

STEPAN CO
Form 10-K
February 27, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018

OR

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

Commission File Number 1-4462

STEPAN COMPANY

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

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

Edens and Winnetka Road, Northfield, Illinois
(Address of principal executive offices)

60093
(Zip Code)

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

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

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Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$1 par value	New York Stock Exchange

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

None

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

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

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 every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

If an emerging growth company, indicate by check mark if registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Aggregate market value at June 30, 2018, of voting and non-voting common stock held by nonaffiliates of the registrant: \$ 1,557,192,793*

Number of shares outstanding of each of the registrant's classes of common stock as of January 31, 2019:

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Class	Outstanding at January 31, 2019
Common Stock, \$1 par value	22,515,141

Documents Incorporated by Reference

Part of Form 10-K Document Incorporated

Part III, Items 10-14 Portions of the Proxy Statement for Annual Meeting of Stockholders to be held

April 30, 2019.

* Based on reported ownership by all directors and executive officers at June 30, 2018.

STEPAN COMPANY

ANNUAL REPORT ON FORM 10-K

December 31, 2018

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K, other than purely historical information, are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements include statements about Stepan Company’s and its subsidiaries’ (the Company) plans, objectives, strategies, financial performance and outlook, trends, the amount and timing of future cash distributions, prospects or future events and involve known and unknown risks that are difficult to predict. As a result, our actual financial results, performance, achievements or prospects may differ materially from those expressed or implied by these forward-looking statements. In some cases, forward-looking statements can be identified by the use of words such as “may,” “could,” “expect,” “intend,” “plan,” “seek,” “anticipate,” “believe,” “estimate,” “guidance,” “predict,” “potential,” “could,” “would,” “should,” “illustrative” and variations of these terms and similar expressions, or the negative of these terms or similar expressions. Such forward-looking statements are necessarily based upon estimates and assumptions that, while considered reasonable by the Company and its management based on their knowledge and understanding of the business and industry, are inherently uncertain. These statements are not guarantees of future performance, and stockholders should not place undue reliance on forward-looking statements. There are a number of risks, uncertainties and other important factors, many of which are beyond the Company’s control, that could cause the Company’s actual results to differ materially from the forward-looking statements contained in this Annual Report on Form 10-K. Such risks, uncertainties and other important factors, include, among others, the risks, uncertainties and factors set forth under “Part I-Item IA. Risk Factors” and “Part II-Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and the risks and uncertainties related to the following:

- accidents, unplanned production shutdowns or disruptions in any of the Company’s manufacturing facilities;
- global competition and the Company’s ability to successfully compete;
- volatility of raw material, natural gas and electricity costs as well as any disruption in their supply;
- disruptions in transportation or significant changes in transportation costs;
- reduced demand for Company products due to customer product reformulations or new technologies;
- the Company’s ability to make acquisitions of suitable candidates and successfully integrate acquisitions;
- the Company’s ability to keep and protect its intellectual property rights;
 - international business risks, including fluctuations in currency exchange rates, legal restrictions and taxes;
- potentially adverse tax consequences due to the international scope of the Company’s operations;
 - compliance with anti-corruption, environmental, health and safety and product registration laws;
- the Company’s ability to operate within the limitations of debt covenants;
- downgrades to the Company’s credit ratings or disruptions to the Company’s ability to access well-functioning capital markets;
- downturns in certain industries and general economic downturns;
- conflicts, military actions, terrorist attacks and general instability, particularly in certain energy-producing nations, along with increased security regulations;
- cost overruns, delays and miscalculations in capacity needs with respect to the Company’s expansion or other capital projects;
- interruption of, damage to or compromise of the Company’s IT systems and failure to maintain the integrity of customer, colleague or Company data;
- unfavorable resolution of litigation against the Company;
 - the Company’s ability to retain its executive management and other key personnel; and
- the other factors set forth under “Risk Factors.”

These factors are not necessarily all of the important factors that could cause the Company's actual financial results, performance, achievements or prospects to differ materially from those expressed in or implied by any of the Company's forward-looking statements. Other unknown or unpredictable factors also could harm the Company's results. All forward-looking statements attributable to us or persons acting on the Company's behalf are expressly qualified in their entirety by the cautionary statements set forth above. Forward-looking statements speak only as of the date they are made, and we do not undertake or assume any obligation to update publicly any of these forward-looking statements to reflect actual results, new information or future events, changes in

assumptions or changes in other factors affecting forward-looking statements, except to the extent required by applicable laws. If we update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

The “Company,” “we,” “our” or “us” means Stepan Company and one or more of its subsidiaries only.

PART I

Item 1. Business

Stepan Company, which was incorporated under the laws of the state of Delaware on February 19, 1959, and its subsidiaries produce specialty and intermediate chemicals, which are sold to other manufacturers and used in a variety of end products. The Company has three reportable segments: Surfactants, Polymers and Specialty Products.

Surfactants are chemical agents that affect the interaction between two surfaces; they can provide actions such as detergency (i.e., the ability of water to remove soil from another surface), wetting and foaming, dispersing, emulsification (aiding two dissimilar liquids to mix), demulsification, viscosity modifications and biocidal disinfectants. Surfactants are the basic cleaning agent in detergents for washing clothes, dishes, carpets, fine fabrics, floors and walls. Surfactants are also used for the same purpose in shampoos, body wash and conditioners, fabric softeners, toothpastes, cosmetics and other personal care products. Commercial and industrial applications include emulsifiers for agricultural products, emulsion polymers such as floor polishes and latex foams and coatings, wetting and foaming agents for wallboard manufacturing and surfactants for oilfield applications.

Polymers, which include polyurethane polyols, polyester resins and phthalic anhydride, are used in a variety of applications. Polyurethane polyols are used in the manufacture of rigid foam for thermal insulation in the construction industry. They are also a raw material base for coatings, adhesives, sealants and elastomers (CASE) applications. Polyester resins, which include liquid and powdered products, are used in CASE applications. Phthalic anhydride is used in polyester resins, alkyd resins, and plasticizers for applications in construction materials and components of automotive, boating, and other consumer products and internally in the Company's polyols.

Specialty Products are chemicals used in food, flavoring, nutritional supplement and pharmaceutical applications.

MARKETING AND COMPETITION

Principal customers for surfactants are manufacturers of detergents, shampoos, body wash, fabric softeners, toothpastes and cosmetics. In addition, surfactants are sold to the producers of agricultural herbicides and insecticides and lubricating products. Surfactants are also sold into the oilfield market to aid production, drilling and hydraulic fracking. Polymers are used in the construction and appliance industries, as well as in applications for the coatings, adhesives, sealants and elastomers industries. Phthalic anhydride, a Polymer product, is also used by automotive, boating and other consumer product companies. Specialty products are used primarily by food, nutritional supplement and pharmaceutical manufacturers.

The Company does not sell directly to the retail market, but sells to a wide range of manufacturers in many industries and has many competitors. The principal methods of competition are product performance, price, technical assistance and ability to meet the specific needs of individual customers. These factors allow the Company to compete on bases other than price alone, reducing the severity of competition compared to that experienced in the sales of commodity chemicals having identical performance characteristics. The Company is one of the leading merchant producers of surfactants in the world. In the case of surfactants, much of the Company's competition comes from several large global and regional producers and the internal divisions of larger customers. In the manufacture of polymers, the Company competes with the chemical divisions of several large companies, as well as with other small specialty chemical manufacturers. In specialty products, the Company competes with several large firms plus numerous small

companies.

MAJOR CUSTOMER AND BACKLOG

The Company did not have any one customer whose business represented more than 10 percent of the Company's consolidated revenue in 2018, 2017 or 2016. The Company has contract arrangements with certain customers, but volumes are generally contingent on purchaser requirements. Much of the Company's business is essentially on a "spot delivery basis" and does not involve a significant backlog.

ENERGY SOURCES

Substantially all of the Company's manufacturing plants operate on electricity and interruptible natural gas. During peak heating demand periods, gas service to all plants may be temporarily interrupted for varying periods ranging from a few days to several months. The plants operate on fuel oil during these periods of interruption. The Company's operations have not experienced any plant shutdowns or adverse effects upon its business in recent years that were caused by a lack of available energy sources, other than temporary service interruptions brought on by mechanical failure or severe weather conditions.

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RAW MATERIALS

The principal raw materials used by the Company are petroleum or plant based. For 2019, the Company has contracts with suppliers that cover the majority of its forecasted requirements for major raw materials and is not substantially dependent upon any one supplier.

ENVIRONMENTAL COMPLIANCE

Compliance with applicable country, state and local regulations regarding the discharge of materials into the environment, or otherwise relating to the protection of the environment, resulted in expenditures by the Company of \$5.4 million during 2018, all of which were classified as capital expenditures. These expenditures represented approximately 6 percent of the Company's total 2018 capital expenditures. Capitalized environmental expenditures are depreciated and charged on a straight-line basis to pretax earnings over their estimated useful lives, which are typically 10 years. Recurring costs associated with the operation and maintenance of facilities for waste treatment and disposal and managing environmental compliance in ongoing operations at our manufacturing locations were approximately \$28.3 million in 2018. Compliance with such regulations is not expected to have a material adverse effect on the Company's earnings and competitive position in the foreseeable future.

EMPLOYMENT

At December 31, 2018 and 2017, the Company employed 2,250 and 2,096 persons, respectively. The Company has collective bargaining agreements with employees at some of its manufacturing locations. While the Company has experienced occasional work stoppages as a result of the collective bargaining process and may experience some work stoppages in the future, management believes that it will be able to negotiate all labor agreements on satisfactory terms. Past work stoppages have not had a significant impact on the Company's operating results. Overall, the Company believes it has good relationships with its employees.

ACQUISITIONS AND DISPOSITIONS

See Note 20, Acquisitions, of the Consolidated Financial Statements (Item 8 of this Form 10-K).

WEBSITE

The Company's website address is www.stepan.com. The Company makes available free of charge on or through its website its code of conduct, annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. The website also includes the Company's corporate governance guidelines and the charters for the audit, compensation and development, compliance and nominating and corporate governance committees of the Board of Directors.

Executive Officers of the Registrant

The Company's executive officers are elected annually by the Board of Directors at the first meeting following the Annual Meeting of Stockholders to serve through the next annual meeting of the Board and until their respective successors are duly qualified and elected.

The executive officers of the Company, their ages and certain other information as of February 27, 2019, are as follows:

Name	Age	Title	Year First Elected Officer
F. Quinn Stepan, Jr.	58	Chairman, President and Chief Executive Officer	1997
Frank Pacholec	63	Vice President, Strategy and Corporate Development and Interim Chief Technology and Sustainability Officer	2003
Arthur W. Mergner	55	Vice President, Supply Chain	2014
Scott R. Behrens	49	Vice President and General Manager – Surfactants	2014
Debra A. Stefaniak	57	Vice President, Business Enablement	2015
Sean T. Moriarty	49	Vice President and General Manager – Polymers	2017
Luis E. Rojo	46	Vice President and Chief Financial Officer	2018
Janet A. Catlett	42	Vice President and Chief Human Resources Officer	2018

F. Quinn Stepan, Jr. assumed the position of Chairman of the Company's Board of Directors in January 2017. He has served the Company as President and Chief Executive Officer since January 2006. He served the Company as President and Chief Operating Officer from 1999 through 2005.

Frank Pacholec has served the Company as Interim Chief Technology and Sustainability Officer since January 2019 and as Vice President, Strategy and Corporate Development since June 2016. He served as Vice President, Research and Development and Corporate Sustainability Officer from May 2010 until June 2016.

Arthur W. Mergner has served the Company as Vice President, Supply Chain since August 2017. From April 2014 until August 2017, he served as Vice President and General Manager – Polymers. From June 2013 until April 2014, he served as Vice President – North America Polymers.

Scott R. Behrens has served the Company as Vice President and General Manager – Surfactants since September 2014. From January 2010 to September 2014 he served as Vice President – Business Management.

Debra A. Stefaniak has served the Company as Vice President, Business Enablement since October 2018. From February 2014 to September 2018, she served as Vice President, Business Transformation and from May 2009 to

February 2014, she served as Vice President, Global Logistics.

Sean T. Moriarty has served the Company as Vice President and General Manager – Polymers since September 2017. From September 2014 through September 2017, he served as Vice President and General Manager – North America Surfactants. From January 2012 through September 2014 he served as Vice President – Global Consumer Products.

Luis E. Rojo has served the Company as Vice President and Chief Financial Officer since April 2018. From February 2018 to April 2018, he served as Global Hair Care Finance Director at Procter & Gamble Co. (P&G), a branded consumer packaged goods company. From April 2014 to February 2018, he served as NA Hair Care Finance Director at P&G, and from August 2012 to April 2014, he served as Latin America Andean Finance Director at P&G.

Janet A. Catlett has served the Company as Vice President and Chief Human Resources Officer since July 2018. From March 2017 to July 2018, she served as Senior Director Total Rewards at Hollister Incorporated, an independent company that develops, manufactures and markets health care products and services worldwide. From September 2014 to March 2017, she served as Director Total Rewards at Hollister Incorporated. From January 2014 to September 2014, she served the Company as Sales Manager U.S. Distribution.

Item 1A. Risk Factors

The following discussion identifies the most significant factors that may materially and adversely affect the Company's business, financial condition, results of operations and cash flows. These and other factors, many of which are beyond the Company's control, may cause future results of operations to differ materially from past results or those results currently expected or desired. The following information should be read in conjunction with Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes included in this Form 10-K.

RISKS RELATED TO OUR BUSINESS

Chemical manufacturing is inherently hazardous and may result in accidents or may require planned or unplanned production shutdowns, which may disrupt our operations or expose us to significant losses or liabilities, which may have a material impact on our business, financial position, results of operations and cash flows.

Manufacturing facilities in the Company's industry are subject to planned and unplanned production shutdowns, turnarounds and outages. Unplanned production disruptions may occur for external reasons, such as natural disasters, weather, disease, strikes, transportation interruption, government regulation, political unrest or terrorism, or internal reasons, such as fire, mechanical failure, maintenance or other manufacturing problems. Certain of our production facilities are, and production facilities acquired or built in the future may be, located in areas where unplanned disruptions are more likely. Alternative facilities with sufficient capacity may not be available, may cost substantially more or may take a significant amount of time to increase production or qualify with Company customers, each of which could negatively impact the Company's business, financial position, results of operations and cash flows. Further, some of the Company's products cannot currently be made, or made in the volume required, at more than one of the Company's locations. For some of these products, the Company has access to external market suppliers, but the Company cannot guarantee that these products will be available to it in amounts sufficient to meet its requirements or at a cost that is competitive with the Company's cost of manufacturing these products. Long-term production disruptions may cause Company customers to seek alternative supply, which could further adversely affect Company profitability.

Although the Company takes precautions to enhance the safety of its operations and minimize the risk of disruptions, the hazards associated with chemical manufacturing and the related storage and transportation of raw materials, products and wastes are inherent in our operations. We cannot eliminate the risk of accidental contamination, discharge or injury resulting from those materials. Also, our suppliers and customers may use and/or generate hazardous materials, and we may be required to indemnify our suppliers, customers or waste disposal contractors against damages and other liabilities arising out of the production, handling or storage of our products or raw materials or the disposal of related wastes. Potential risks include explosions and fires, chemical spills and other discharges or releases of toxic or hazardous substances or gases, and pipeline and storage tank leaks and ruptures. Those hazards may result in personal injury and loss of life, damage to property, damages to public health and contamination of the environment, which may result in a suspension of operations and the imposition of civil or criminal fines, penalties and other sanctions, cleanup costs, and claims by governmental entities or third-parties. Furthermore, the Company is subject to present and future claims with respect to workplace exposure, exposure of contractors on Company premises as well as other persons located nearby, workers' compensation and other matters.

