three and six months ended June 30, 2012 and 2011 are summarized below:

(In thousands)	Surfactants	Polymers	Specialty Products	Segment Totals
For the three months ended June 30, 2012				
Net sales	$ 335,114	$ 113,923	$ 21,194	$ 470,231
Operating income	31,024	11,775	3,395	46,194
For the three months ended June 30, 2011				
Net sales	$ 343,767	$ 120,854	$ 12,368	$ 476,989
Operating income	24,693	15,064	3,485	43,242
For the six months ended June 30, 2012				
Net sales	$ 682,270	$ 210,672	$ 42,558	$ 935,500
Operating income	64,016	23,526	7,290	94,832
For the six months ended June 30, 2011				
Net sales	$ 668,652	$ 207,253	$ 23,682	$ 899,587
Operating income	52,857	21,429	6,749	81,035

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

(In thousands)	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Operating income segment totals	$ 46,194	$ 43,242	$ 94,832	$ 81,035
Unallocated corporate expenses [1]	(11,373)	(9,164)	(24,611)	(17,106)
Total operating income	34,821	34,078	70,221	63,929
Interest expense, net	(2,086)	(2,194)	(4,690)	(4,257)
Loss from equity in joint ventures	(1,300)	(805)	(2,441)	(1,770)
Other, net	83	253	1,148	565
Consolidated income before income taxes	$ 31,518	$ 31,332	$ 64,238	$ 58,467

(1) Unallocated corporate expenses primarily comprise corporate administrative expenses (e.g., corporate finance, legal, human resources, information systems and deferred compensation) that are not included in segment operating income and not used to evaluate segment performance.

11. DEBT

At June 30, 2012, and December 31, 2011, debt comprised the following:

(In thousands)	Maturity Dates	June 30, 2012	December 31, 2011
Unsecured private placement notes			
4.86%	2017-2023	$ 65,000	$ 65,000
5.88%	2016-2022	40,000	40,000
5.69%	2012-2018	40,000	40,000
6.86%	2012-2015	17,142	17,142
6.59%	2012-2012	2,727	2,727
Debt of foreign subsidiaries			
Secured bank term loans, foreign currency	2012-2016	10,688	12,496
Secured bank term loan, U.S. dollars	2012-2014	4,667	5,833
Other loans, foreign currency	2012-2015	15,119	16,256
Total debt		$ 195,343	$ 199,454
Less current maturities		33,294	34,487
Long-term debt		$ 162,049	$ 164,967

The Company has a $60,000,000 U.S. revolving credit agreement scheduled to expire in August 2013. The Company also maintains standby letters of credit under its workers compensation insurance agreements and for other purposes, as needed from time to time, which are issued under the revolving credit agreement. As of June 30, 2012, the Company had outstanding letters of credit totaling $2,627,000 and no outstanding debt under this agreement. There was $57,373,000 available under the revolving credit agreement as of June 30, 2012.

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. Based on the loan agreement provisions that place limitations on dividend payments, unrestricted retained earnings (i.e., retained earnings available for dividend distribution) were $211,664,000 and $184,738,000 at June 30, 2012, and December 31, 2011, respectively.

12. OTHER, NET

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

(In thousands)	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Foreign exchange gain	$ 505	$ 279	$ 120	$ 105
Investment income	14	9	18	22
Realized and unrealized gain (loss) on investments	(436)	(35)	1,010	438
Other, net	$ 83	$ 253	$ 1,148	$ 565

13. PURCHASE OF THE REMAINING INTEREST IN STEPAN PHILIPPINES INC.

On March 22, 2012, the Company purchased the remaining interest in Stepan Philippines, Inc. (SPI), increasing the Company s ownership share from 88.8 percent to 100 percent. The Company paid $2,000,000 of cash to the holder of the noncontrolling interest to acquire the remaining interest in SPI. As a result of this transaction, the Company s equity (additional paid-in capital) increased by $551,000. In addition, $197,000 of cumulative translation adjustments (gains) that previously had been allocated to the noncontrolling interest was reclassified to the Company s AOCI.

14. ACQUISITION

On June 23, 2011, the Company purchased the Clarinol®, Marinol®, and PinnoThin® product lines of Lipid Nutrition B.V., a part of Loders Croklaan B.V. The acquired product lines are included in the Company s specialty products segment, and provide a portfolio of nutritional fats for the global food, supplement and nutrition industries. The acquisition purchase price was $13,562,000 of cash. In addition to the purchase price paid, the Company incurred $0.3 million of acquisition-related costs, including legal and consulting expenses, which were reflected in administrative expenses on the Company s consolidated statement of income.

The acquisition was accounted for as a business combination and, accordingly, the assets acquired and liabilities assumed were measured and recorded at their estimated fair values. The following table summarizes the assets acquired and liabilities assumed at June 23, 2011:

(In thousands)	
Assets:	
Inventory	$ 5,000
Identifiable intangible assets:	
Patents	6,948
Customer lists	736
Trademarks, know-how	429
Total identifiable intangible assets	8,113
Goodwill	483
Total assets acquired	$ 13,596
Current liabilities	$ 34
Net assets acquired	$ 13,562

The acquired goodwill, which is allocated entirely to the Company s specialty products segment, is deductable for tax purposes. The goodwill reflects the potential manufacturing and marketing synergies arising from combining the new product lines with the Company s existing food and health services products. The weighted average amortization periods for the identifiable intangible assets at the time of acquisition were as follows: patents-12 years; customer lists-five years; and trademarks and know-how-five years. The purchase price allocation for the acquisition is final, and no purchase price allocation adjustments were made to the amounts originally recorded at the acquisition date.