We are dependent on the continued operation of our production facilities and the loss or shutdown of operations over an extended period could have a material adverse effect on our financial condition, or results of operations. The Company maintains property, business interruption, products liability and casualty insurance policies, which we believe are in accordance with customary industry practices, as well as insurance policies covering other types of risks, including pollution legal liability insurance. However, some of these potential manufacturing hazards and risks

may not be insurable. Moreover, even when such hazards and risks are insurable, the insurance coverage may not be sufficient to cover all losses resulting from the occurrence of any of these events. Each of these insurance policies is subject to customary exclusions, deductibles and coverage limits, in accordance with industry standards and practices. As a result of market conditions, premiums and deductibles for certain insurance policies can increase substantially and, in some instances, certain insurance may become unavailable or available only with reduced amounts of coverage. There is also a risk, beyond the reasonable control of the Company, that an insurance carrier may not have the financial resources to cover an insurable loss. As a result, the occurrence of any of these events could have a material adverse effect on the Company's business, financial position, results of operations and cash flows.

The Company faces significant global competition in each of its operating segments. If the Company cannot successfully compete in the marketplace, its business, financial position, results of operations and cash flows may be materially and adversely affected.

The Company faces significant competition from numerous global companies as well as national, regional and local companies in the markets it serves. Many of the Company's competitors have access to greater financial resources, which may enable them to invest significant capital into their businesses, including expenditures for research and development. Some of the Company's competitors have their own raw material resources and may be able to produce products more economically. In addition, some of the Company's customers have internal manufacturing capabilities that allow them to achieve make-versus-buy economics, which may

result at times in the Company losing business with these customers in volumes that could adversely affect the Company's profitability.

To achieve expected profitability levels, the Company must, among other things, maintain the service levels, product quality and performance and competitive pricing necessary to retain existing customers and attract new customers. The Company's inability to do so could place it at a competitive disadvantage relative to its competitors, and if the Company cannot successfully compete in the marketplace, its business, financial position, results of operations and cash flows may be materially and adversely affected.

The volatility of raw material, natural gas and electricity costs as well as any disruption in their supply may result in increased costs and materially and adversely affect the Company's business, financial position, results of operations and cash flows.

The costs of raw materials, natural gas and electricity represent a substantial portion of the Company's operating costs. The principal raw materials used in the Company's products are petroleum-based or plant-based. Natural gas is used in the Company's manufacturing sites primarily to generate steam for its manufacturing processes. The prices of many of these raw materials have recently increased and been volatile. These fluctuations in prices may be affected by supply and demand factors, such as general economic conditions, restrictions on the transport of raw materials (some of which may be viewed as hazardous), currency exchange rates, political instability or terrorist attacks, all of which are beyond the Company's control. The Company may not be able to pass increased raw material or energy costs on to customers through increases in product prices as a result of arrangements the Company has with certain customers and competitive pressures in the market. If the Company is unable to minimize the effects of increased raw material and energy costs or pass such increased costs on to customers, or manage any interruption to the supply of raw materials or energy, its business, financial position, results of operations and cash flows may be materially and adversely affected.

The Company relies heavily on third party transportation to deliver raw materials to Company manufacturing facilities and ship products to Company customers. Disruptions in transportation or significant changes in transportation costs could affect the Company's business, financial position, results of operations and cash flows.

The Company relies heavily on railroads, ships, and other over-the-road shipping methods to transport raw materials to its manufacturing facilities and to ship finished products to customers. Transport operations are exposed to various risks, such as extreme weather conditions, natural disasters, work stoppages, personnel shortages and operating hazards, as well as interstate and international transportation requirements. If the Company experiences transportation problems, or if there are significant changes in the cost of these services, the Company may not be able to arrange efficient alternatives and timely means to obtain raw materials or ship finished product, which could result in an adverse effect on Company revenues, costs and operating results.

Customer product reformulations or new technologies can reduce the demand for the Company's products.

The Company's products are used in a broad range of customer product applications. Customer product reformulations or development and use of new technologies may lead to reduced consumption of Company-produced products or make some Company products obsolete. It is imperative that the Company continue to develop new products to replace the sales of products that mature and decline in use. The Company's business, financial position, results of operations and cash flows could be materially and adversely affected if the Company is unable to successfully manage the maturation of existing products and the introduction of new products.

To the extent the Company seeks acquisition opportunities, it may not be able to make acquisitions of suitable candidates or integrate acquisitions successfully.

In recent years, the Company has used acquisitions to expand into new markets and to enhance its position in its existing markets. To the extent it seeks to do so in the future it may not be able to successfully identify suitable candidates, negotiate appropriate acquisition terms, obtain financing needed to consummate those acquisitions, complete proposed acquisitions or successfully integrate acquired businesses into its existing operations. In addition, any acquisition, once successfully integrated, may not perform as planned, be accretive to earnings, or otherwise prove beneficial to the Company.

Acquisitions involve numerous risks, including the assumption of undisclosed or unindemnified liabilities, difficulties in the assimilation of the operations and the transfer of all necessary licenses and permits, technologies, services and products of the acquired companies and the diversion of management's attention from other business concerns. In addition, prior acquisitions have resulted, and future acquisitions could result, in the incurrence of substantial additional indebtedness and other expenses.

If the Company is unable to keep and protect its intellectual property rights, the Company's ability to compete may be negatively impacted.

The Company's patents and other intellectual property may not prevent competitors from independently developing or selling similar or duplicative products and services, and there can be no assurance that the resources the Company invests to protect its intellectual property will be sufficient or that the Company's intellectual property portfolio will adequately deter misappropriation or improper use of its technology. The Company could also face competition in some countries where it has not invested in an intellectual property portfolio, or where intellectual property rights are more difficult to obtain and/or assert. In addition, the Company may be the target of aggressive and opportunistic enforcement of patents by third parties, including non-practicing entities. Regardless of the merit of such claims, responding to infringement claims can be expensive and time-consuming. If the Company is found to infringe any third-party rights, it could be required to pay substantial damages or it could be enjoined from offering some of its products and services. Also, there can be no assurances that the Company will be able to obtain or renew from third parties the licenses it may need in the future, and there is no assurance that such licenses can be obtained on reasonable terms.

The Company's results of operations may be adversely affected by international business risks, including fluctuations in currency exchange rates, legal restrictions and taxes.

The Company has substantial operations outside the United States. In the year ended December 31, 2018, the Company's sales outside of the United States constituted approximately 40 percent of the Company's net sales. In addition to the risks described in this Annual Report on Form 10 K that are common to both the Company's U.S. and non-U.S. operations, the Company faces, and will continue to face, risks related to the Company's foreign operations such as:

- variability of intellectual property laws outside the United States, which may impact enforceability and consistency of protection of intellectual property assets;
- high levels of inflation;
- fluctuations in foreign currency exchange rates, which may affect product demand and may adversely affect the profitability in U.S. Dollars of products and services the Company provides in international markets where payment for the Company's products and services is made in the local currency;
- political, economic, financial and market conditions, which may be unstable;
- changes in labor conditions and difficulties in staffing and managing international operations;
- differing economic cycles and adverse economic conditions;
- trade and currency restrictions, including tariffs and currency exchange controls imposed by the United States and foreign countries;
- changes in foreign laws and tax rates or U.S. laws and tax rates (including as a result of the implementation of recent U.S. federal income tax reform) with respect to foreign income, which may unexpectedly increase the rate at which the Company's income is taxed, impose new and additional taxes on remittances, repatriation or other payments by subsidiaries, or cause the loss of previously recorded tax benefits;
- greater difficulty enforcing contracts and collecting accounts receivable;
 - enforceability and compliance with U.S. and foreign laws affecting operations outside of the United States, including the U.S. Foreign Corrupt Practices Act (FCPA) (and foreign equivalents), export controls and regulations administered by the Office of Foreign Assets Control; and
- evolving laws and regulations over chemicals and chemical production and transportation for the U.S. Toxic Substances Control Act (TSCA), the EU Registration, Evaluation, Authorization and Restriction of Chemical Substances Act (REACH) and changing laws related to operating permits and licenses) that could result in material costs relating to regulatory compliance, liabilities, litigation proceedings, or other impacts, such as restrictions or prohibitions on our products.

The actual occurrence of any or all of the foregoing could have a material adverse effect on the Company's business, financial position, results of operations and cash flows in the future.

Fluctuations in foreign currency exchange rates could affect Company financial results.

The Company is also exposed to fluctuations in exchange rates. The Company's results of operations are reported in U.S. dollars. However, outside the United States, the Company's sales and costs are denominated in a variety of currencies including the European euro, British pound, Canadian dollar, Mexican peso, Colombian peso, Philippine peso, Brazilian real, Polish zloty,

Singapore dollar and Chinese RMB. The Company translates its local currency financial results into U.S. dollars based on average exchange rates prevailing during the reporting period or the exchange rate at the end of that period. During times of a strengthening U.S. dollar, the Company's reported international sales and earnings may be reduced because the local currency may translate into fewer U.S. dollars. Fluctuations in exchange rates may materially and adversely affect the Company's business, financial position, results of operations and cash flows.

In all jurisdictions in which the Company operates, the Company is also subject to laws and regulations that govern foreign investment, foreign trade and currency exchange transactions. These laws and regulations may limit the Company's ability to repatriate cash as dividends or otherwise to the United States or to efficiently allocate cash to support strategic initiatives, and may limit the Company's ability to convert foreign currency cash flows into U.S. dollars. A weakening of the currencies in which the Company generates sales relative to the foreign currencies in which the Company's costs are denominated may lower the Company's operating profits and cash flows.

The international scope of the Company's operations and corporate structure may expose the Company to potentially adverse tax consequences.

The Company is subject to taxation in and to the tax laws and regulations of multiple jurisdictions as a result of the international scope of its operations and corporate structure. The Company is also subject to intercompany pricing laws, including those relating to the flow of funds between its entities pursuant to, for example, purchase agreements, licensing agreements or other arrangements. Adverse developments in these laws or regulations (including pursuant to recent U.S. tax legislation, described below), or any change in position regarding the application, administration or interpretation of these laws or regulations in any applicable jurisdiction could have a material adverse effect on the Company's business, financial position, results of operations and cash flows. In addition, the tax authorities in any applicable jurisdiction may disagree with the positions the Company has taken or intends to take regarding the tax treatment or characterization of any of the Company's transactions, including the tax treatment or characterization of the Company's indebtedness. If any applicable tax authorities were to successfully challenge the tax treatment or characterization of any of the Company's transactions, it could result in the disallowance of deductions, the imposition of withholding taxes on internal deemed transfers or other consequences that could have a material adverse effect on the Company's business, financial position, results of operations and cash flows.

The Company's failure to comply with the anti-corruption laws of the United States and various international jurisdictions could negatively impact its reputation and results of operations.

Doing business on a worldwide basis requires the Company to comply with anti-corruption laws and regulations imposed by governments around the world with jurisdiction over our operations, which may include the FCPA and the U.K. Bribery Act 2010 (the Bribery Act), as well as the laws of the countries where the Company does business. These laws and regulations can apply to companies and individual directors, officers, employees and agents, and may restrict the Company's operations, trade practices, investment decisions and partnering activities. Where they apply, the FCPA and the Bribery Act prohibit, among other things, the Company and its officers, directors, employees and business partners, including joint venture partners and agents acting on the Company's behalf, from corruptly offering, promising, authorizing or providing anything of value to "foreign officials" for the purposes of influencing official decisions or obtaining or retaining business or otherwise obtaining favorable treatment. The Bribery Act also prohibits non-governmental "commercial" bribery and accepting bribes. Part of the Company's business may involve dealings with governments and state-owned business enterprises, the employees and representatives of which may be considered "foreign officials" for purposes of the FCPA and the Bribery Act. The Company is also subject to the jurisdiction of various governments and regulatory agencies around the world, which may bring Company personnel and agents into contact with "foreign officials" responsible for issuing or renewing permits, licenses, or approvals or for enforcing other governmental regulations. The Company's global operations, including in countries with high levels of perceived corruption, expose it to the risk of violating, or being accused of violating, anti-corruption laws. Any failure

on the part of the Company to successfully comply with these laws and regulations may expose the Company to reputational harm as well as significant sanctions, including criminal fines, imprisonment of its employees or representatives, civil penalties, disgorgement of profits, injunctions and debarment from government contracts, as well as other remedial measures. Investigations of alleged violations can be expensive and disruptive. Compliance with these laws can increase the cost of doing business globally. The Company maintains policies and procedures designed to assist the Company and its subsidiaries in complying with applicable anti-corruption laws. However, there can be no guarantee that these policies and procedures will effectively prevent violations by Company employees or representatives for which the Company may be held responsible, and any such violation could adversely affect the Company's reputation, business, financial position and results of operations.

The Company is subject to a variety of environmental, health and safety and product registration laws dealing with the production and sale of chemicals that could require us to incur additional costs or to reformulate or discontinue certain of our products.

The Company's operations are regulated under a number of federal, state, local and foreign environmental, health and safety laws and regulations that govern, among other things, the production and marketing of chemical substances and discharge, use,

handling, transport, storage and disposal of hazardous materials into the air, soil and water. In the United States, these laws and regulations include, but are not limited to TSCA, the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA), the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act (RCRA), the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and state and local laws, such as California's Safe Drinking Water and Toxic Enforcement Act of 1986 (Proposition 65). Analogous laws outside the United States apply to us in many jurisdictions, including, among others, the European Union's REACH regulation and its Biocidal Products Regulation. Compliance with these environmental laws and regulations is a major consideration for the Company, and to comply with some of these laws, we may need to alter our product lines, which could lead to a material adverse effect on our results of operations. In addition, the transportation of certain raw materials is highly regulated and is subject to increased regulation or restrictions. These regulations may restrict or prohibit transport of these raw materials, resulting in these raw materials not being available to the Company in quantities desired by the Company or at costs attractive to the Company, which may restrict or substantially limit the Company's manufacturing operations.

The REACH regulation was fully implemented in 2018, and any new substances introduced to the EU market in the future must be registered. The costs associated with these registrations could be substantial. Moreover, if a registration in the future is not submitted by any applicable deadline, our ability to sell those products may be negatively impacted until the registration process has been completed. In addition, the European Chemical Agency is evaluating existing chemical registrations and may require additional testing and data collection. Chemicals may be assessed and removed from EU commerce entirely, potentially requiring the Company to discontinue certain product lines and to reformulate others, which could materially alter our marketplace position or otherwise have a material financial effect on our costs or revenues. Regulators in other countries are also implementing chemical registration regulations similar to REACH. Furthermore, some of the laws and regulations applicable to us have changed in recent years to impose new obligations that could also force us to reformulate or discontinue certain of our products. For example, the European Union is now requiring a review of existing active biocide substances, and based on this review, the European Commission or an individual member state may decide not to authorize the product for continued sale. As another example, TSCA now mandate that the U.S. Environmental Protection Agency (USEPA) must designate "high priority" chemicals and perform a risk evaluation, which could result in a finding of "unreasonable risk" and a decision to promulgate new regulations to address such risk.

Compliance with environmental laws could restrict the Company's ability to expand its facilities or require the Company to modify its facilities and processes or acquire additional costly pollution control equipment, incur other significant expenses, or expose the Company to greater liability associated with its production processes and products. The Company has incurred and will continue to incur capital expenditures and operating costs in complying with these laws and regulations. In addition, our operations currently use, and have historically used, hazardous materials and generate, and have historically generated, quantities of hazardous waste. We are subject to regulatory oversight and investigation, remediation, and monitoring obligations at certain current and former U.S. Superfund sites, as well as third-party disposal sites, under federal laws and their state and local analogues, including the RCRA, the Clean Water Act, the Clean Air Act, and CERCLA, as well as analogous foreign laws. See Item 3, Legal Proceedings, in this Form 10-K and Note 16, Contingencies, in the Notes to Consolidated Financial Statements for a summary of current significant environmental proceedings related to certain environmental sites. In the event that new contamination is discovered, the Company may become subject to additional obligations. The costs and liabilities associated with these issues may have a material adverse effect on the Company's business, financial position, results of operations and cash flows.

The Company is also subject to numerous federal, state, local and foreign laws that regulate the manufacture, storage, distribution and labeling of many of the Company's products, including some of the Company's disinfecting, sanitizing and antimicrobial products. Some of these laws require the Company to have operating permits for the Company's production facilities, warehouse facilities and operations. Various federal, state, local and foreign laws and

regulations also require the Company to register the Company's products and to comply with specified requirements with respect to those products. Additionally, those requirements, and enforcement of those requirements, may become more stringent in the future. The ultimate cost of compliance with any such requirements could be material.

Although it is our policy to comply with such laws and regulations, it is possible that we have not been or may not be at all times in material compliance with all of those requirements. If the Company fails to comply with any of these laws and regulations, including permitting and licensing requirements, it may be liable for damages and the costs of remedial actions in excess of the Company's recorded liabilities, and may also be subject to fines, injunctions or criminal sanctions or to revocation, non-renewal or modification of the Company's operating permits and revocation of the Company's product registrations. Any such revocation, modification or non-renewal may require the Company to cease or limit the manufacture and sale of its products at one or more of the Company's facilities, which may limit or prevent the Company's ability to meet product demand or build new facilities and may have a material adverse effect on the Company's business, financial position, results of operations and cash flows. Any such revocation, non-renewal or modification may also result in an event of default under the indenture for the Company's notes or under the Company's credit facilities, which, if not cured or waived, may result in the acceleration of all the Company's indebtedness.

In addition to the costs of complying with environmental, health and safety requirements, the Company has incurred and may incur in the future costs defending against environmental litigation and/or investigations brought by government agencies and private

parties, including administrative proceedings. The Company is, and may be in the future, a defendant in lawsuits brought by parties alleging environmental damage, personal injury or property damage. A significant judgment or settlement, to the extent not covered by existing insurance policies, against the Company could have a material adverse effect on its business, financial position, results of operations and cash flows. Although the Company has insurance that may cover some of these potential losses, there is always uncertainty as to whether such insurance may be available to the Company based on case-specific factors and the specific provisions of the Company's insurance policies.

The potential cost to the Company relating to environmental, health and safety and product registration matters is uncertain due to factors such as the complexity and evolving nature of laws and regulations relating to the environment, health and safety and product registration, including those outside of the United States. Environmental and product registration laws may also become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with any violation, as well as restricting or prohibiting the sale of existing or new products, which may also negatively impact the Company's operating results. Without limiting the foregoing, these laws or regulations may restrict or prohibit the use of non-renewable or carbon-based substances, or impose fees or penalties for the use of these substances. Accordingly, the Company may become subject to additional liabilities and increased operating costs in the future under these laws and regulations. The impact of any such changes, which are unknown at this time, may have a material adverse effect on the Company's business, financial position, results of operations and cash flows.

The Company has a significant amount of indebtedness and may incur additional indebtedness, or need to refinance existing indebtedness, in the future, which may adversely affect the Company's business, financial position, results of operations and cash flows.

The Company has a significant amount of indebtedness and may incur additional indebtedness in the future. As of December 31, 2018, the Company had \$276.1 million of debt on its balance sheet. U.S. debt included \$268.3 million in unsecured promissory notes with maturities extending from 2019 until 2027. In addition, on December 31, 2018 the Company was party to a \$350 million credit facility.

Certain of the Company's foreign subsidiaries also maintain bank term loans and short-term bank lines of credit in their respective countries to meet working capital requirements as well as to fund capital expenditure programs and acquisitions. As of December 31, 2018, the Company's foreign subsidiaries' aggregate outstanding debt totaled \$7.8 million.

The Company's current indebtedness and any additional indebtedness incurred in the future may materially and adversely affect its business, financial position, results of operations and cash flows. For example, such indebtedness could:

- require the Company to dedicate a substantial portion of cash flow from operations to pay principal and interest on the Company's debt, which would reduce funds available to fund future working capital, capital expenditures and other general operating requirements;
- limit the Company's ability to borrow funds that may be needed to operate and expand its business;
- limit the Company's flexibility in planning for or reacting to changes in the Company's business and the industries in which the Company operates;
- increase the Company's vulnerability to general adverse economic and industry conditions or a downturn in the Company's business; and
- place the Company at a competitive disadvantage compared to its competitors that have less debt.

The Company's loan agreements contain provisions that, among others, require maintenance of certain financial ratios and place limitations on additional debt, investments and payment of dividends. Failure to comply with these loan

agreements would require debt restructuring that could be materially adverse to the Company's financial position, results of operations and cash flows.

An increase in interest rates could limit the Company's ability to incur additional debt to fund the Company's strategic plans or to refinance maturing debt without incurring significant additional cost, and could make borrowings under the Company's credit facility or other floating rate debt materially more expensive. Additionally, any future disruptions in the credit and financial markets may reduce the availability of debt financing or refinancing and increase the costs associated with such financing. If the Company is unable to secure financing on satisfactory terms, or at all, its business financial position, results of operations and cash flows may be materially and adversely affected.

The Company could be adversely affected by downgrades to its credit ratings or disruptions in its ability to access well-functioning capital markets.

Historically, the Company has relied on the debt capital markets to fund portions of its capital investments and access to bank credit facilities as part of its working capital management strategy. The Company's continued access to these markets, and the terms of such access, depend on multiple factors including the condition of debt capital markets, the Company's operating performance, and its credit ratings. These ratings are based on a number of factors, which include rating agencies' assessment of the Company's financial strength and financial policies. There can be no assurance that any particular rating assigned to the Company will remain in effect for any given period of time or that a rating will not be changed or withdrawn by a rating agency, if in that rating agency's judgment, future circumstances relating to the basis of the rating so warrant. Incurrence of additional debt by the Company could adversely affect its credit ratings. The Company depends on banks and other financial institutions to provide credit to its business and perform under the Company's agreements with them. Defaults by one or more of these counterparties on their obligations to the Company could materially and adversely affect it. Any downgrade of the Company's credit ratings could materially adversely affect its cost of funds, liquidity, competitive position and access to capital markets and increase the cost of and counterparty risks associated with existing facilities, which could materially and adversely affect Company business operations, financial condition, and results of operations.

Downturns in certain industries and general economic downturns may have an adverse effect on the Company's business, financial position, results of operations and cash flows.

Economic downturns may adversely affect users of some end products that are manufactured using the Company's products and the industries in which such end products are used. During economic downturns, these users may reduce their volume of purchases of such end products or may purchase alternative products, which would reduce demand for the Company's products. Reduced demand from the primary end markets for the Company's products, such as the consumer products industry, could adversely affect the Company. Additionally, uncertain conditions in the credit markets pose a risk to the overall economy that may impact consumer and customer demand of some of the Company's products, as well as the Company's ability to manage normal commercial relationships with its customers, suppliers and creditors. Some of the Company's customers may not be able to meet the terms of sale and suppliers may not be able to fully perform their contractual obligations due to tighter credit markets or a general slowdown in economic activity.

In the event that economic conditions worsen or result in a prolonged downturn or recession, the Company's business, financial position, results of operations and cash flows may be materially and adversely affected.

Conflicts, military actions, terrorist attacks and general instability, particularly in certain energy-producing nations, along with increased security regulations related to our industry, could adversely affect the Company's business.

Conflicts, military actions and terrorist attacks have precipitated economic instability and turmoil in financial markets. Instability and turmoil, particularly in energy-producing nations, may result in raw material cost increases. The uncertainty and economic disruption resulting from hostilities, military action or acts of terrorism may impact any or all of the Company's facilities and operations or those of its suppliers or customers. Accordingly, any conflict, military action or terrorist attack that impacts the Company or any of its suppliers or customers, could have a material adverse effect on the Company's business, results of operations, financial position and cash flows.

Cost overruns, delays and miscalculations in capacity needs with respect to the Company's expansion or other capital projects could adversely affect the Company's business, financial position, results of operations and cash flows.

From time to time, the Company initiates expansion and other significant capital projects. Projects of this type are subject to risks of delay or cost overruns inherent in any large construction project resulting from numerous factors, including the following: shortages of equipment, materials or skilled labor; work stoppages; unscheduled delays in the delivery of ordered materials and equipment; unanticipated cost increases; difficulties in obtaining necessary permits or in meeting permit conditions; difficulties in meeting regulatory requirements or obtaining regulatory approvals; availability of suppliers to certify equipment for existing and enhanced regulations; design and engineering problems; and failure or delay of third party service providers, civil unrest and labor disputes. Significant cost overruns or delays in completing a project could have a material adverse effect on the Company's return on investment, results of operations and cash flows. In addition, if the Company misjudges its future capacity needs, this too could negatively impact its operations, financial condition and results of operations.

The Company relies extensively on information technology (IT) systems to conduct its business. Interruption of, damage to or compromise of the Company's IT systems and failure to maintain the integrity of customer, colleague or Company data could harm the Company's reputation and have an adverse effect on the Company's business, financial position, results of operations and cash flows.

The Company relies on IT systems in its operations, including production, supply chain, research and development, finance, human resource and regulatory functions. The Company's ability to effectively manage its business depends on the security, reliability and adequacy of these systems. IT system failures due to events including but not limited to network disruptions, programming errors, computer viruses and security breaches (e.g., cyber-attacks) could impact production activities, impede shipment of products, cause delays or cancellations of customer orders, or hamper the processing of transactions or reporting of financial results. These or similar occurrences, whether accidental or intentional, could result in theft, unauthorized use or publication of our intellectual property, confidential business information of our employees, customers, suppliers or other third parties, which could harm our reputation and competitive position, reduce the value of our investment in research and development and other strategic initiatives, result in a loss of business, as well as remedial and other costs, fines, investigations, enforcement actions or lawsuits or otherwise adversely affect our business.

The Company continues to develop and enhance controls and security measures to protect against the risk of theft, loss or fraudulent or unlawful use of customer, supplier, third party, employee or Company data, and it maintains an ongoing process to re-evaluate the adequacy of its controls and measures. The Company may also be required to expend additional resources to continue to enhance its information privacy and security measures and/or to investigate and remediate any information security vulnerabilities. The Company maintains what it believes to be adequate and collectible insurance in the event of the theft, loss, fraudulent or unlawful use of customer, supplier, third party, employee or Company data, but any such occurrences could result in costs that may not be covered or may be in excess of any available insurance that the Company may have procured. While the Company has a comprehensive program in place for continuously reviewing, maintaining, testing and upgrading its IT systems and security, there can be no assurance that such efforts will prevent breakdowns or breaches in Company systems that could adversely affect the Company's business, financial position, results of operations and cash flows.

Various liability claims could materially and adversely affect the Company's financial position, operating results and cash flows.

The Company may be required to pay for losses or injuries purportedly caused by its products. The Company faces an inherent exposure to various types of claims including general liability, product liability, product recall, toxic tort and environmental, among others, if its products, or the end products that are manufactured with the Company's products, result in property damage, injury or death. In addition, because the Company conducts business in multiple jurisdictions, the Company also faces an inherent exposure to other general claims based on its operations in those jurisdictions and the laws of those jurisdictions, including but not limited to claims arising from its relationship with employees, distributors, agents and customers, and other parties with whom it has a business relationship, directly or indirectly. Many of these claims may be made against the Company even if there is no evidence of a loss from that claim, and these claims may be made by individual persons, groups of persons, or groups of plaintiffs in a class action. Defending these claims could result in significant legal expenses relating to defense costs and/or damage awards and diversion of management's time and the Company's resources. Any claim brought against the Company could materially and adversely affect the Company's business financial position, results of operations and cash flows.

The Company's success depends on its executive management and other key personnel.

The Company's future success depends to a significant degree on the skills, experience and efforts of its executive management and other key personnel and their ability to provide the Company with uninterrupted leadership and

direction. The availability of highly qualified talent is limited, and the competition for talent is robust and the Company may not be able to recruit and retain the personnel it needs if it were to lose an existing member of senior management. The Company's future success will depend on its ability to have adequate succession plans in place and to attract, retain and develop qualified personnel. A failure to efficiently replace members of executive management and other key personnel and to attract, retain and develop new qualified personnel could have an adverse effect on the Company's business financial position, results of operations and cash flows.

Item 1B. Unresolved Staff Comments

None

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Item 2. Properties

The following are the Company's principal plants and other important physical properties. Unless otherwise noted, the listed properties are owned by the Company. Management believes that the facilities are suitable and adequate for the Company's current operations.

Name of Facility	Location	Site Size	Segment
1. Millsdale	Millsdale (Joliet), Illinois	492 acres	Surfactants/Polymers
2. Fieldsboro	Fieldsboro,	45 acres	Surfactants
3. Anaheim	New Jersey Anaheim,	8 acres	Surfactants
4. Winder	California Winder,	202 acres	Surfactants
5. Maywood	Georgia Maywood,	19 acres	Surfactants /
6. Columbus	New Jersey Columbus, Georgia	29.8 acres	Specialty Products Polymers
7. Pasadena	Pasadena, Texas	50 acres	Surfactants
8. Stepan France	Voreppe, France	20 acres	Surfactants
9. Stepan Mexico	Matamoros, Mexico	13 acres	Surfactants
10. Stepan Ecatepec	Ecatepec, Mexico	34 acres	Surfactants
11. Stepan Germany	Wesseling,	12 acres	Polymers
12. Stepan UK	Germany Stalybridge,	11 acres	Surfactants
13. Stepan Colombia	United Kingdom Manizales,	5 acres	Surfactants
14. Stepan China	Colombia Nanjing, China (Nanjing Chemical Industrial Park)	13 acres (right of use arrangement)	Polymers
15. Stepan Brazil	Vespasiano, Minas Gerais, Brazil	27 acres	Surfactants
16. Tebras Tensoativos Do Brasil Ltda. and PBC Industria Quimica Ltda.	Salto, Sao Paulo, Brazil	14 acres	Surfactants
17. Stepan Philippines	Bauan, Batangas, Philippines	9 acres (leased)	Surfactants
18. Stepan Poland	Brzeg Dolny, Poland	4 acres (perpetual use right)	Polymers
19. Stepan Asia	Jurong Island, Singapore	8 acres (leased)	Surfactants
20. Company Headquarters and Central Research Laboratories	Northfield,	8 acres	N/A

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21. Company Corporate Supply Chain, Human Resources, Legal and Finance Functions	Illinois Northbrook, Illinois	3.25 acres	N/A
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Item 3. Legal Proceedings

There are a variety of legal proceedings pending or threatened against the Company that occur in the normal course of the Company's business, the majority of which relate to environmental matters. 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 CERCLA and the Superfund amendments of 1986 (Superfund) as well as comparable regulations applicable to the Company's foreign locations. Over the years, the Company has received requests for information relative to or has been named by government authorities as a potentially responsible party (PRP) at a number of 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 is likely to incur with respect to these sites. For most of these sites, the involvement of the Company is expected to be minimal. Material legal proceedings are described below:

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 the 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. USEPA has not yet issued a ROD for chemically-contaminated groundwater for the Maywood site. Based on the most current information available, the Company believes its recorded liability is reasonable having considered the range of estimated cost of remediation for the Maywood site. The 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, if a groundwater ROD is issued 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 entered into an Administrative Settlement Agreement and Administrative Order on Consent with USEPA which requires payment of certain costs and 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 a lawsuit in the U.S. District Court for the District of New Jersey that involved the D'Imperio Property Site located in New Jersey. In 2016, the PRPs were provided with updated 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 is reasonable having considered the range of estimated cost of remediation for the D'Imperio 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.