Pro forma financial information has not been included because revenues and earnings of the Company s consolidated entity would not have been materially different than reported had the acquisition date been January 1, 2011.

15. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments result in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRSs), and do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices. The amendments in this update are effective during interim and annual periods beginning after December 15, 2011. Adoption of the new requirement did not have an effect on the Company s financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. In this update, FASB eliminated the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. The amendments require that all non-owner changes in equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this update are effective for fiscal years, and interim periods within these years, beginning after December 15, 2011. This date does not apply to the requirement for the presentation of reclassifications of items out of other comprehensive income to net income. This requirement has been deferred indefinitely by ASU No. 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*. Although adoption of the new requirement had an effect on the Company s presentation of comprehensive income, it did not have an effect on the Company s financial position, results of operations or cash flows.

In September 2011, the FASB issued ASU No. 2011-08, *Intangibles Goodwill and Other (Topic 350): Testing Goodwill for Impairment*, which amends the guidance on testing goodwill for impairment. The new standard provides entities that are testing goodwill for impairment the option of performing a qualitative assessment before calculating the fair value of the reporting unit (i.e., step 1 of the goodwill impairment test). If an entity determines, on the basis of the qualitative assessment, that the fair value of the reporting unit is more likely than not (i.e., a likelihood of greater than 50 percent) less than the reporting unit s carrying amount, the traditional two-step impairment test would be required. The ASU does not change how goodwill is calculated or assigned to reporting units, nor does it revise the requirement to test goodwill annually for impairment. Furthermore, the ASU does not amend the requirement to test goodwill for impairment between annual tests if events or circumstances warrant. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company did not employ the qualitative assessment made available by this update for the Company s 2012 annual goodwill impairment testing. Application of the option provided in this update did not have an effect on the Company s financial position, results of operations or cash flows.

In December 2011, the FASB issued ASU No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*. This update creates new disclosure requirements about the nature of an entity s rights of setoff and related arrangements associated with its financial and derivative instruments. Entities are required to apply the new disclosure requirements for annual and interim reporting periods beginning on or after January 1, 2013. Retrospective application is required. Adoption of the new requirement will not have an effect on the Company s financial position, results of operations or cash flows.

In July 2012, the FASB issued ASU No. 2012-02, *Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment.* The amendments in this update aim to simplify the impairment test for indefinite-lived intangible assets by permitting an entity the option to first to assess qualitative factors to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that an indefinite-lived intangible asset is impaired as a basis for determining whether the quantitative impairment test included in Accounting Standards Codification Subtopic 350-30, *Intangibles Goodwill and Other General Intangibles Other than Goodwill* must be performed. The amendment is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company currently has no indefinite-lived intangible assets other than goodwill reported on its consolidated balance sheet. As such, adoption of this amendment is not expected to have an effect on the Company s 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.

Except for the historical statements contained in this report, the matters discussed in the following discussion and analysis are forward-looking statements that are subject to certain risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words, anticipate, believe, estimate, expect, intend, may, objective, outlook, plan, project, possible, pote similar expressions. Actual results may vary materially.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake any obligation to update them to reflect changes that occur after that date. Factors that could cause actual results to differ materially include the items described in Item 1A of the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

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 72 percent of consolidated net sales in the first half of 2012, 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), three Latin American sites (Mexico, Brazil and Colombia) and two Asian sites (Philippines and Singapore). The Company acquired controlling interest in Stepan Philippines Inc. (SPI) in the third quarter of 2010, bringing the Company s total interest in the joint venture to 88.8 percent. On March 22, 2012, the Company purchased the remaining 11.2 percent interest for $2.0 million and, as of that date, owns 100 percent of SPI. The Company also holds a 50 percent ownership interest in a joint venture, TIORCO, LLC (TIORCO), that markets chemical solutions for increasing the production of crude oil and natural gas from existing fields. The joint venture is accounted for under the equity method, and its financial results are excluded from surfactant segment operating results. Profits on sales of the Company s surfactants to enhanced oil recovery customers are included in surfactants segment results.

Polymers Polymers, which accounted for 23 percent of consolidated net sales in the first half of 2012, include two primary product lines: polyols and phthalic anhydride. Polyols are used in the manufacture of rigid laminate insulation board for thermal insulation in the construction industry. Polyols are also a base raw material for flexible foams, coatings, adhesives, sealants and elastomers. 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 addition, phthalic anhydride is used internally in the production of polyols. In the U.S., polymer product lines are manufactured at the Company s Millsdale, Illinois, site. In Europe, polyols are manufactured at the Company s subsidiaries in Germany and Poland. In Asia, polyols are produced at the Company s 80-percent owned joint venture in Nanjing, China.