Wilmington Site

The Company is currently contractually obligated to contribute to the response costs associated with the Company's formerly-owned site in 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. The Company had paid the current owner \$2.6 million for the Company's portion of environmental response costs through December 31, 2018. 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 it has adequate reserves for the claims related to this site. 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.

Federal Insecticide, Fungicide and Rodenticide Act

On March 22, 2017, the Company received a pre-filing notice from USEPA for alleged violations of FIFRA associated with three of the Company's biocide products sold by a licensed distributor. On January 9, 2018, USEPA issued a Consent Agreement and Final Order (CAFO) to the Company for the alleged FIFRA violations. The CAFO assessed a civil penalty of \$131,440, which the Company paid on January 16, 2018.

Other Matters

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

Item 4. Mine Safety Disclosures

Not Applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

(a) The Company's common stock is listed and traded on the New York Stock Exchange under the symbol SCL. On January 31, 2019, there were 1,698 holders of record of the Company's common stock.

(b) Below is a summary by month of shares purchases by the Company during the fourth quarter of 2018:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October	1,426	⁽²⁾ \$ 84.37	—	—
November	3,783	⁽³⁾ \$ 80.72	2,100	⁽⁴⁾ 518,175
December	23,888	⁽⁴⁾ \$ 76.70	23,888	⁽⁴⁾ 494,287
Total	29,097	\$ 77.60	25,988	494,287

(1) On February 19, 2013, the Company's Board of Directors authorized the Company to repurchase up to 1,000,000 shares of its outstanding common stock.

(2) Represents shares tendered by employees to settle statutory withholding taxes related to the distribution of performance stock awards.

(3) Includes 1,683 shares of Company common stock tendered by employees to settle statutory withholding taxes related to the exercise of SARs.

(4) Represents shares of Company common stock purchased on the open market.

(c) Stock Performance Graph

The following stock performance graph compares the yearly change since December 31, 2013, in cumulative return on the common stock of the Company on a dividend reinvested basis to the Dow Jones Chemical Industry Index and the Russell 2000 Index. The Dow Jones Chemical Industry Index is a market-capitalization weighted grouping of 35 chemical companies, including major manufacturers of both basic and specialty products. The Company is not included in the Dow Jones Chemical Industry Index. The Russell 2000 Index is a market-capitalization weighted grouping of 2,000 small to medium sized companies in a broad range of industries. The Company has been included in the Russell 2000 Index since 1992. The graph assumes \$100 was invested on December 31, 2013, and shows the cumulative total return as of each December 31 thereafter.

Item 6. Selected Financial Data

(In thousands, except per share data)

For the Year	2018	2017	2016	2015	2014
Net Sales	\$ 1,993,857	\$ 1,925,007	\$ 1,766,166	\$ 1,776,167	\$ 1,927,213
Operating Income ^(a)	151,419	147,195	127,830	124,918	90,931
Percent of Net Sales	7.6	% 7.6	% 7.2	% 7.0	% 4.7
Income Before Provision for Income Taxes	139,923	139,237	113,816	102,856	75,535
Percent of Net Sales	7.0	% 7.2	% 6.4	% 5.8	% 3.9
Provision for Income Taxes	27,173	47,690	27,618	26,819	18,454
Net Income Attributable to Stepan Company	112,762	91,578	86,191	75,968	57,101
Per Diluted Share	4.83	3.92	3.73	3.32	2.49
Percent of Net Sales	5.7	% 4.8	% 4.9	% 4.3	% 3.0
Percent to Total Stepan Company					
Stockholders' Equity ^(b)	14.8	% 13.3	% 14.5	% 13.9	% 10.5
Cash Dividends Paid	20,857	18,907	17,329	16,300	15,387
Per Common Share	0.9300	0.8600	0.7800	0.7300	0.6900
Depreciation and Amortization	81,115	79,022	74,967	66,985	63,804
Capital Expenditures	86,647	78,613	103,076	119,349	101,819
Weighted-average Common Shares					
Outstanding (Diluted)	23,325	23,377	23,094	22,858	22,917
As of Year End					
Working Capital	\$463,948	\$468,483	\$388,276	\$376,329	\$326,043
Current Ratio	2.4	2.5	2.3	2.5	2.3
Property, Plant and Equipment, Net	608,892	598,443	582,714	555,463	524,195
Total Assets	1,484,666	1,470,861	1,353,890	1,239,661	1,162,014
Long-term Debt Obligations, Less Current					
Maturities	239,022	268,299	288,859	313,817	246,897
Total Stepan Company Stockholders' Equity	783,766	740,096	634,604	556,984	535,546

(a) The 2017, 2016, 2015 and 2014 amounts for the noted line item have been immaterially changed from the amounts originally reported as a result of the Company's first quarter 2018 adoption of Accounting Standards Update (ASU) No. 2017-7, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.

(b) Based on average equity.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis (MD&A) of certain significant factors that have affected the Company's financial condition and results of operations during the annual periods included in the accompanying consolidated financial statements.

Overview

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

Surfactants – Surfactants, which accounted for 70 percent of the Company's consolidated net sales in 2018, are principal ingredients in consumer and industrial cleaning products such as detergents for washing clothes, dishes, carpets, floors and walls, as well as shampoos and body washes. Other applications include fabric softeners, germicidal quaternary compounds, lubricating ingredients, emulsifiers for spreading agricultural products and industrial applications such as latex systems, plastics and composites. Surfactants are manufactured at five North American sites, two European sites (United Kingdom and France – Germany ceased Surfactant production in the fourth quarter of 2018), five Latin American sites (Colombia and two sites in each of Mexico and Brazil) and two Asian sites (Philippines and Singapore). Recent significant Surfactants events include:

- o In March 2018, the Company, through a subsidiary in Mexico, acquired a production facility and a portion of its related surfactant business from BASF Mexicana, S.A. DE C.V. (BASF) (see Note 20, Acquisitions, for additional details).
- o During the third quarter of 2018, the Company approved a plan to shut down Surfactants operations at its plant site in Germany (see Note 22, Business Restructuring and Asset Impairments, for additional details).
- o During the fourth quarter of 2017, the Company approved a plan to restructure a portion of its Fieldsboro, New Jersey production facility (see Note 22, Business Restructuring and Asset Impairments, for additional details).
- o In 2016, the Company shut down its production facility in Canada, moving the production of goods previously manufactured in Canada to other Company North American production sites. Manufacturing operations at that facility ceased in the fourth quarter of 2016 but decommissioning activities continued throughout 2018 (see Note 22, Business Restructuring and Asset Impairments, for additional details).

Polymers – Polymers, which accounted for 26 percent of consolidated net sales in 2018, include polyurethane polyols, polyester resins and phthalic anhydride. Polyurethane polyols are used in the manufacture of rigid foam for thermal insulation in the construction industry and are also a base raw material for coatings, adhesives, sealants and elastomers (collectively, CASE products). Powdered polyester resins are used in coating applications. CASE and polyester resins are collectively referred to as specialty polyols. 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, the Company uses phthalic anhydride internally in the production of polyols. In the United States, polyurethane polyols and phthalic anhydride are manufactured at the Company's Millsdale, Illinois, site, and specialty polyols are manufactured at the Company's Columbus, Georgia, site. In Europe, polyurethane polyols are manufactured by the Company's subsidiary in Germany, and specialty polyols are manufactured by the Company's Poland subsidiary. In China, polyurethane polyols and specialty polyols are manufactured at the Company's Nanjing, China, manufacturing plant.

Specialty Products – Specialty Products, which accounted for four percent of consolidated net sales in 2018, include flavors, emulsifiers and solubilizers used in food, flavoring, nutritional supplement and pharmaceutical applications. Specialty products are primarily manufactured at the Company's Maywood, New Jersey, site and, in some instances, at outside contractors.

2018 Acquisition

On March 26, 2018, the Company, through a subsidiary in Mexico, acquired BASF production facility in Ecatepec, Mexico, and a portion of its related surfactants business. The facility, which is near Mexico City, has over 50,000 metric tons of capacity, 124,000 square feet of warehouse space, a laboratory and office space. The acquisition supports the Company's growth strategy in Latin America. The Company believes that this acquisition should enhance its market position and supply capabilities for surfactants in Mexico and position the Company to grow in both the consumer and functional surfactants markets. See Note 20, Acquisitions, for additional details.

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 presented in the following table:

	Income (Expense)		
	For the Year		
	Ended December 31		
(In millions)	2018	2017	Change
Deferred Compensation (Operating expenses)	\$2.3	\$(4.8)	\$ 7.1 (1)
Investment Income (Other, net)	1.5	0.9	0.6
Realized/Unrealized Gains (Losses) on Investments			
(Other, net)	(2.7)	4.0	(6.7)
Pretax Income Effect	\$1.1	\$0.1	\$ 1.0

	Income (Expense)		
	For the Year		
	Ended December 31		
(In millions)	2017	2016	Change
Deferred Compensation (Operating expenses)	\$(4.8)	\$(16.8)	\$ 12.0 (1)
Investment Income (Other, net)	0.9	0.6	0.3
Realized/Unrealized Gains on Investments			
(Other, net)	4.0	0.1	3.9
Pretax Income Effect	\$0.1	\$(16.1)	\$ 16.2

(1) See the applicable Corporate Expenses section of this MD&A for details regarding the period-to-period changes in deferred compensation.

Below are the year-end Company common stock market prices used in the computation of deferred compensation income and expense:

December 31

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	2018	2017	2016	2015
Company Stock Price	\$74.00	\$78.97	\$81.48	\$49.69

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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 year-over-year comparisons of financial statement items (i.e., because foreign exchange rates fluctuate, similar year-to-year local currency results for a foreign subsidiary may translate into different U.S. dollar results). The following tables present the effects that foreign currency translation had on the year-over-year changes in consolidated net sales and various income line items for 2018 compared to 2017 and 2017 compared to 2016:

(In millions)	For the Year Ended		Increase	to Foreign Currency
	December 31	December 31		
	2018	2017		Translation
Net Sales	\$1,993.9	\$1,925.0	\$ 68.9	\$ 0.1
Gross Profit	341.5	338.5	3.0	(0.7)
Operating Income	151.4	147.2	4.2	(0.6)
Pretax Income	139.9	139.2	0.7	(0.5)

(In millions)	For the Year Ended		Increase	to Foreign Currency
	December 31	December 31		
	2017	2016		Translation
Net Sales	\$1,925.0	\$1,766.2	158.8	\$ 9.9
Gross Profit	338.5	339.0	(0.5)	2.6
Operating Income	147.2	127.8	19.4	1.7
Pretax Income	139.2	113.8	25.4	1.6

(1)The 2017 and 2016 gross profit and operating income line items have been immaterially changed from the amounts originally reported as a result of the Company's first quarter 2018 adoption of ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715).

Results of Operations

2018 Compared with 2017

Summary

Net income attributable to the Company for 2018 increased 23 percent to \$112.8 million, or \$4.83 per diluted share, from \$91.6 million, or \$3.92 per diluted share, for 2017. Adjusted net income increased five percent to \$113.8 million, or \$4.88 per diluted share, from \$108.7 million, or \$4.65 per diluted share in 2017 (see the "Reconciliations of Non-GAAP Adjusted Net Income and Diluted Earnings per Share" section of this MD&A for reconciliations between reported net income attributable to the Company and reported earnings per diluted share and non-GAAP adjusted net income and adjusted earnings per diluted share). 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 performance for 2018 compared to 2017 follows the summary.

Consolidated net sales increased \$68.9 million, or four percent, between years. Higher sales volume, higher selling prices and the favorable impact of foreign currency translation positively impacted net sales by \$64.7 million, \$4.1 million and \$0.1 million, respectively. Total Company sales volume increased three percent. Sales volume increased five percent and three percent for the Surfactants and Specialty Products segments, respectively. Sales volume declined three percent for the Polymers segment. Unit margins improved for Surfactants and Specialty Products and declined for Polymers.

Operating income improved \$4.2 million, or 3 percent, between years. Most of this improvement was related to lower 2018 deferred compensation expense which declined by \$7.1 million. Operating income improved for the Surfactant and Specialty Products segments and declined for the Polymers segment. Business restructuring expenses were \$0.5 million lower in the current year and corporate expenses were up \$3.4 million year-over-year. Foreign currency translation had an unfavorable \$0.6 million effect on year-over-year consolidated operating income.

Operating expenses (including deferred compensation expense and business restructuring expenses) decreased \$1.2 million, or one percent, between years. Changes in the individual income statement line items that comprise the Company's operating expenses were as follows:

• Selling expenses increased \$2.2 million, or four percent, year over year largely due to higher salaries and cloud-based application expense. A portion of the higher salaries is attributable to the 2018 acquisition in Mexico.

• Administrative expenses increased \$3.6 million, or five percent, year over year. The increase was primarily due to higher employee separation costs and salaries.

• Research, development and technical service (R&D) expenses increased \$0.6 million, or one percent, year over year.

• Deferred compensation was income of \$2.3 million in 2018 versus expense of \$4.9 million in 2017. See the "Overview" and "Segment Results - Corporate Expenses" sections of this MD&A for further details.

• Business restructuring expenses were \$2.6 million in 2018 versus \$3.1 million in 2017. Current year restructuring charges are comprised of asset and spare part write-downs related to the Company's decision to cease Surfactant operations in Germany (\$1.4 million) and decommissioning costs associated with the Company's manufacturing facility in Canada, which ceased operations in the fourth quarter of 2016 (\$1.2 million). The 2017 restructuring charges related to decommissioning costs associated with the Canadian plant closure (\$2.0 million), severance costs related to a partial restructuring of the Company's production facility in Fieldsboro, New Jersey (\$0.9 million) and workforce reduction expense at the Company's Singapore plant. These business restructuring charges were excluded from the determination of segment operating income. See Note 22 to the consolidated financial statements for additional information.

Net interest expense for 2018 declined \$0.7 million, or six percent, from net interest expense for 2017. The decline in interest expense was principally attributable to higher interest income earned on excess cash and lower average debt levels due to scheduled repayments.

Other, net was \$0.7 million of expense in 2018 versus \$3.5 million of income in 2017. The Company recognized \$1.4 million of investment losses (including realized and unrealized gains and losses) for the Company's deferred compensation and supplemental defined contribution mutual fund assets in 2018 compared to \$5.1 million of gains in 2017. Partially offsetting this decrease was foreign exchange gains of \$1.9 million in 2018 compared to foreign exchange losses of \$0.6 million in 2017. In addition, the Company reported \$1.2 million of net periodic pension cost in 2018 versus \$1.0 million of net periodic pension cost in 2017.