Specialty Products Specialty products, which accounted for 5 percent of consolidated net sales in the first half of 2012, include flavors, emulsifiers and solubilizers used in the food and pharmaceutical industries. Specialty products are primarily manufactured at the Company s Maywood, New Jersey, site. In the second quarter of 2011, the Company purchased three product lines from Lipid Nutrition B.V. (Lipid Nutrition), a part of Loders Croklaan B.V. The acquired product lines, which are produced at the Company s Maywood, New Jersey, plant and outside contract manufacturers, provide a portfolio of nutritional fats for the food, supplement and nutrition industries.

All three segments have growth strategies that require investment outside of North America. The Company s recent surfactant investments in Brazil and Singapore, polymer investments in Germany and Poland and specialty products investment in the Netherlands (Lipid Nutrition) have resulted in planned higher costs while facilitating the Company s long-term growth strategies.

Deferred Compensation Plans

The accounting for the Company s deferred compensation plans can cause period-to-period fluctuations in Company expenses and profits. Compensation expense results when the values of Company common stock and mutual fund investment assets held for the plans increase, and compensation income results when the values of Company common stock and mutual fund investment assets decline. The pretax effect of all deferred compensation-related activities (including realized and unrealized gains and losses on the mutual fund assets held to fund the deferred compensation obligations) and the income statement line items in which the effects of the activities were recorded are displayed in the following tables:

(In millions)	Income (Expense) For the Three Months Ended June 30		
	2012	2011	Increase (Decrease)
Deferred Compensation (Administrative expense)	$ (1.5)	$ 0.3	$ (1.8)[1]
Realized/Unrealized Gains (Loss) on Investments (Other, net)	(0.3)		(0.3)
Pretax Income Effect	$ (1.8)	$ 0.3	($ 2.1)

(In millions)	Income (Expense) For the Six Months Ended June 30		
	2012	2011	Increase (Decrease)
Deferred Compensation (Administrative expense)	$ (5.0)	$ 0.7	$ (5.7)[1]
Realized/Unrealized Gains on Investments (Other, net)	1.0	0.4	0.6
Pretax Income Effect	$ (4.0)	$ 1.1	$ (5.1)

(1) See the Corporate Expenses section of this management s discussion and analysis for details regarding the period-over-period changes in deferred compensation expense.

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 six month periods ended June 30, 2012, the U.S. dollar strengthened against most of the foreign currencies in the locations where the Company does business when compared to the exchange rates for the three and six month periods ended June 30, 2011. Consequently, reported net sales, expense and income amounts for the second quarter and first half of 2012 were lower than they would have been had the foreign currency exchange rates remained constant with the rates for the same periods of 2011. The following tables present the effects that foreign currency translation had on the period-over-period changes in consolidated net sales and various income line items between the three and six months ended June 30, 2012 and 2011:

	Three Months Ended June 30			
(In millions)	2012	2011	Increase (Decrease)	(Decrease) Due to Foreign Translation
Net Sales	$ 470.2	$ 477.0	$ (6.8)	$ (17.5)
Gross Profit	73.4	69.6	3.8	(2.3)
Operating Income	34.8	34.1	0.7	(1.2)
Pretax Income	31.5	31.3	0.2	(1.1)

	Six Months Ended June 30			
(In millions)	2012	2011	Increase	(Decrease) Due to Foreign Translation
Net Sales	$ 935.5	$ 899.6	$ 35.9	$ (22.5)
Gross Profit	150.2	131.4	18.8	(2.9)
Operating Income	70.2	63.9	6.3	(1.5)
Pretax Income	64.2	58.5	5.7	(1.4)

RESULTS OF OPERATIONS

Three Months Ended June 30, 2012 and 2011

Summary

Net income attributable to the Company for the second quarter of 2012 increased three percent to $21.4 million, or $1.89 per diluted share, compared to $20.9 million, or $1.87 per diluted share, for the second quarter of 2011. Below is a summary discussion of the major factors leading to the quarter-over-quarter changes in net sales, profits and expenses. A detailed discussion of segment operating results for the second quarter of 2012 compared to the prior year quarter follows the summary.

Consolidated net sales declined $6.8 million, or one percent, quarter over quarter. The effects of foreign currency translation and a decline in average selling prices accounted for approximately $17.5 million and $12.1 million, respectively, of the decrease. Sales volume improved five percent, which offset the impact of currency translation and lower prices by $22.8 million. The decline in average selling prices reflected reduced quarter-over-quarter commodity raw material costs. The sales volume growth was driven by a six percent increase for the surfactants segment. Specialty products sales volume was up between quarters due to the Lipid Nutrition business that was acquired in June of 2011. Polymers sales volume declined one percent primarily due to lower phthalic anhydride sales.

Operating income for the second quarter of 2012 increased $0.7 million, or two percent, over operating income reported for the second quarter of 2011. Gross profit grew $3.8 million, or five percent, due to higher margins, improved sales mix and increased sales volumes, particularly for surfactants. Gross profit improved despite a $3.2 million decline in polymers gross profit and a $2.3 million quarter-over-quarter negative foreign currency translation impact. The polymers decrease was primarily due to the planned triennial maintenance shutdown at the Company s North American polymer plant.

Operating expenses increased $3.1 million, or nine percent, between comparative quarters. The following summarizes the quarter-over-quarter changes in the individual income statement line items that comprise the Company s operating expenses:

Administrative expenses increased $1.4 million, or 11 percent, primarily due to a $1.8 million increase in deferred compensation expense. An increase in the value of Company stock to which a large portion of the deferred compensation obligation is tied led to the higher quarter-over-quarter deferred compensation expense. See the Overview and Corporate Expenses sections of this management discussion and analysis for further details. The effects of foreign currency translation reduced the quarter-over-quarter change in administrative expenses by $0.4 million.

Selling expenses increased $0.8 million, or seven percent, quarter over quarter. Approximately $1.0 million of the change was due to added expense incurred to support the Lipid Nutrition business. Selling expenses in Brazil were $0.3 million higher quarter-over-quarter due mainly to increased personnel expenses resulting from higher staffing levels to support the Company s growth initiatives in that country. The effects of foreign currency translation reduced the quarter-over-quarter selling expense change by $0.5 million.

Research, development and technical service expenses were up $0.8 million, or eight percent, quarter over quarter. Higher U.S. salary and fringe benefit expenses accounted for $0.4 million of the increase. There was also $0.2 million of additional Lipid Nutrition product development expenses (primarily personnel costs) in the current year quarter.

The loss from the Company s 50-percent equity joint venture (TIORCO) increased $0.5 million between quarters primarily due to higher operating expenses.

Other, net was $0.1 million of income for the second quarter of 2012 compared to $0.3 million of income for the second quarter of 2011. A $0.4 million decrease in investment related income for the Company s deferred compensation and supplemental defined contribution mutual fund assets, partially offset by a $0.2 million increase in foreign exchange gains, accounted for the quarter-over-quarter increase in other, net.

The effective tax rate was 31.8 percent for the second quarter ended June 30, 2012, compared to 33.0 percent for the second quarter ended June 30, 2011. The decrease was primarily attributable to a greater percentage of consolidated income being generated outside the U.S. where the effective tax rates are lower. This decrease was partially offset by the expiration of the U.S. research and development credit.

Segment Results

(In thousands)	Surfactants	Polymers	Specialty Products	Segment Results	Corporate	Total
For the three months ended						
June 30, 2012						
Net sales	$ 335,114	$ 113,923	$ 21,194	$ 470,231		$ 470,231
Operating income	31,024	11,775	3,395	46,194	(11,373)	34,821
For the three months ended						
June 30, 2011						
Net sales	$ 343,767	$ 120,854	$ 12,368	$ 476,989		$ 476,989
Operating income	24,693	15,064	3,485	43,242	(9,164)	34,078

Surfactants

Surfactants net sales for the second quarter of 2012 declined $8.7 million, or three percent, from net sales for the second quarter of 2011. Decreased average selling prices and the unfavorable effects of foreign currency translation accounted for approximately $17.1 million and $12.8 million, respectively, of the net sales change. Sales volume increased six percent quarter over quarter, which offset the effects of lower prices and foreign currency translation by $21.2 million.

A quarter-over-quarter comparison of net sales by region follows:

(In thousands)	For the Three Months Ended			
	June 30, 2012	June 30, 2011	Increase (Decrease)	Percent Change
North America	$ 210,398	$ 216,648	$ (6,250)	-3
Europe	71,419	79,706	(8,287)	-10
Latin America	38,984	34,721	4,263	+12
Asia	14,313	12,692	1,621	+13
Total Surfactants Segment	$ 335,114	$ 343,767	$ (8,653)	-3

Net sales for North American operations declined three percent due to a four percent decrease in average selling prices and the unfavorable effects of foreign currency translation, which accounted for $9.5 million and $0.8 million, respectively, of the net sales change. Sales volume increased two percent quarter over quarter, which offset the effects of lower prices and foreign currency translation by $4.0 million. Average selling prices declined due to lower quarter-over-quarter average raw material costs, partially offset by a more favorable mix of sales. The increase in sales volume was attributable primarily to an increase in sales of functional surfactants used in agricultural and oilfield applications. The impact of increased functional products sales volume was reduced by declines in sales volumes for products used in laundry and cleaning and personal care applications.

Net sales for European operations declined 10 percent due to an 11 percent decrease in quarter-over-quarter average selling prices and the unfavorable effects of foreign currency translation, which accounted for $9.9 million and $6.6 million, respectively, of the net sales change. Sales volume increased 10 percent between quarters, which reduced the effects of lower prices and foreign currency translation by $8.2 million. Average selling prices fell as a result of raw material cost declines. A quarter-over-quarter weakening of the European euro and the British pound sterling against the U.S. dollar led to the foreign currency translation effect. Stronger demand for laundry and cleaning products, principally fabric softeners, led to the sales volume increase.

Net sales for Latin American operations increased 12 percent as a result of a 19 percent increase in average selling prices and a seven percent increase in sales volume, which accounted for $7.3 million and $2.5 million, respectively, of the quarter-over-quarter net sales change. The unfavorable effects of foreign currency translation reduced the net sales change by $5.5 million. The increase in average selling prices was primarily attributable to customer mix. The Brazil subsidiary accounted for most of the quarter-over-quarter sales volume increase, as the Company continued to benefit from its prior year capital expansion. A quarter-over-quarter weakening of the Brazilian real and the Mexican peso against the U.S. dollar accounted for the foreign currency translation effect.