The year-to-date effective tax rate was 19.4 percent in 2018 compared to 34.3 percent in 2017. This decrease was primarily attributable to the following items: (a) a lower U.S. statutory tax rate of 21 percent in 2018 versus a rate of 35 percent in 2017; and (b) the enactment of U.S. tax reform which resulted in a net tax cost of \$14.9 million in 2017 that did not recur in 2018. The 2018 benefits were partially offset by certain unfavorable U.S. tax reform changes that became effective on January 1, 2018 (i.e., global intangible low-taxed income, non-deductible executive compensation, and the repeal of the domestic production activities deduction). In addition, during the third quarter of 2018, the Company filed applications to automatically change certain tax accounting methods related to the 2017 tax year. These method changes provided a favorable tax benefit that was partially offset by the negative tax impact recognized as a result of the Company's decision to repatriate approximately \$100.0 million of foreign cash in the fourth quarter of 2018. See Note 9 to the consolidated financial statements for a reconciliation of the statutory U.S. federal income tax rate to the effective tax rate.

Segment Results

(In thousands)	For the Year Ended		Increase (Decrease)	Percent Change
	December 31, 2018	December 31, 2017		
Net Sales				
Surfactants	\$1,385,932	\$1,297,555	\$ 88,377	7
Polymers	527,420	546,634	(19,214)	-4
Specialty Products	80,505	80,818	(313)	0
Total Net Sales	\$1,993,857	\$1,925,007	\$ 68,850	4

(In thousands)	For the Year Ended		Increase (Decrease)	Percent Change
	December 31, 2018	December 31, 2017 ⁽¹⁾		
Operating Income				
Surfactants	\$137,506	\$120,861	\$ 16,645	14
Polymers	64,539	82,951	(18,412)	-22
Specialty Products	11,661	9,965	1,696	17
Segment Operating Income	\$213,706	\$213,777	\$(71)	0
Corporate Expenses, Excluding Deferred Compensation and Restructuring	62,028	58,656	3,372	6
Deferred Compensation Expense (Income)	(2,329)	4,857	(7,186)	NM
Business Restructuring and Asset Impairments	2,588	3,069	(481)	-16
Total Operating Income	\$151,419	\$147,195	\$ 4,224	3

(1)The 2017 segment and total operating income line items have been immaterially changed from the amounts originally reported as a result of the Company's first quarter 2018 adoption of ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715).

Surfactants

Surfactants 2018 net sales increased \$88.4 million, or seven percent, over net sales reported in 2017. Higher sales volume and selling prices accounted for \$69.5 million and \$26.2 million, respectively, of the year-over-year increase in net sales. Sales volume increased five percent year-over-year. The unfavorable effects of foreign currency translation negatively impacted the year-over-year change in net sales by \$7.3 million. A year-over-year comparison of net sales by region follows:

(In thousands)	For the Year Ended		Increase (Decrease)	Percent Change
	December 31,	December 31,		

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	2018	2017		
North America	\$831,592	\$763,044	\$ 68,548	9
Europe	276,742	275,121	1,621	1
Latin America	212,824	190,802	22,022	12
Asia	64,774	68,588	(3,814)	-6
Total Surfactants Segment	\$1,385,932	\$1,297,555	\$ 88,377	7

Net sales for North American operations increased nine percent between years. Sales volume increased six percent which favorably impacted the change in net sales by \$42.0 million. The sales volume growth was largely driven by higher sales volume of products used in personal care and oilfield applications. Sales volume of general surfactants to our distribution partners also increased. Average selling prices increased three percent between years and positively impacted the year-over-year change in net sales by \$26.4 million. The increase in selling prices was largely due to a more favorable mix of sales. Foreign currency translation positively impacted the change in net sales by \$0.1 million. The foreign currency impact reflected a weaker U.S. dollar relative to the Canadian dollar.

Net sales for European operations increased one percent versus prior year. The favorable effects of foreign currency translation positively impacted the year-over-year change in net sales by \$11.8 million. A weaker U.S. dollar relative to the European euro and British pound sterling led to the foreign currency effect. Lower selling prices of four percent unfavorably impacted the year-over-year change in net sales by \$10.5 million. Sales volume was flat versus the prior year. Net sales in 2017 were positively impacted by \$4.7 million related to a favorable resolution of a prior year customer claim (see Note 23 to the consolidated financial statements for further information).

Net sales for Latin American operations increased \$22.0 million, or 12 percent, primarily due a 12 percent increase in sales volume and higher selling prices. These two items accounted for \$22.5 million and \$16.1 million, respectively, of the year-over-year change in net sales. The higher volume is mostly related to the Company's first quarter acquisition in Ecatepec, Mexico and partially offset by lower demand and lost commodity business in Brazil. The higher selling prices primarily reflect the pass through to customers of increased raw material costs. Foreign currency translation negatively impacted the year-over-year change in net sales by \$16.6 million. The foreign currency translation primarily reflects the year-over-year weakening of the Brazilian real and Mexican peso relative to the U.S. dollar.

Net sales for Asian operations declined \$3.8 million, or six percent, primarily due to the negative impact of foreign currency translation and lower average selling prices. These items negatively impacted the year-over-year change in net sales by \$2.5 million and \$2.0 million, respectively. The foreign currency impact primarily reflected a weaker Philippine peso relative to the U.S. dollar. Sales volume increased one percent, which positively impacted the year-over-year change in net sales by \$0.7 million. The sales volume increase was mostly due to higher sales of general surfactants to our distribution partners.

Surfactant operating income for 2018 increased \$16.6 million, or 14 percent, versus operating income reported in 2017. Gross profit increased \$20.1 million, primarily due to improved results for North American operations. Operating expenses increased \$3.4 million, or four percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

	For the Year Ended		Increase	Percent
	December 31,	December 31,		
(In thousands)	2018	2017 ⁽¹⁾	(Decrease)	Change
Gross Profit and Operating Income				
North America	\$ 158,773	\$ 132,585	\$ 26,188	20
Europe	30,540	31,706	(1,166)	-4
Latin America	26,574	29,061	(2,487)	-9
Asia	17,030	19,488	(2,458)	-13
Surfactants Segment Gross Profit	\$ 232,917	\$ 212,840	\$ 20,077	9
Operating Expenses	95,411	91,979	3,432	4
Operating Income	\$ 137,506	\$ 120,861	\$ 16,645	14

(1)The 2017 gross profit, operating expenses and operating income line items have been immaterially changed from the amounts originally reported as a result of the Company's first quarter 2018 adoption of ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715).

Gross profit for North American operations increased 20 percent, or \$26.2 million, between years primarily due to higher unit margins and higher sales volumes. These items positively impacted the year-over-year change in gross profit by \$18.9 million and \$7.3 million, respectively. The higher unit margins were primarily due to a more favorable customer and product mix. Higher year-over-year sales of products used in personal care, agricultural and oilfield applications, along with products sold to our distribution partners contributed to the 2018 volume growth.

Gross profit for European operations decreased four percent between years principally due to the aforementioned non-recurring \$4.7 million favorable customer claim resolution in 2017. Lower unit margins, principally due to the

non-recurrence of the prior year favorable customer claim resolution, negatively impacted the year-over-year change in gross profit by \$2.5 million. Foreign currency translation positively affected the change in gross profit by \$1.3 million. Sales volume was flat year-over-year.

Gross profit for Latin American operations decreased \$2.5 million, or nine percent, year-over-year primarily due to lower unit margins and the negative impact of foreign currency translation. These items unfavorably impacted the change in year-over-year gross profit by \$3.1 million and \$2.8 million, respectively. The lower unit margins principally related to higher integration and start-up costs associated with the Company's first quarter 2018 acquisition in Ecatepec, Mexico. Sales volume growth of 12 percent positively impacted current year gross profit by \$3.4 million. This growth primarily reflects the Company's first quarter acquisition in Mexico partially offset by lower demand and lost commodity business in Brazil. The Ecatepec, Mexico acquisition was slightly accretive to Latin America gross profit in 2018.

Asia gross profit decreased 13 percent largely due to lower unit margins and the unfavorable impact of foreign currency translation. These item unfavorably impacted the year-over-year change in gross profit by \$2.3 million and \$0.4 million, respectively. Sales volume growth of one percent positively impacted the year-over-year change in gross profit by \$0.2 million.

Operating expenses for the Surfactants segment increased \$3.4 million, or four percent, year-over-year. Most of this increase was attributable to higher North American expenses. The higher North American expenses were primarily due to higher consulting fees, salaries, and cloud-based application expense.

Polymers

Polymer net sales for 2018 decreased \$19.2 million, or four percent, over net sales for 2017. Lower sales volumes and selling prices negatively impacted the year-over-year change in net sales by \$16.9 million and \$9.0 million, respectively. The favorable effects of foreign currency translation positively impacted the year-over-year change in net sales by \$6.7 million. The foreign currency effect reflected a weaker U.S. dollar relative to the Polish zloty. A year-over-year comparison of net sales by region follows:

	For the Year Ended			
	December	December	Increase	Percent
	31,	31,		
(In thousands)	2018	2017	(Decrease)	Change
North America	\$323,360	\$329,629	\$ (6,269)	-2
Europe	172,632	188,244	(15,612)	-8
Asia and Other	31,428	28,761	2,667	9
Total Polymers Segment	\$527,420	\$546,634	\$ (19,214)	-4

Net sales for North American operations declined two percent due to a sales volume decline of two percent and slightly lower selling prices. These items negatively impacted the year-over-year change in net sales by \$5.5 million and \$0.8 million, respectively. Sales volume of phthalic anhydride and polyols used in rigid foam applications declined three and one percent, respectively. Sales volume of polyols used in rigid foam applications increased six percent in the second half of 2018 due to recaptured market share. Sales volume of specialty polyols was flat with the prior year.

Net sales for European operations decreased eight percent primarily due to a seven percent decline in sales volume and lower selling prices which negatively impacted the year-over-year change in net sales by \$12.8 million and \$9.5 million, respectively. The lower volume was principally due to customer inventory builds prior to the end of 2017, the carryover effect of the 2017 MDI shortage and extended winter weather which delayed the start of construction projects. The effects of foreign currency translation positively impacted the year-over-year change in net sales by \$6.7 million.

Net sales for Asia and Other operations increased nine percent between years due a six percent increase in sales volume, higher selling prices and the favorable effects of foreign currency translation. These items accounted for \$1.6 million, \$1.0 million and \$0.1 million, respectively, of the year-over-year net sales increase.

Polymer operating income for 2018 declined \$18.4 million, or 22 percent, compared to operating income for 2017. Gross profit decreased \$18.5 million, or 17 percent, primarily due to a three percent decline in sales volumes and lower unit margins. Operating expenses were flat versus prior year. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

For the Year Ended

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	December 31,	December 31,	Increase	Percent
(In thousands)	2018	2017 ⁽¹⁾	(Decrease)	Change
Gross Profit and Operating Income				
North America	\$67,034	\$79,582	\$(12,548)	-16
Europe	24,756	31,451	(6,695)	-21
Asia and Other	892	114	778	682
Polymers Segment Gross Profit	\$92,682	\$111,147	\$(18,465)	-17
Operating Expenses	28,143	28,196	(53)	0
Operating Income	\$64,539	\$82,951	\$(18,412)	-22

(1)The 2017 gross profit, operating expenses and operating income line items have been immaterially changed from the amounts originally reported as a result of the Company's first quarter 2018 adoption of ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715).

Gross profit for North American operations declined 16 percent year-over-year primarily due to lower unit margins and a two percent decline in sales volume. These two items negatively impacted the year-over-year change in gross profit by \$11.2 million and \$1.3 million, respectively. The decline in margins primarily reflected competitive market pressures.

Gross profit for European operations declined 21 percent primarily due to lower unit sales margins and a seven percent decline in sales volume. These items negatively impacted the year-over-year change in gross profit by \$5.6 million and \$2.1 million, respectively. The lower margins were primarily due to higher overhead resulting from lower production throughput in 2018 versus 2017. The favorable impact of foreign currency translation positively impacted the year-over-year change in gross profit by \$1.0 million.

Gross profit for Asia and Other operations improved \$0.8 million primarily due to higher unit margins and the favorable impact of foreign currency translation. These items positively impacted the year-over-year change in gross profit by \$0.7 million and \$0.1 million, respectively.

Operating expenses for the Polymers segment decreased \$0.1 million year-over-year.

Specialty Products

Net sales for 2018 were flat with the prior year. Sales volume was up three percent versus the prior year. Operating income increased \$1.7 million versus prior year primarily due to the higher sales volume and improved unit margins.

Corporate Expenses

Corporate expenses, which include deferred compensation and other operating expenses that are not allocated to the reportable segments, declined \$4.3 million year-over-year to \$62.3 million in 2018 from \$66.6 million in 2017. The decline in corporate expenses was primarily attributable to lower deferred compensation expense (\$7.2 million) and business restructuring expense (\$0.5 million). These decreases were partially offset by higher 2018 employee separation costs and salaries.

Deferred compensation was \$2.3 million of income in 2018 compared to \$4.9 million of expense in 2017. The favorable year-over-year change was primarily due to less mutual fund related expense incurred in the current year combined with a steeper drop in Stepan share price in 2018 versus 2017.

	December 31			
	2018	2017	2016	2015
Company Stock Price	\$74.00	\$78.97	\$81.48	\$49.69

2017 Compared with 2016

Summary

Net income attributable to the Company for 2017 increased six percent to \$91.6 million, or \$3.92 per diluted share, from \$86.2 million, or \$3.73 per diluted share, for 2016. Adjusted net income increased 11 percent to \$108.7 million, or \$4.65 per diluted share, from \$98.2 million, or \$4.25 per diluted share in 2016 (see the “Reconciliations of Non-GAAP Adjusted Net Income and Diluted Earnings per Share” section of this MD&A for reconciliations between reported net income attributable to the Company and reported earnings per diluted share and non-GAAP adjusted net income and adjusted earnings per diluted share). 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 performance for 2017 compared to 2016 follows the summary.

Consolidated net sales increased \$158.9 million, or nine percent, between years. Higher average selling prices favorably affected the year-over-year net sales change by \$174.5 million. The increase in average selling prices was

mostly attributable to the pass through of higher raw material costs within the Surfactants and Polymers segments. Consolidated sales volume declined one percent, which had a \$25.5 million unfavorable impact on the year-over-year change in net sales. Sales volume decreased two percent and seven percent for the Surfactants and Specialty Products segments, respectively. Sales volume was flat year-over-year for the Polymers segment. Foreign currency translation positively affected the year-over-year net sales change by \$9.9 million. The favorable foreign currency translation effect reflected a weaker U.S. dollar against the majority of currencies for countries where the Company has foreign operations. Unit margins improved for Surfactants and declined for Polymers and Specialty Products.

Operating income improved \$19.4 million, or 15 percent, between years. Most of this improvement was related to lower 2017 deferred compensation expense and lower business restructuring and asset impairment charges, which declined by \$11.9 million and \$4.0 million, respectively. Operating income improved for the Surfactant segment and declined for the Polymers and Specialty Products segments. The Surfactant segment operating income increased 20 percent largely due to the non-recurrence of two customer claims incurred in 2016 (\$7.4 million), a favorable resolution of one of the prior year claims in 2017 (\$4.7 million), improved product mix, higher unit margins, savings from the 2016 Canadian plant shutdown and the full year accretive impact of the October 2016

Tebras and PBC acquisitions in Brazil. The Polymers segment operating income declined 15 percent primarily due to lower sales volume and unit margins in North America. Foreign currency translation had a favorable \$1.7 million effect on the consolidated operating income.

Operating expenses (including deferred compensation expense and business restructuring and asset impairment expenses) decreased \$20.1 million, or 10 percent, between years. Changes in the individual income statement line items that comprise the Company's operating expenses were as follows:

• Selling expenses decreased \$2.8 million, or five percent, year over year largely due to lower U.S. fringe benefit expenses (\$2.4 million). The lower fringe benefits were primarily due to lower incentive-based compensation expense (stock-based compensation and bonuses). Higher expenses associated with Tebras and PBC, acquired in October 2016, partially offset the consolidated decrease in selling expenses.

• Administrative expenses increased \$0.8 million, or one percent, year over year. The increase was primarily due to higher legal and consulting expenses, partially offset by lower U.S. fringe benefit expenses resulting from lower incentive-based compensation expense.

• Research, development and technical service (R&D) expenses decreased \$2.1 million, or four percent, year over year primarily due to lower U.S. fringe benefit expenses resulting from lower incentive-based compensation expense.

• Deferred compensation plan expense was \$11.9 million lower in 2017 than in 2016 primarily due to a \$2.51 per share decrease in the market price of Company common stock in 2017 versus a \$31.79 per share increase in 2016. See the "Overview" and "Corporate Expenses" sections of this MD&A for further details.

• Business restructuring and asset impairment charges totaled \$3.1 million in 2017 versus \$3.1 million in 2016. 2017 restructuring charges are primarily comprised of decommissioning costs related to the Company's Canadian plant closure (\$2.0 million) and severance costs related to a partial restructuring of the Company's production facility in Fieldsboro, New Jersey (\$0.9 million). The 2016 restructuring expenses primarily related to the closure of the Company's surfactant plant in Canada (\$2.8 million) and severance costs related to a partial restructuring of the Company's production facility in Fieldsboro. See Note 22 to the consolidated financial statements for additional information. The business restructuring and asset impairment charges were excluded from the determination of segment operating income.

Net interest expense for 2017 declined \$1.8 million, or 13 percent, from net interest expense for 2016. The decline in interest expense was principally attributable to higher interest income earned on excess cash and lower average debt levels due to scheduled repayments.

Other, net was income of \$3.5 million for 2017 versus \$0.8 million of expense in 2016. Most of the increase in income was attributable to investment income (including realized and unrealized gains and losses) from the Company's deferred compensation and supplemental defined contribution mutual fund assets. Investment income (including realized and unrealized gains and losses) was \$5.1 million in 2017 versus \$0.8 million in 2016, an increase of \$4.4 million year-over-year. Partially offsetting this increase was foreign exchange activity, which resulted in a \$0.6 million loss in 2017 versus an insignificant loss in 2016. Other, net also included net periodic benefit cost, which was \$1.0 million expense in 2017 versus \$1.6 million expense in 2016.

The effective tax rate was 34.3 percent in 2017 compared to 24.3 percent in 2016. The increase was primarily attributable to the enactment of the U.S. Tax Cuts and Jobs Act (Tax Act) which resulted in a net tax cost of \$14.9 million. This net expense consists of a net benefit attributable to the U.S. federal corporate income tax rate reduction of \$4.5 million and a net expense attributable to the Transition Tax of \$19.4 million. The increase in the effective tax rate attributable to the Tax Act was partially offset by the following favorable nonrecurring items: 1) a foreign tax credit benefit from the repatriation of foreign earnings, and 2) a tax benefit from a change in accounting method related to tax depreciation. See Note 9 to the consolidated financial statements for a reconciliation of the statutory U.S.

federal income tax rate to the effective tax rate.

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Segment Results

(In thousands)	For the Year Ended		Increase (Decrease)	Percent Change
	December 31, 2017	December 31, 2016		
Net Sales				
Surfactants	\$1,297,555	\$1,181,563	\$ 115,992	10
Polymers	546,634	498,826	47,808	10
Specialty Products	80,818	85,777	(4,959)	-6
Total Net Sales	\$1,925,007	\$1,766,166	\$ 158,841	9

(In thousands)	For the Year Ended		Increase	Percent Change
	December 31, 2017	December 31, 2016		
Operating Income			(Decrease)	
Surfactants	\$120,861	\$101,092	\$ 19,769	20
Polymers	82,951	97,102	(14,151)	-15
Specialty Products	9,965	10,725	(760)	-7
Segment Operating Income	\$213,777	\$208,919	\$ 4,858	2
Corporate Expenses, Excluding Deferred				
Compensation and Restructuring	58,656	57,220	1,436	3
Deferred Compensation Expense (Income)	4,857	16,805	(11,948)	-71
Business Restructuring and Asset Impairments	3,069	7,064	(3,995)	-57
Total Operating Income	\$147,195	\$127,830	\$ 19,365	15

Surfactants

Surfactants 2017 net sales increased \$116.0 million, or 10 percent, from net sales reported in 2016. Higher selling prices and the favorable effects of foreign currency translation accounted for \$139.7 million and \$1.8 million, respectively, of the year-over-year increase in net sales. The increase in selling prices mostly reflected the pass through to customers of higher costs for certain raw materials and more favorable sales mix. The favorable sales mix was primarily attributable to higher sales of products used in household, industrial and institutional (HI&I), agricultural and oilfield applications. Sales volume decreased two percent between years, which had a \$25.5 million negative effect on year-over-year net sales. All regions, except Latin America, experienced sales volume declines. The majority of the sales volume decline was attributable to lower commodity surfactant demand. The Latin America sales volume increase was principally due to the full year impact of the region's October 2016 acquisitions of Tebras and PBC. A year-over-year comparison of net sales by region follows:

(In thousands)	For the Year Ended		Increase	Percent Change
	December 31,	December 31,		

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	2017	2016		
North America	\$763,044	\$724,619	\$38,425	5
Europe	275,121	237,489	37,632	16
Latin America	190,802	151,229	39,573	26
Asia	68,588	68,226	362	1
Total Surfactants Segment	\$1,297,555	\$1,181,563	\$115,992	10

Net sales for North American operations increased five percent between years. Higher selling prices and the favorable effect of foreign currency translation positively affected the year-over-year change in net sales by \$58.8 million and \$0.6 million, respectively. A three percent decline in sales volume offset the impacts of selling prices and currency translations by \$21.0 million. Selling prices increased eight percent year-over-year mainly due to the pass through of certain increased raw material costs to customers and to a more favorable mix of sales. The three percent decline in sales volume reflected decreased sales of commodity products used in laundry and cleaning and personal care applications partially offset by increased sales of products used in HI&I, agricultural and oilfield applications. The foreign currency impact reflected a weaker U.S. dollar relative to the Canadian dollar.

Net sales for European operations increased 16 percent from 2016 to 2017. Most of this increase was attributable to higher selling prices which favorably affected the year-over-year change in net sales by \$44.4 million. The increase in selling prices primarily resulted from the pass through of higher costs for certain raw materials. A three percent decline in sales volume and the unfavorable effect of foreign currency translation negatively affected the year-over-year change in net sales by \$6.0 million and \$0.8 million, respectively. The decline in sales volume was largely attributable to lower demand for personal care commodity anionics and reduced sales volumes of general surfactants sold through our distribution partners, partially offset by higher demand for agricultural

chemicals. A weaker British pound sterling, partially offset by a stronger Euro, relative to the U.S. dollar, accounted for the foreign currency effect. Net sales in 2016 were negatively impacted by \$7.4 million of expense from two customer claims (see Note 23 to the consolidated financial statements for further information) whereas net sales in 2017 were positively impacted by \$4.7 million related to a favorable resolution of one of the prior year claims.

Net sales for Latin American operations increased 26 percent due to higher selling prices, a seven percent increase in sales volume and the favorable impact of foreign currency translation, which accounted for \$23.2 million, \$10.8 million and \$5.6 million, respectively, of the year-over-year increase in net sales. Selling prices increased 14 percent due to the pass through to customers of higher raw material costs and a more favorable mix of sales. The improved sales volume reflected new business associated with the October 2016 acquisition of Tebras and PBC and higher demand for agricultural chemicals, partially offset by lower demand and lost commodity business for products used in laundry and cleaning applications. The year-over-year strengthening of the Brazilian real and the Colombian peso against the U.S. dollar generated the favorable foreign currency effect. Net sales in 2016 included \$4.3 million of compensation for future lost revenue related to a negotiated settlement with a major customer under contract with the region's Bahia, Brazil, plant that exited the product line for which the Company supplied them product (see Note 22 to the consolidated financial statements for further information).

Net sales for Asian operations increased one percent primarily due to a 23 percent increase in average selling prices. Higher average selling prices, primarily resulting from the pass through of certain increased raw material costs, favorably impacted net sales by \$13.3 million. Lower sales volume and the effect of foreign currency translation negatively affected the year-over-year change in net sales by \$9.2 million and \$3.7 million, respectively. The 14 percent sales volume decline was primarily due to weaker demand for commodity laundry and cleaning products. A weaker Philippine peso relative to the U.S. dollar caused the negative foreign currency translation adjustment.

Surfactant operating income for 2017 increased \$19.8 million, or 20 percent, from operating income reported in 2016. The operating income increase was due to higher 2017 gross profit of \$16.0 million and lower operating expenses of \$3.7 million. The eight percent increase in gross profit was largely due to the non-recurrence of the aforementioned European customer claims incurred in 2016, a favorable resolution of one of the customer claims in 2017 and more favorable sales mix resulting from higher sales of products used in HI&I, agricultural and oilfield applications. Gross profit for 2016 was also negatively affected by accelerated depreciation (\$4.5 million) related to the Canadian plant shutdown whereas gross profit for 2017 was negatively impacted by accelerated depreciation (\$1.3 million) related to the Fieldsboro, New Jersey plant restructuring. Lower manufacturing costs resulting from the prior year plant closures in Canada and Brazil also benefited 2017 gross profit. The effects of foreign currency translation had a favorable \$1.2 million impact on the year-over-year gross profit change. Operating expenses decreased \$3.7 million, or four percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

	For the Year Ended			
	December	December	Increase	Percent
	31,	31,		
(In thousands)	2017	2016 (a)	(Decrease)	Change
Gross Profit and Operating Income				
North America	\$ 132,585	\$ 124,431	\$ 8,154	7
Europe	31,706	23,246	8,460	36
Latin America	29,061	28,374	687	2

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Asia	19,488	20,502	(1,014)	-5
Surfactants Segment Gross Profit	\$212,840	\$196,553	\$16,287	8
Operating Expenses	91,979	95,949	(3,970)	-4
Operating Income	\$120,861	\$100,604	\$20,257	20

(a) In 2017, the Company changed its internal financial statement classification for certain transportation costs, transferring such costs from operating expenses to cost of sales. In this segment discussion, the 2016 North America gross profit and total operating expenses have been changed from the amounts presented before to make such amounts consistent with the current year classification. Surfactant segment operating income remained unchanged.

Gross profit for North American operations increased seven percent principally due to improved product mix. The improved product mix primarily reflects decreased sales of commodity products used in laundry and cleaning and personal care applications partially offset by increased sales of products used in HI&I, agricultural and oilfield applications. The current year also benefited from lower manufacturing costs resulting from the closure of the Company's Canada manufacturing operations in the fourth quarter of 2016. The Company incurred \$4.5 million of accelerated depreciation associated with the Canadian plant closure in 2016 versus \$1.3 million of accelerated depreciation associated with the restructuring of the Fieldsboro, New Jersey plant in 2017.

Gross profit for European operations increased 36 percent between years largely due to the aforementioned non-recurring \$7.4 million customer claims incurred in 2016 and a favorable customer claim resolution in 2017 of \$4.7 million. Gross profit also improved due to more favorable product mix principally resulting from higher demand for agricultural chemicals. Prior year manufacturing costs also included approximately \$0.6 million of expenses associated with the planned 30-day mandatory inspection shutdown of the Company's plant in Germany. There was no such inspection in 2017. Foreign currency translation positively affected the change in gross profit by \$0.8 million.

Gross profit for Latin American operations improved one percent mainly due to a more profitable mix of sales, the full year contribution of the October 2016 Tebras and PBC acquisitions and lower manufacturing costs resulting from the prior year Bahia, Brazil plant closure. Gross profit in 2016 included \$4.3 million of income resulting from a negotiated customer contract termination settlement related to the Bahia, Brazil plant closure. Foreign currency translation positively impacted the change in gross profit by \$1.0 million.

Asia gross profit decreased five percent largely due to the 14 percent decrease in sales volume mostly related to the Company's Philippine operations. Foreign currency translation, mostly related to a weaker Philippine peso relative to the U.S. dollar, negatively impacted the change in gross profit by \$0.7 million.

Operating expenses for the Surfactants segment decreased \$3.7 million, or four percent, year-over-year. Most of this decrease was attributable to lower North American expenses. North American expenses were down primarily due to lower U.S. incentive-based compensation, primarily related to stock-based compensation and bonuses. The North American decrease was partially offset by higher Latin American expenses resulting from the full year impact of the October 2016 Tebras and PBC acquisitions.

Polymers

Polymer net sales for 2017 increased \$47.8 million, or 10 percent, over net sales for 2016. Higher selling prices, resulting from the pass through of increased costs for certain raw materials, and the positive effect of foreign currency translation favorably affected the year-over-year net sales change by \$40.9 million and \$7.9 million, respectively. Sales volume, essentially flat between years, had a \$1.0 million unfavorable effect on the year-over-year net sales change. A decline in North American sales volume was offset by sales volume improvement in Europe and Asia. The foreign currency translation effect reflected a weaker U.S. dollar relative to the Polish zloty. A year-over-year comparison of net sales by region follows:

	For the Year Ended		Increase	Change
	December 31,	December 31,		
(In thousands)	2017	2016		
North America	\$329,629	\$319,769	\$9,860	3
Europe	188,244	153,986	34,258	22
Asia and Other	28,761	25,071	3,690	15
Total Polymers Segment	\$546,634	\$498,826	\$47,808	10

Net sales for North American operations increased three percent due to higher selling prices, partially offset by lower sales volumes. Selling prices increased five percent, which had a \$15.4 million positive effect on the year-over-year change in net sales. The pass through of certain higher raw material costs to customers led to increased selling prices. Sales volume declined two percent which unfavorably impacted the net sales change by \$5.5 million. Sales volume of polyols used in rigid foam applications declined two percent mainly due to lost share from one major

customer. Phthalic anhydride sales volume declined seven percent. Sales volume of specialty polyols increased eight percent due to greater demand for product used in CASE applications and powdered resins.

Net sales for European operations increased 22 percent due to higher selling prices, the favorable effect of foreign currency translation and a three percent increase in sales volumes, which accounted for \$22.4 million, \$7.9 million and \$4.0 million, respectively, of the year-over-year net sales increase. Selling prices increased 14 percent primarily due to the pass through to customers of cost increases for certain raw materials. The sales volume improvement was primarily attributable to increased sales of specialty polyols, which reflected the Company's successful efforts to utilize the production capacity of its new reactor in Poland. Sales volume also grew slightly due to increased demand for polyols used in rigid foam insulation and insulated metal panels.

Net sales for Asia and Other operations increased 15 percent between years due to higher selling prices, a two percent increase in sales volume and the favorable effect of foreign currency, which accounted for \$3.1 million, \$0.5 million and \$0.1 million, respectively, of the year-over-year net sales increase.