Net sales for Asia operations increased 13 percent primarily due to improved sales volume. New business for the Philippines subsidiary drove the volume increase. The effect of the sales volume improvement was tempered by lower average selling prices that resulted largely from a change in sales mix.

Surfactants operating income for the second quarter of 2012 increased $6.3 million, or 26 percent, over operating income for the second quarter of 2011. Gross profit increased $5.9 million principally due to improved sales mix, margins and sales volume. The unfavorable effects of foreign currency translation reduced the quarter-over-quarter gross profit increase by $1.6 million. Operating expenses declined $0.5 million, or two percent. Quarter-over-quarter comparisons of gross profit by region and total segment operating expenses and operating income follow:

(In thousands)	For the Three Months Ended			
	June 30, 2012	June 30, 2011	Increase (Decrease)	Percent Change
Gross Profit				
North America	$ 38,663	$ 36,862	$ 1,801	+5
Europe	6,056	6,148	(92)	-1
Latin America	5,189	1,931	3,258	+169
Asia	1,812	928	884	+95
Total Surfactants Segment	$ 51,720	$ 45,869	$ 5,851	+13
Operating Expenses	20,696	21,176	(480)	-2
Operating Income	$ 31,024	$ 24,693	$ 6,331	+26

North American gross profit grew five percent quarter over quarter due to an improved sales mix and higher sales volume. Higher functional surfactant sales volumes led to the more favorable sales mix. Although average selling prices declined between quarters, average raw material costs fell to a greater degree, which led to improved comparative unit margins and enabled the Company to continue to recover margin lost due to raw material inflation in prior periods.

Gross profit for European operations declined one percent due to the unfavorable effects of foreign currency translation ($0.6 million) and a slight loss of margin caused by the lower average selling prices noted earlier. The positive impact of a 10 percent increase in sales volume largely offset the drop in profit attributable to currency translation and selling price reductions.

Gross profit for Latin American operations improved 169 percent. The quarter s results benefited from a seven percent increase in sales volume and lower costs, as the prior year included one-time costs related to a delay in the start up of the Brazil subsidiary s capacity expansion.

The increase in gross profit for Asia operations was principally due to an increase in sales volume. The start-up of the Singapore manufacturing site was delayed slightly. The new plant is in the final preparation and testing phase and is currently expected to commence commercial operations in July 2012.

Operating expenses for the surfactants segment declined $0.5 million, or two percent, quarter over quarter. The effects of foreign currency translation accounted for $0.8 million of the expense reduction. Therefore, excluding the currency impact, operating expenses were up $0.3 million, or two percent, between quarters. Higher research and development expenses accounted for the increase.

Polymers

Polymers net sales for the second quarter of 2012 declined $6.9 million, or six percent, from net sales for the same quarter of 2011. The effects of foreign currency translation, lower average selling prices and a one percent decrease in sales volume accounted for $4.7 million, $1.3 million and $0.9 million, respectively, of the decline. A quarter-over-quarter comparison of net sales by region is displayed below:

(In thousands)	For the Three Months Ended			
	June 30, 2012	June 30, 2011	(Decrease)	Percent Change
North America	$ 71,319	$ 75,392	$ (4,073)	-5
Europe	35,487	36,847	(1,360)	-4
Asia and Other	7,117	8,615	(1,498)	-17
Total Polymers Segment	$ 113,923	$ 120,854	$ (6,931)	-6

Net sales for North American operations declined five percent due to a four percent decrease in sales volume and a two percent decrease in average selling prices, which accounted for $2.8 million and $1.3 million, respectively, of the quarter-over-quarter net sales drop. The sales volume decline was attributable to an eight percent decrease in phthalic anhydride sales. Reduced demand from plasticizer customers caused the decrease in phthalic anhydride sales volume. Higher phthalic anhydride selling prices, precipitated by increased quarter-over-quarter costs for orthoxylene (the raw material for phthalic anhydride), partially offset the effect of lower sales volume. Polyol sales volume was flat quarter over quarter, and average polyol selling prices declined due to lower raw material costs.

Net sales for European operations declined four percent due to the unfavorable effects of foreign currency translation ($4.9 million) offset by the impact of a 10 percent increase in sales volume ($3.5 million). A quarter-over-quarter weakening of the European euro and the Polish zloty against the U.S. dollar led to the foreign currency translation effect. The sales volume increase was attributable to new business for the Company s Poland subsidiary, particularly for polyol products used in adhesive applications.

Net sales for Asia and Other operations declined 17 percent quarter over quarter due to a 14 percent decrease in sales volume and a seven percent decrease in average selling prices, which accounted for $1.2 million and $0.5 million, respectively, of the net sales change. The favorable effects of foreign currency translation lessened the quarter-over-quarter decline by $0.2 million. Lower demand from customers in Southeast Asia caused the drop in sales volume. Decreased raw material costs led to the decline in average selling prices.

Polymer operating income for the second quarter of 2012 declined $3.3 million, or 22 percent, from operating income for the second quarter of 2011. Gross profit fell $3.2 million, or 16 percent, quarter over quarter, largely due to maintenance and product outsourcing costs incurred during a planned maintenance shutdown of the phthalic anhydride plant completed in the quarter. The effects of foreign currency translation had a $0.7 million negative effect on the quarter-over-quarter change in gross profit. Operating expenses increased $0.1 million, or two percent. Quarter-over-quarter comparisons of gross profit by region and total segment operating expenses and operating income follow:

(In thousands)	For the Three Months Ended			
	June 30, 2012	June 30, 2011	Increase (Decrease)	Percent Change
Gross Profit				
North America	$ 11,398	$ 15,193	$ (3,795)	-25
Europe	5,116	4,668	448	+10
Asia and Other	857	698	159	+23
Total Polymers Segment	$ 17,371	$ 20,559	$ (3,188)	-16
Operating Expenses	5,596	5,495	101	+2
Operating Income	$ 11,775	$ 15,064	$ (3,289)	-22

Gross profit for North American operations declined 25 percent primarily due to $2.0 million of increased plant expenses and outsourcing costs related to the planned triennial polymer plant maintenance shutdown. In addition, margins were negatively affected by higher average raw material costs, which resulted in an over $1.0 million decline in quarter-over-quarter gross profit.

Gross profit for European operations increased 10 percent as a result of improved unit margins and sales volumes. The unfavorable effects of foreign currency translation reduced the quarter-over-quarter gross profit increase by $0.7 million. The increase in unit margins primarily resulted from lower quarter-over-quarter raw material costs and elimination of outsourced volumes. Outsourced sales volume from the Company s North American facility accounted for 18 percent of total sales volume in the second quarter of 2011.

The increase in gross profit for Asia and Other operations was entirely due to improved margins that more than offset the impact of lower sales volume. Margins improved as the result of lower raw material prices and improved product mix.

Operating expenses increased $0.1 million, or two percent, quarter-over-quarter. Increased selling ($0.2 million) and research and development ($0.2 million) expenses, partially offset by the effects of foreign currency translation ($0.2 million), accounted for most of the rise in operating expenses.

Specialty Products

Net sales for the second quarter of 2012 increased $8.8 million, or 71 percent, over net sales for the second quarter of 2011. The increase was attributable to the Lipid Nutrition product lines acquired in June 2011. Gross profit was up $1.1 million quarter-over-quarter due to the Lipid Nutrition product lines. Operating income declined $0.1 million, or three percent, due to a $1.2 million increase in operating expenses primarily related to costs associated with supporting the Lipid Nutrition business.

Corporate Expenses

Corporate expenses, which comprise operating expenses that are not allocated to the reportable segments, increased $2.2 million (24 percent) to $11.4 million for the second quarter of 2012 from $9.2 million for the second quarter of 2011. Deferred compensation expense accounted for $1.8 million of the quarter-over-quarter increase. In the second quarter of 2012, the Company recorded $1.5 million of deferred compensation expense compared to $0.3 million of income for the same quarter of 2011. Increases in the value of Company stock, to which a large portion of the deferred compensation obligation is tied, caused the higher quarter-over-quarter deferred compensation expense. For the second quarter of 2012, the value of Company stock increased $6.38 per share from $87.80 per share at March 31, 2012, to $94.18 per share at June 30, 2012. For the second quarter of 2011, the Company s common stock price declined $1.60 per share from $72.50 per share at March 31, 2011, to $70.90 per share at June 30, 2011. The deferred compensation expense that resulted from the second quarter 2012 increase in the value of Company common stock was partially offset by a second quarter 2012 decline in the value of the mutual fund assets held for the plans. The accounting for the Company s deferred compensation plans results in expense when the values of Company common stock and mutual fund investment assets held for the plans increase and income when the values of Company common stock and mutual funds decline.

Six Months Ended June 30, 2012 and 2011

Summary

Net income attributable to the Company for the first half of 2012 increased 10 percent to $43.7 million, or $3.85 per diluted share, compared to $39.6 million, or $3.55 per diluted share, for the first half of 2011. Below is a summary discussion of the major factors leading to the year-over-year changes in net sales, profits and expenses. A detailed discussion of segment operating results for the first half of 2012 follows the summary.

Consolidated net sales increased $35.9 million, or four percent, year over year. Higher sales volumes and average selling prices accounted for approximately $40.5 million and $17.9 million, respectively, of the increase. Foreign currency translation had a $22.5 million unfavorable effect on the year-over-year net sales change. Sales volume improved five percent between years, reflecting increases for all three segments. Higher year-over-year raw material costs and a more favorable sales mix accounted for the increase in average selling prices.

Operating income for the first half of 2012 improved $6.3 million, or 10 percent, over operating income reported for the same period of 2011. Gross profit increased $18.8 million, or 14 percent, due to better margins and higher sales volumes. All three segments contributed to the gross profit and operating income improvements. The effects of foreign currency translation reduced the gross profit increase by $2.9 million.

Operating expenses increased $12.5 million, or 19 percent, between comparative periods. The following summarizes the year-over-year changes in the individual income statement line items that comprise the Company s operating expenses:

Administrative expenses increased $7.5 million, or 32 percent, due in large part to a $5.7 million increase in deferred compensation expense. Increases in the values of Company stock and mutual fund investments to which the deferred compensation obligation is tied led to the higher quarter-over-quarter deferred compensation expense. See the Overview and Corporate Expenses sections of this management discussion and analysis for further details. Patent and trademark filing fees were up $0.5 million between years to support the Lipid Nutrition business and other Company global growth initiatives. In addition to the foregoing, last year s expenses were $0.5 million lower than usual due to the capitalization of normally expensed internal personnel costs to a software implementation project. The accumulation of small increases for a number of other expense items, including salary, travel and software maintenance costs, accounted for the remainder of the year-over-year change in administrative expenses. The effects of foreign currency translation reduced the year-over-year administrative expense change by $0.4 million.