Polymer operating income for 2017 declined \$14.2 million, or 15 percent, compared to operating income for 2016. Gross profit decreased \$15.0 million, or 12 percent, primarily due to reduced margins and lower sales volumes in North American operations. European operations reported a 14 percent gross profit improvement due to sales volume growth and lower manufacturing costs. Operating expenses declined \$0.8 million, or three percent, versus prior year. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

	For the Year Ended		Increase	Percent
	December 31,	December 31,		
(In thousands)	2017	2016 ^(a)	(Decrease)	Change
Gross Profit and Operating Income				
North America	\$79,582	\$96,665	\$(17,083)	-18
Europe	31,451	27,702	3,749	14
Asia and Other	114	1,737	(1,623)	-93
Polymers Segment Gross Profit	\$111,147	\$126,104	\$(14,957)	-12
Operating Expenses	28,196	29,002	(806)	-3
Operating Income	\$82,951	\$97,102	\$(14,151)	-15

(a) In 2017, the Company changed its internal financial statement classification for certain transportation costs, transferring such costs from operating expenses to cost of sales. In this segment discussion, the 2016 North America gross profit and total operating expenses have been changed from the amounts presented before to make such amounts consistent with the current year classification. Polymer segment operating income remained unchanged.

Gross profit for North American operations declined 18 percent year over year primarily due to reduced margins and a two percent decline in sales volume. The decline in margins reflected the effect of higher raw material costs that, due to competitive reasons, could not entirely be passed on to customers.

Gross profit for European operations increased 14 percent primarily due to a three percent increase in sales volume and lower unit manufacturing costs. The 2016 results were negatively affected by higher plant expenses that resulted from the planned 30-day mandatory inspection shutdown of manufacturing operations in Germany during the third quarter of 2016. As a result of the shutdown, 2016 plant expenses included \$2.4 million of inspection and storage expenses not incurred in 2017. The favorable effects of foreign currency translation positively impacted the year-over-year change in gross profit by \$1.2 million.

Gross profit for Asia and Other operations declined 93 percent despite a two percent increase in sales volume. Most of the decline was attributable to higher overhead costs incurred in 2017. Overhead costs were lower in 2016 as the Nanjing plant benefited from higher throughput to supply material to the Company's European market to compensate for the mandatory shutdown at the German plant. The intercompany production reduced site overhead in 2016.

Operating expenses for the Polymers segment decreased \$0.8 million, or three percent, year over year largely due to lower U.S. incentive-based compensation expense.

Specialty Products

Net sales for 2017 declined \$5.0 million, or six percent, compared to net sales for 2016. A seven percent decrease in sales volume accounted for most of the net sales decline. Most of the sales volume decrease was attributable to lower

demand for food ingredient applications and nutritional supplemental products. Operating income decreased \$0.8 million year over year primarily due to the lower sales volume partially offset by more favorable product mix.

Corporate Expenses

Corporate expenses, which are comprised of deferred compensation and other operating expenses that are not allocated to the reportable segments, declined \$14.5 million year-over-year to \$66.6 million in 2017 from \$81.1 million in 2016. The decline in corporate expense was primarily attributable to lower deferred compensation expense (\$11.9 million), U.S. incentive-based compensation (\$2.4 million) and the previously discussed restructuring and impairment charges (\$4.0 million). These decreases were partially offset by higher legal and consulting related expenses (\$3.6 million) in 2017.

Deferred compensation was \$4.9 million of expense for 2017 compared to \$16.8 million of expense for 2016. The lower expense primarily resulted from a \$2.51 per share decrease in the value of Company common stock over the twelve months ended December 31, 2017, compared to a \$31.79 per share increase for the same period of 2016. The following table presents the year-end Company common stock market prices used in the computation of deferred compensation expense:

	December 31		
	2017	2016	2015
Company Stock Price	\$78.97	\$81.48	\$49.69

Liquidity and Capital Resources

Overview

Historically, the Company's principal sources of liquidity have included cash flows from operating activities, available cash and cash equivalents and the use of available borrowing facilities. The Company's principal uses of cash have included funding operating activities, capital investments and acquisitions.

For the twelve months ended December 31, 2018, operating activities were a cash source of \$171.1 million versus a source of \$198.9 million for the comparable period in 2017. For the current year, investing cash outflows totaled \$107.8 million, as compared to an outflow of \$82.7 million in the prior year period, and financing activities were a use of \$51.6 million, as compared to a use of \$50.5 million in the prior year period. Cash and cash equivalents increased by \$1.3 million compared to December 31, 2017, including an unfavorable exchange rate impact of \$10.4 million.

As of December 31, 2018, the Company's cash and cash equivalents totaled \$300.2 million. Cash in U.S. demand deposit accounts and money market funds totaled \$61.0 million and \$141.6 million, respectively. The Company's non-U.S. subsidiaries held \$97.6 million of cash outside the United States as of December 31, 2018.

Operating Activity

Net income in 2018 increased by \$21.2 million versus the comparable period in 2017. Working capital was a cash use of \$39.2 million in 2018 versus a source of \$19.3 million in 2017.

Accounts receivable were a source of \$5.2 million in 2018 compared to a use of \$16.4 million in 2017. Inventories were a use of \$26.8 million in 2018 versus a source of \$5.7 million in 2017. Accounts payable and accrued liabilities were a use of \$19.0 million in 2018 compared to a source of \$30.5 million for the same period in 2017.

Working capital requirements were higher in 2018 compared to 2017 primarily due to the changes noted above. The change in inventories was primarily due to higher quantities, a portion which related to the Company's first quarter acquisition in Ecatepec, Mexico. The change in accrued liabilities was primarily related to lower U.S. tax liabilities in 2018 versus 2017. It is management's opinion that the Company's liquidity is sufficient to provide for potential increases in working capital requirements during 2019.

Investing Activity

Cash used for investing activities increased \$25.1 million year-over-year. Cash outflows from investing activities included capital expenditures of \$86.6 million compared to \$78.6 million in 2017. Other investing activities were a use of \$21.2 million in 2018 versus a use of \$4.1 million in 2017. The increase in other investing activities was

primarily attributable to a use of \$22.9 million cash related to the acquisition of a surfactant production facility in Ecatepec, Mexico and a portion of their related surfactant business during the first quarter of 2018.

For 2019, the Company estimates that total capital expenditures will range from \$120 million to \$140 million including infrastructure and optimization spending in the United States, Mexico and Brazil.

Financing Activity

Cash flow from financing activities was a use of \$51.6 million in 2018 versus a use of \$50.5 million in 2017.

The Company purchases shares of its common stock in the open market or from its benefit plans from time to time to fund its own benefit plans and also to mitigate the dilutive effect of new shares issued under its benefit plans. The Company may, from time to time, seek to retire or purchase additional amounts of its outstanding equity and/or debt securities through cash purchases and/or exchanges for other securities, in open market purchases, privately negotiated transactions or otherwise, including pursuant to plans meeting the requirements of Rule 10b5-1 promulgated by the SEC. Such repurchases or exchanges, if any, will depend on prevailing market conditions, the Company's liquidity requirements, contractual restrictions and other factors. The amounts involved may be material. For the twelve months ended December 31, 2018, the Company purchased 205,983 shares at a total cost of \$15.5 million. At December 31, 2018, there were 494,287 shares remaining under the current share repurchase authorization.

Debt and Credit Facilities

Consolidated balance sheet debt decreased by \$14.7 million for 2018, from \$290.8 million to \$276.1 million, primarily due to lower domestic debt. In 2018, net debt (which is defined as total debt minus cash – See the “Reconciliation of Non-GAAP Net Debt” section of this MD&A) decreased by \$16.0 million, from a negative \$8.1 million to a negative \$24.1 million.

As of December 31, 2018, the ratio of total debt to total debt plus shareholders' equity was 26.0 percent compared to 28.2 percent at December 31, 2017. As of December 31, 2018, the ratio of net debt to net debt plus shareholders' equity was negative 3.2 percent, compared to negative 1.1 percent at December 31, 2017. At December 31, 2018, the Company's debt included \$268.3 million of unsecured private placement loans with maturities ranging from 2019 through 2027 which were issued to insurance companies pursuant to note purchase agreements (the Note Purchase Agreements). These notes are the Company's primary source of long-term debt financing and are supplemented by bank credit facilities to meet short and medium-term needs.

On January 30, 2018, the Company entered into a five year committed \$350 million multi-currency revolving credit facility that matures on January 30, 2023 with a syndicate of banks. This credit facility replaced the Company's prior \$125 million credit agreement. Loans under the credit agreement may be incurred, at the discretion of the Company, with terms to maturity of one to six months. The Company may choose from two interest rate options: (1) LIBOR applicable to each currency plus spreads ranging from 1.25 percent to 1.875 percent, depending on the Company's net leverage ratio, or (2) the prime rate plus 0.25 percent to 0.875 percent, depending on the Company's net leverage ratio. The credit agreement requires the Company to pay a commitment fee ranging from 0.15 percent to 0.325 percent per annum, which also depends on the Company's net leverage ratio.

The Company's outstanding Note Purchase Agreements were amended effective January 30, 2018 to make certain covenants consistent with those included in the credit agreement. As of December 31, 2018, the Company had outstanding letters of credit totaling \$4.7 million under the revolving credit agreement and no borrowings. There was \$345.3 million remaining available under the revolving credit agreement as of December 31, 2018.

The Company anticipates that cash from operations, committed credit facilities and cash on hand will be sufficient to fund anticipated capital expenditures, working capital, dividends and other planned financial commitments for the foreseeable future.

Certain foreign subsidiaries of the Company maintain short-term bank lines of credit in their respective local currencies to meet working capital requirements as well as to fund capital expenditure programs and acquisitions. At

December 31, 2018, the Company's foreign subsidiaries had outstanding debt of \$7.8 million.

The Company has material debt agreements that require the maintenance of minimum interest coverage and minimum net worth. These agreements also limit the incurrence of additional debt as well as the payment of dividends and repurchase of treasury shares. As of December 31, 2018, testing for these agreements was based on the Company's consolidated financial statements. Under the most restrictive of these debt covenants:

1. The Company is required to maintain a minimum interest coverage ratio, as defined within the agreements, not to exceed 3.50 to 1.00, for the preceding four calendar quarters.
2. The Company is required to maintain a maximum net leverage ratio, as defined within the agreements, not to exceed 3.50 to 1.00.
3. The Company is required to maintain net worth of at least \$325.0 million.

4. The Company is permitted to pay dividends and purchase treasury shares after December 31, 2017, in amounts of up to \$100.0 million plus 100 percent of net income and cash proceeds of stock option exercises, measured cumulatively December 31, 2017. The maximum amount of dividends that could have been paid within this limitation is disclosed as unrestricted retained earnings in Note 6 to the consolidated financial statements. The Company believes it was in compliance with all of its loan agreements as of December 31, 2018.

Contractual Obligations

At December 31, 2018, the Company's contractual obligations, including estimated payments by period, were as follows:

(In thousands)	Payments Due by Period				
	Total	Less than 1 year	1-3 years	3 – 5 years	More than 5 years
Long-term debt obligations ^(a)	\$277,058	\$37,058	\$72,858	\$81,430	\$85,712
Interest payments on debt obligations ^(b)	46,668	10,966	17,917	11,039	6,746
Operating lease obligations	49,997	9,740	14,321	9,343	16,593
Purchase obligations ^(c)	5,489	3,966	1,523	—	—
Other ^(d)	31,247	8,447	2,620	2,550	17,630
Total	\$410,459	\$70,177	\$109,239	\$104,362	\$126,681

(a) Excludes unamortized debt issuance costs of \$1.0 million.

(b) Interest payments on debt obligations represent interest on all Company debt at December 31, 2018. The interest payment amounts related to the variable rate component of the Company's debt assume that interest will be paid at the rates prevailing at December 31, 2018. Future interest rates may change, and, therefore, actual interest payments could differ from those disclosed in the above table.

(c) Purchase obligations consist of raw material, utility and telecommunication service purchases made in the normal course of business.

(d) The "Other" category comprises deferred revenues that represent commitments to deliver products, expected 2019 required contributions to the Company's funded defined benefit pension plans, estimated payments related to the Company's unfunded defined benefit supplemental executive and outside director pension plans, estimated payments (undiscounted) related to the Company's asset retirement obligations, environmental remediation payments for which amounts and periods can be reasonably estimated and income tax liabilities for which payments and periods can be reasonably estimated.

The above table does not include \$86.9 million of other non-current liabilities recorded on the balance sheet at December 31, 2018, as summarized in Note 15 to the consolidated financial statements. The significant non-current liabilities excluded from the table are defined benefit pension, deferred compensation, environmental and legal liabilities and unrecognized tax benefits for which payment periods cannot be reasonably determined. In addition, deferred income tax liabilities are excluded from the table due to the uncertainty of their timing.

Pension Plans

The Company sponsors a number of defined benefit pension plans, the most significant of which cover employees in its U.S. and U.K. locations. The U.S. and U.K. plans are frozen, and service benefit accruals are no longer being made. The underfunded status (pretax) of the Company's defined benefit pension plans was \$23.8 million at December 31, 2018 versus \$23.3 million at December 31, 2017. See Note 13, Postretirement Benefit Plans, to the

consolidated financial statements for additional details.

The Company contributed \$5.8 million to its defined benefit plans in 2018. In 2019, the Company expects to contribute a total of \$0.5 million to the U.K. defined benefit plan. As a result of pension funding relief included in the Highway and Transportation Funding Act of 2014, the Company has no 2019 contribution requirement to the U.S. pension plans. Payments to participants in the unfunded non-qualified plans should approximate \$0.3 million in 2019, which is the same as payments made in 2018.

Letters of Credit

The Company maintains standby letters of credit under its workers' compensation insurance agreements and for other purposes as needed. The insurance letters of credit are renewed annually and amended to the amounts required by the insurance agreements. As of December 31, 2018, the Company had a total of \$4.7 million of outstanding standby letters of credit.

Off-Balance Sheet Arrangements

The Securities and Exchange Commission requires disclosure of off-balance sheet arrangements that either have, or are reasonably likely to have, a current or future effect on the Company's financial condition, changes in financial condition, revenues or

expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. During the periods covered by this Form 10-K, the Company was not party to any such off-balance sheet arrangements.

Environmental and Legal Matters

The Company's operations are subject to extensive federal, state and local environmental laws and regulations or similar laws in the other countries in which the Company does business. Although the Company's environmental policies and practices are designed to ensure compliance with these regulations, future developments and increasingly stringent environmental regulation may require the Company to make additional unforeseen environmental expenditures. The Company will continue to invest in the equipment and facilities necessary to comply with existing and future regulations. During 2018, the Company's expenditures for capital projects related to the environment were \$5.4 million. Expenditures related to capital projects related to the environment projects are capitalized and depreciated over their estimated useful lives, which are typically 10 years. Recurring costs associated with the operation and maintenance of facilities for waste treatment and disposal and managing environmental compliance in ongoing operations at the Company's manufacturing locations were approximately \$28.3 million for 2018, \$28.2 million for 2017 and \$25.0 million for 2016.