Selling expenses were up $3.6 million, or 16 percent, between years. Approximately $2.0 million of the change was due to added expense incurred to support the Lipid Nutrition business. North American salary and related fringe benefit expenses increased $1.0 million. Selling expenses in Brazil were $0.6 million higher due mainly to increased personnel expenses resulting from higher staffing levels to support the Company s growth initiatives in that country. Bad debt expense increased $0.5 million primarily due to increased reserve requirements for European operations. The effects of foreign currency translation reduced the year-over-year selling expense change by $0.7 million.

Research, development and technical service expenses increased $1.4 million, or seven percent, year over year. Higher U.S. salary and fringe benefit expenses accounted for $1.1 million of the increase. There was also $0.3 million of additional Lipid Nutrition product development expenses (primarily personnel costs) in the current year.

Net interest expense for the first half of 2012 was up $0.4 million, or 10 percent, over net interest expense for the first half of 2011. Higher average debt levels led to the increase. In the fourth quarter of 2011, the Company secured $65 million of additional long-term notes to take advantage of current low interest rates and to support global growth initiatives.

The loss from the Company s 50-percent equity joint venture (TIORCO) increased $0.7 million year over year primarily due to higher operating expenses.

Other, net was $1.1 million of income for the first half of 2012 compared to $0.6 million of income for the same period of 2011. A $0.6 million increase in investment related income for the Company s deferred compensation and supplemental defined contribution mutual fund assets accounted for the increase.

The effective tax rate was 31.7 percent for the first six months ended June 30, 2012, compared to 31.9 percent for the first six months ended June 30, 2011. The decrease was primarily attributable to a greater percentage of consolidated income being generated outside the U.S. where the effective tax rates are lower. This decrease was mostly offset by the expiration of the U.S. research and development credit.

Segment Results

(In thousands)	Surfactants	Polymers	Specialty Products	Segment Results	Corporate	Total
For the six months ended June 30, 2012						
Net sales	$ 682,270	$ 210,672	$ 42,558	$ 935,500		$ 935,500
Operating income	64,016	23,526	7,290	94,832	(24,611)	70,221
For the six months ended June 30, 2011						
Net sales	$ 668,652	$ 207,253	$ 23,682	$ 899,587		$ 899,587
Operating income	52,857	21,429	6,749	81,035	(17,106)	63,929

Surfactants

Surfactants net sales for the first half of 2012 increased $13.6 million, or two percent, over net sales for the same period of 2011. The increase was driven by a five percent increase in sales volume, which accounted for $32.8 million of the net sales change. The unfavorable effects of foreign currency translation and a decline in average selling prices reduced the year-over-year net sales change by $16.7 million and $2.5 million, respectively. A year-over-year comparison of net sales by region follows:

(In thousands)	For the Six Months Ended			
	June 30, 2012	June 30, 2011	Increase (Decrease)	Percent Change
North America	$ 434,915	$ 422,798	$ 12,117	+3
Europe	147,070	156,899	(9,829)	-6
Latin America	78,214	66,918	11,296	+17
Asia	22,071	22,037	34	
Total Surfactants Segment	$ 682,270	$ 668,652	$ 13,618	+2

Net sales for North American operations increased three percent due to a two percent increase in sales volume and a one percent increase in average selling prices, which accounted for $10.4 million and $2.7 million, respectively, of the net sales change. The unfavorable effects of foreign currency translation reduced the year-over-year net sales change by $1.0 million. An increase in sales of functional surfactants used in agricultural and oilfield applications, partially offset by a decline in sales volume of laundry and cleaning and personal care products, led to the sales volume increase. Average selling prices increased due to the higher mix of functional surfactants sales.

Net sales for European operations declined six percent due to a six percent decline in average selling prices and the unfavorable effects of foreign currency translation, which accounted for $10.8 million and $8.7 million, respectively, of the year-over-year net sales decline. A six percent increase in sales volume offset the effects of translation and lower average selling prices by $9.7 million. Average selling prices fell as a result of raw material cost decreases. A weakening of the European euro and British pound sterling against the U.S. dollar led to the foreign currency translation effect. Stronger demand for laundry and cleaning products, principally fabric softeners, led to the sales volume increase.

Net sales for Latin American operations increased 17 percent as a result of a 20 percent increase in average selling prices and a seven percent increase in sales volume, which accounted for $14.0 million and $4.5 million, respectively, of the year-over-year net sales change. The unfavorable effects of foreign currency translation reduced the net sales change by $7.2 million. Increased year-over-year raw material costs led to the higher average selling prices. The Brazil subsidiary accounted for about 87 percent of the year-over-year sales volume increase, as the Company benefited from its prior year capital expansion. A weakening of the Brazilian real and Mexico peso against the U.S. dollar led to the foreign currency translation effect.

Net sales for Asia operations were flat between years as a 32 percent increase in sales volume and a favorable currency translation effect were offset by a decline in average selling prices.

Surfactants operating income for the first half of 2012 increased $11.2 million, or 21 percent, over operating income for the first half of 2011. Gross profit increased $12.5 million mainly due to improved sales volumes, sales mix and margins. The effects of foreign currency translation reduced the year-over-year gross profit change by $2.0 million. Operating expenses increased $1.3 million, or three percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

(In thousands)	For the Six Months Ended			
	June 30, 2012	June 30, 2011	Increase (Decrease)	Percent Change
Gross Profit				
North America	$ 80,915	$ 74,408	$ 6,507	+9
Europe	14,074	11,849	2,225	+19
Latin America	9,121	5,096	4,025	+79
Asia	1,593	1,899	(306)	-16
Total Surfactants Segment	$ 105,703	$ 93,252	$ 12,451	+13
Operating Expenses	41,687	40,395	1,292	+3
Operating Income	$ 64,016	$ 52,857	$ 11,159	+21

Gross profit for North American operations increased nine percent between years due to increased unit sales margins and higher sales volume. A more favorable sales mix and lower year-over-year raw material costs drove the improvement. Higher functional surfactant sales volumes led to the more favorable sales mix.

Gross profit for European operations increased 19 percent largely due to improved unit margins and increased sales volume. Although average selling prices declined six percent year over year, average raw material costs fell to a greater degree, which led to improved comparative margins. The unfavorable effects of foreign currency translation reduced the year-over-year increase in gross profit by $0.9 million.

Gross profit for Latin American operations improved 79 percent primarily as a result of lower costs and higher sales volumes. The majority of the growth was attributable to Brazil. Lower costs led to the increased profit for Brazil, as gross profit for the first half 2011 was negatively affected by one-time costs related to a delay in the start up of the site s capacity expansion.

Gross profit for Asia operations declined $0.3 million mainly due to start-up and preproduction expenses related to the new plant in Singapore, which offset the impact of higher sales volume for the Philippine subsidiary. The start-up of the Singapore manufacturing site was delayed slightly, and the new plant is currently expected to commence commercial operations in July 2012.

Operating expenses for the surfactants segment were up $1.3 million, or three percent, between years. Approximately $1.7 million of the increase was attributable to higher selling expenses, primarily resulting from increased staffing levels and related costs associated with the Company s growth initiatives. Also contributing to the selling expense increase was European bad debt expense, which was up $0.5 million year over year primarily due to greater reserve requirements. Research and development expenses contributed $0.7 million to the rise in operating expenses. Higher salary and related fringe benefit expenses drove the research and development expense result. The effects of foreign currency translation reduced the year-over-year operating expense increase by $1.0 million.

Polymers

Polymers net sales for the first half of 2012 increased $3.4 million, or two percent, over net sales for the first half of 2011. A three percent improvement in sales volume and higher average selling prices accounted for $5.5 million and $3.7 million, respectively, of the increase. The unfavorable effects of foreign currency translation reduced the year-over-year net sales change by $5.8 million. A year-over-year comparison of net sales by region is displayed below:

(In thousands)	For the Six Months Ended			
	June 30, 2012	June 30, 2011	Increase (Decrease)	Percent Change
North America	$ 131,943	$ 129,581	$ 2,362	+2
Europe	67,516	65,427	2,089	+3
Asia and Other	11,213	12,245	(1,032)	-8
Total Polymers Segment	$ 210,672	$ 207,253	$ 3,419	+2

Net sales for North American operations increased two percent due to a two percent increase in average selling prices. Sales volume declined less than one percent between years. The higher average selling prices reflected increases in phthalic anhydride raw material costs. Selling prices for polyols fell slightly between years as a result of lower raw material costs. Sales volume for polyols was up three percent year over year. Phthalic anhydride sales volume to external customers was down three percent, principally due to reduced demand from plasticizer customers.

Net sales for European operations improved three percent due to an 11 percent increase in sales volume and a two percent increase in average selling prices, which accounted for $7.0 million and $1.3 million, respectively, of the net sales increase. The effects of foreign currency translation reduced the effects of the higher sales volume and prices by $6.2 million. New polyol adhesive application business for the Poland subsidiary accounted for most of the year-over-year sales volume increase. Sales volume of polyol used in insulation applications was up one percent. Sales mix accounted for most of the increase in average selling prices.

Net sales for Asia and Other operations declined eight percent between years due to a six percent decrease in sales volume and a five percent decrease in average selling prices, which accounted for $0.7 million and $0.6 million, respectively, of the net sales change. The effects of foreign currency translation had a $0.3 million favorable effect on the year-over-year net sales change. Lower demand in Southeast Asia led to the drop in sales volume. Sales volume in China was slightly above 2011 levels. Decreased raw material costs led to the decline in average selling prices.

Polymers operating income for the first half of 2012 increased $2.1 million over operating income for the same period of 2011. Gross profit increased $3.1 million between years, due largely to higher European margins and volumes. The gross profit for the first half of 2012 was tempered by the impact of the second quarter planned triennial maintenance shutdown at the North American plant. Operating expenses increased $1.0 million, or 10 percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

(In thousands)	For the Six Months Ended	
	June 30, 2012	June 30, 2011