Over the years, the Company has received requests for information related to or has been named by government authorities as a potentially responsible party at a number of waste disposal sites where cleanup costs have been or may be incurred under CERCLA and similar state or foreign 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 is likely to incur with respect to the sites. See the Critical Accounting Policies section that follows for a discussion of the Company's environmental liabilities accounting policy. After partial remediation payments at certain sites, the Company has estimated a range of possible environmental and legal losses from \$23.4 million to \$44.7 million at December 31, 2018, compared to \$24.2 million to \$45.4 million at December 31, 2017. Within the range of possible environmental losses, currently management has concluded that there are no amounts within the ranges that are more likely to occur than any other amounts in the ranges and, thus, has accrued at the lower end of the ranges; that accrual totaled \$23.4 million at December 31, 2018 as compared to \$24.2 million at December 31, 2017. Because the liabilities accrued are estimates, actual amounts could differ from the amounts reported. During 2018, cash outlays related to legal and environmental matters approximated \$1.6 million compared to \$2.0 million expended in 2017.

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. 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, management believes that the Company has no liability at these sites and that these matters, individually and in the aggregate, will not have a material effect on the Company's financial position.

See Item 3, Legal Proceedings, in this Form 10-K and Note 16, Contingencies, in the Notes to Consolidated Financial Statements for a summary of the significant environmental proceedings related to certain environmental sites.

Outlook

After record results in each of the past three years, management believes that its Surfactants segment will continue to benefit from diversification efforts into functional products, new technologies, improved internal efficiencies and

expanded sales into its broad customer base globally. Management believes that its Polymer segment will benefit from the growing market for insulation materials and will deliver both full year volume growth and incremental margin improvement versus 2018. Management believes that its Specialty Products segment will improve year over year.

Climate Change Legislation

Based on currently available information, the Company does not believe that existing or pending climate change legislation or regulation is reasonably likely to have a material effect on the Company's financial condition, results of operations or cash flows.

Critical Accounting Policies

The Company prepares its financial statements in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles or GAAP). Preparation of financial statements in accordance with generally

accepted accounting principles requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The following is a summary of the accounting policies the Company believes are the most important to aid in understanding its financial results:

Deferred Compensation

The Company sponsors deferred compensation plans that allow management employees to defer receipt of their annual bonuses and outside directors to defer receipt of their fees until retirement, departure from the Company or as elected by the participant. The plans allow for the deferred compensation to grow or decline based on the results of investment options chosen by the participants. The investment options include Company common stock and a limited selection of mutual funds. The Company funds the obligations associated with these plans by purchasing investment assets that match the investment choices made by the plan participants. A sufficient number of shares of treasury stock are maintained on hand to cover the equivalent number of shares that result from participants electing the Company common stock investment option. As a result, the Company must periodically purchase its common shares in the open market or in private transactions. Upon retirement or departure from the Company, participants receive cash amounts equivalent to the payment date value of the investment choices they have made or Company common stock shares equal to the number of share equivalents held in the accounts.

Some plan distributions may be made in cash or Company common stock at the option of the participant. Other plan distributions can only be made in Company common stock. For deferred compensation obligations that may be settled in cash, the Company must record appreciation in the market value of the investment choices made by participants as additional compensation expense. Conversely, declines in the value of Company stock or the mutual funds result in a reduction of compensation expense since such declines reduce the cash obligation of the Company as of the date of the financial statements. These market price movements may result in significant period-to-period fluctuations in the Company's income. The increases or decreases in compensation expenses attributable to market price movements are reported in the operating expenses section of the consolidated statements of income. Because the obligations that must be settled only in Company common stock are treated as equity instruments, fluctuations in the market price of the underlying Company stock do not affect earnings.

At December 31, 2018 and December 31, 2017, the Company's deferred compensation liability was \$50.5 million and \$58.9 million, respectively. In 2018 and 2017, approximately 53 percent and 55 percent, respectively, of deferred compensation liability represented deferred compensation tied to the performance of the Company's common stock. The remainder of the deferred compensation liability was tied to the chosen mutual fund investment assets. A \$1.00 increase in the market price of the Company's common stock will result in approximately \$0.4 million of additional compensation expense. A \$1.00 reduction in the market price of the common stock will reduce compensation expense by a like amount. The expense or income associated with the mutual fund component will generally fluctuate in line with the overall percentage increase or decrease of the U.S. stock markets.

The mutual fund assets related to the deferred compensation plans are recorded on the Company's balance sheet at cost when acquired and adjusted to their market values at the end of each reporting period. As allowed by generally accepted accounting principles, the Company elected the fair value option for recording the mutual fund investment assets. Therefore, market value changes for the mutual fund investment assets are recorded in the income statement in the same periods that the offsetting changes in the deferred compensation liabilities are recorded. Dividends, capital gains distributed by the mutual funds and realized and unrealized gains and losses related to mutual fund shares are recognized as investment income or loss in the other, net line of the consolidated statements of income.

Environmental Liabilities

It is the Company's accounting policy to record environmental liabilities when environmental assessments and/or remedial efforts are probable and the cost or range of possible costs can be reasonably estimated. When no amount within a range of possible costs is a better estimate than any other amount, the minimum amount in the range is accrued. Some of the factors on which the Company bases its estimates include information provided by feasibility studies, potentially responsible party negotiations and the development of remedial action plans.

Estimates for environmental liabilities are subject to potentially significant fluctuations as new facts emerge related to the various sites where the Company is exposed to liability for the remediation of environmental contamination. See the Environmental and Legal Matters section of this MD&A for discussion of the Company's recorded liabilities and range of cost estimates.

Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The Company's contracts typically have a single performance obligation that is satisfied at the time product is shipped and control passes

to the customer as compared to the “risk and rewards” criteria used in prior years. For a small portion of the business, performance obligations are deemed satisfied when product is delivered to a customer location. For arrangements where the Company consigns product to a customer location, revenue is recognized when the customer uses the inventory. The Company accounts for shipping and handling as activities to fulfill a promise to transfer a good. As such, shipping and handling fees billed to customers in a sales transaction are recorded in Net Sales and shipping and handling costs incurred are recorded in Cost of Sales. Volume and cash discounts due customers are estimated and recorded in the same period as the sales to which the discounts relate and are reported as reductions of revenue in the consolidated statements of income. See Note 21 to the consolidated financial statements for more details.

Recent Accounting Pronouncements

See Note 1 to the consolidated financial statements, included in Part II, Item 8, for information on recent accounting pronouncements which affect the Company.

Reconciliations of Non-GAAP Adjusted Net Income and Dilutive Earnings per Share

(In millions, except per share amounts)	Twelve Months Ended December 31					
	2018		2017		2016	
	Net Income	Diluted EPS	Net Income	Diluted EPS	Net Income	Diluted EPS
Net Income Attributable to the Company as Reported	\$ 112.8	\$ 4.83	\$ 91.6	\$ 3.92	\$ 86.2	\$ 3.73
Deferred Compensation (Income) Expense	(1.1)	(0.04)	(0.1)	—	16.1	0.70
Business Restructuring and Asset Impairments	2.6	0.11	3.1	0.13	7.1	0.30
Contract Termination Settlement	—	—	—	—	(4.3)	(0.18)
Cumulative Tax Effect on Above Adjustment Items	(0.5)	(0.02)	(0.8)	(0.04)	(6.9)	(0.30)
Tax Reform Impact	—	—	14.9	0.64	—	—
Adjusted Net Income	113.8	\$ 4.88	\$ 108.7	\$ 4.65	\$ 98.2	\$ 4.25

The Company believes that certain non-GAAP measures, when presented in conjunction with comparable GAAP measures, are useful for evaluating the Company’s operating performance and provide better clarity on the impact of non-operational items. Internally, the Company uses this non-GAAP information as an indicator of business performance and evaluates management’s effectiveness with specific reference to these indicators. These measures should be considered in addition to, not a substitute for or superior to, measures of financial performance prepared in accordance with GAAP. The cumulative tax effect was calculated using the statutory tax rates for the jurisdictions in which the transactions occurred.

Reconciliations of Non-GAAP Net Debt

(In millions)	December 31	
	2018	2017
Current Maturities of Long-Term Debt as Reported	\$ 37.1	\$ 22.5
Long-Term Debt as Reported	\$ 239.0	\$ 268.3
Total Debt as Reported	\$ 276.1	\$ 290.8
Less Cash and Cash Equivalents as Reported	\$(300.2)	\$(298.9)
Net Debt	\$(24.1)	\$(8.1)

Management uses the non-GAAP net debt metric to show a more complete picture of the Company's overall liquidity, financial flexibility and leverage level. This adjusted measure should be considered supplemental to and not a substitute for financial information prepared in accordance with GAAP. The Company's definition of this adjusted measure may differ from similarly titled measures used by other entities.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Exchange Risk

Because the Company operates globally, its cash flows and operating results are subject to movements in foreign currency exchange rates. Except for the financial transactions, balances and forward contracts referred to below, most of the Company's foreign subsidiaries' financial instruments are denominated in their respective functional currencies.

The Company uses forward contracts to mitigate the exposure of certain foreign currency transactions and balances to fluctuating exchange rates. At December 31, 2018, the Company had forward contracts with an aggregated notional amount of \$28.9 million. Except for the Company's subsidiaries in Brazil, China and Colombia, foreign currency exposures are substantially hedged by forward contracts. The fair value of all forward contracts as of December 31, 2018, was a net asset of \$0.2 million. As of December 31, 2018, the potential reduction in the Company's earnings resulting from the impact of hypothetical adverse changes in exchange rates on the fair value of its outstanding foreign currency contracts of 10 percent for all currencies would have been \$2.7 million.

Interest Rates

The Company's debt was made up of fixed-rate and variable-rate borrowings totaling \$269.3 million and \$7.8 million, respectively, as of December 31, 2018. For 2019, it is projected that interest related expenses on short-term variable-rate borrowings will total approximately \$0.7 million. A hypothetical 10 percent average change to short-term interest rates would result in less than a \$0.1 million increase or decrease to interest expense for 2019.

The fair value of the Company's long term fixed-rate debt, including current maturities, was estimated to be \$266.3 million as of December 31, 2018, which was approximately \$3.0 million below the carrying value. Market risk was estimated as the potential increase to the fair value that would result from a hypothetical 10 percent decrease in the Company's weighted average long-term borrowing rates at December 31, 2018, or \$4.4 million.

Commodity Price Risk

Certain raw materials used in the manufacture of the Company's products are subject to price volatility caused by weather, petroleum price fluctuations, general economic demand and other unpredictable factors. Increased raw material costs are recovered from customers as quickly as the marketplace allows; however, certain contractual arrangements allow for price changes only on a quarterly basis, and competitive pressures sometimes prevent the recovery of cost increases from customers, particularly in periods where there is excess industry capacity. As a result, for some product lines or market segments it may take time to recover raw material price increases. Periodically, firm purchase commitments are entered into which fix the price of a specific commodity that will be delivered at a future time. Forward purchase contracts are used to aid in managing the Company's natural gas costs. At December 31, 2018, the Company had open forward contracts for the purchase of 0.9 million dekatherms of natural gas at a cost of \$2.4 million. Because the Company has agreed to fixed prices for the noted quantity of natural gas, a hypothetical 10 percent fluctuation in the price of natural gas would cause the Company's actual natural gas cost to be \$0.2 million higher or lower than the cost at market price.

Item 8. Financial Statements and Supplementary Data

The following statements and data are included in this item:

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<u>Consolidated Statements of Income (For years ended December 31, 2018, 2017 and 2016)</u>	42
<u>Consolidated Statements of Comprehensive Income (For years ended December 31, 2018, 2017 and 2016)</u>	43
<u>Consolidated Balance Sheets (December 31, 2018 and 2017)</u>	44
<u>Consolidated Statements of Cash Flow (For years ended December 31, 2018, 2017 and 2016)</u>	45
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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of:

Stepan Company

Northfield, Illinois

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Stepan Company and subsidiaries (the “Company”) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2019, expressed an unqualified opinion on the Company’s internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatements of the financial statements, whether due to error or fraud, and performing procedures that respond to

those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Deloitte & Touche LLP
DELOITTE & TOUCHE LLP

Chicago, Illinois

February 27, 2019

We have served as the Company's auditor since 2002.

Stepan Company

Consolidated Statements of Income

For the years ended December 31, 2018, 2017 and 2016

(In thousands, except per share amounts)	2018	2017	2016
Net Sales (Note 1)	\$1,993,857	\$1,925,007	\$1,766,166
Cost of Sales ^(a)	1,652,354	1,586,485	1,426,897
Gross Profit ^(a)	341,503	338,522	339,269
Operating Expenses:			
Selling (Note 1) ^(a)	56,319	54,090	56,922
Administrative (Note 1) ^(a)	79,243	75,615	74,872
Research, development and technical services (Note 1) ^(a)	54,263	53,696	55,776
Deferred compensation expense (income)	(2,329)	4,857	16,805
	187,496	188,258	204,375
Business restructuring and asset impairments (Note 22)	(2,588)	(3,069)	(7,064)
Operating Income ^(a)	151,419	147,195	127,830
Other Income (Expense):			
Interest, net (Note 6)	(10,771)	(11,444)	(13,205)
Other, net (Note 8) ^(a)	(725)	3,486	(809)
	(11,496)	(7,958)	(14,014)
Income Before Provision for Income Taxes	139,923	139,237	113,816
Provision for Income Taxes (Note 9)	27,173	47,690	27,618
Net Income	112,750	91,547	86,198
Net (Income) Loss Attributable to Noncontrolling Interests (Note 1)	12	31	(7)
Net Income Attributable to Stepan Company	\$112,762	\$91,578	\$86,191
Net Income Per Common Share Attributable to Stepan Company (Note 18):			
Basic	\$4.90	\$3.99	\$3.78
Diluted	\$4.83	\$3.92	\$3.73
Shares Used to Compute Net Income Per Common Share			
Attributable to Stepan Company (Note 18):			
Basic	23,022	22,946	22,793
Diluted	23,325	23,377	23,094

(a) The 2017 and 2016 amounts for the noted line items have been immaterially changed from the amounts originally reported as a result of the Company's first quarter 2018 adoption of ASU No. 2017-7, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.

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

Stepan Company

Consolidated Statements of Comprehensive Income

For the years ended December 31, 2018, 2017 and 2016

(In thousands)	2018	2017	2016
Net Income	\$112,750	\$91,547	\$86,198
Other Comprehensive Income (Loss):			
Foreign currency translation adjustments (Note 19)	(37,966)	26,293	(8,533)
Defined benefit pension plans:			
Net actuarial gain (loss) arising in period (net of taxes of \$2,300, \$771 and \$3,391 for 2018, 2017 and 2016, respectively)	(7,080)	(582)	3,818
Amortization of prior service cost included in pension expense (net of taxes of \$3, \$4 and \$4 for 2018, 2017 and 2016, respectively)	10	10	10
Amortization of actuarial loss included in pension expense (net of taxes of \$979, \$1,240 and \$1,301 for 2018, 2017 and 2016, respectively)	3,080	2,269	2,207
Net defined benefit pension plan activity (Note 19)	(3,990)	1,697	6,035
Cash flow hedges:			
Losses arising in period (net of taxes of \$0, \$0 and \$9 in 2018, 2017 and 2016, respectively)	—	—	(19)
Reclassifications to income in period (net of taxes of \$0, \$0 and \$28 in 2018, 2017 and 2016, respectively)	(10)	(9)	45
Net cash flow hedge activity (Note 19)	(10)	(9)	26
Other Comprehensive Income (Loss)	(41,966)	27,981	(2,472)
Comprehensive Income	70,784	119,528	83,726
Comprehensive (Income) Loss Attributable to Noncontrolling Interests	58	(48)	88
Comprehensive Income Attributable to Stepan Company	\$70,842		