

STEPAN CO
Form 10-Q
August 01, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2018

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

Commission File Number 1-4462

STEPAN COMPANY

(Exact name of registrant as specified in its charter)

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

Edens and Winnetka Road, Northfield, Illinois 60093

(Address of principal executive offices)

Registrant's telephone number (847) 446-7500

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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.

(Check one): Large accelerated filer	Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company) Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the 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

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

Class	Outstanding at July 20, 2018
Common Stock, \$1 par value	22,522,507 Shares

Part I FINANCIAL INFORMATION

Item 1 - Financial Statements

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	June 30 2018	2017	June 30 2018	2017
Net Sales	\$519,866	\$495,101	\$1,019,201	\$963,370
Cost of Sales ^(a)	430,586	405,113	840,351	781,263
Gross Profit ^(a)	89,280	89,988	178,850	182,107
Operating Expenses:				
Selling ^(a)	13,369	13,230	28,259	26,686
Administrative ^(a)	18,098	17,769	37,537	35,661
Research, development and technical services ^(a)	13,720	14,254	27,334	27,633
Deferred compensation expense	(865)	5,016	749	5,392
Business restructuring expenses (Note 15)	(273)	(586)	(631)	(1,372)
Operating Income ^(a)	44,685	39,133	84,340	85,363
Other Income (Expense):				
Interest, net	(2,672)	(2,863)	(5,823)	(5,855)
Other, net ^(a) (Note 14)	484	793	1,644	1,885
	(2,188)	(2,070)	(4,179)	(3,970)
Income Before Provision for Income Taxes	42,497	37,063	80,161	81,393
Provision for Income Taxes (Note 17)	9,574	9,167	16,522	21,585
Net Income	32,923	27,896	63,639	59,808
Net (Income) Loss Attributable to Noncontrolling Interests (Note 2)	2	(14)	9	(13)
Net Income Attributable to Stepan Company	\$32,925	\$27,882	\$63,648	\$59,795
Net Income Per Common Share Attributable to Stepan Company				
(Note 9):				
Basic	\$1.43	\$1.21	\$2.76	\$2.61
Diluted	\$1.41	\$1.19	\$2.73	\$2.56
Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9):				
Basic	23,039	22,953	23,059	22,927
Diluted	23,295	23,381	23,341	23,356

Dividends Declared Per Common Share	\$0.23	\$0.21	\$0.45	\$0.41
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- (a) The 2017 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 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.

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

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

(In thousands)	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2018	2017	2018	2017
Net income	\$32,923	\$27,896	\$63,639	\$59,808
Other comprehensive income :				
Foreign currency translation adjustments (Note 10)	(35,059)	5,997	(26,242)	16,451
Defined benefit pension adjustments, net of tax (Note 10)	752	567	1,505	1,132
Derivative instrument activity, net of tax (Note 10)	(2)	(3)	(5)	(5)
Total other comprehensive income	(34,309)	6,561	(24,742)	17,578
Comprehensive income (loss)	(1,386)	34,457	38,897	77,386
Comprehensive (income) loss attributable to noncontrolling interests (Note 2)	49	(34)	24	(46)
Comprehensive income (loss) attributable to Stepan Company	\$(1,337)	\$34,423	\$38,921	\$77,340

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

STEPAN COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(In thousands)	June 30, 2018	December 31, 2017
Assets		
Current Assets:		
Cash and cash equivalents	\$256,736	\$298,894
Receivables, net	312,220	293,541
Inventories (Note 6)	188,461	172,748
Other current assets	23,136	23,553
Total current assets	780,553	788,736
Property, Plant and Equipment:		
Cost	1,632,103	1,603,286
Less: Accumulated depreciation	(1,032,955)	(1,004,843)
Property, plant and equipment, net	599,148	598,443
Goodwill, net	22,972	25,118
Other intangible assets, net	16,035	18,538
Long-term investments (Note 3)	27,229	28,270
Other non-current assets	12,848	11,756
Total assets	\$1,458,785	\$1,470,861
Liabilities and Equity		
Current Liabilities:		
Current maturities of long-term debt (Note 13)	\$24,312	\$22,500
Accounts payable	201,313	204,977
Accrued liabilities	80,088	92,776
Total current liabilities	305,713	320,253
Deferred income taxes	14,060	10,962
Long-term debt, less current maturities (Notes 13)	262,504	268,299
Other non-current liabilities	114,474	130,433
Commitments and Contingencies (Note 7)		
Equity:		
Common stock, \$1 par value; authorized 60,000,000 shares;		
26,278,816 issued shares in 2018 and 26,070,787 issued shares in 2017	26,279	26,071
Additional paid-in capital	177,779	170,408
Accumulated other comprehensive loss (Note 10)	(124,290)	(99,563)
Retained earnings	775,031	721,741
Less: Common treasury stock, at cost, 3,756,309 shares in 2018		
and 3,561,509 shares in 2017	(93,559)	(78,561)
Total Stepan Company stockholders' equity	761,240	740,096
Noncontrolling interests (Note 2)	794	818
Total equity	762,034	740,914

Total liabilities and equity	\$1,458,785	\$1,470,861
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The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

(In thousands)	Six Months Ended	
	June 30	
	2018	2017
Cash Flows From Operating Activities		
Net income	\$63,639	\$59,808
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	40,500	37,729
Deferred compensation	749	5,392
Realized and unrealized gains on long-term investments	(504)	(2,576)
Stock-based compensation	3,387	4,551
Deferred income taxes	2,463	2,741
Other non-cash items	830	2,972
Changes in assets and liabilities:		
Receivables, net	(23,969)	(33,697)
Inventories	(14,409)	(1,477)
Other current assets	442	(2,050)
Accounts payable and accrued liabilities	(18,579)	(11,777)
Pension liabilities	(122)	(58)
Environmental and legal liabilities	(479)	(469)
Deferred revenues	(162)	(162)
Net Cash Provided By Operating Activities	53,786	60,927
Cash Flows From Investing Activities		
Expenditures for property, plant and equipment	(43,741)	(38,331)
Business acquisition (Note 16)	(21,475)	(4,339)
Other, net	1,775	(2,184)
Net Cash Used In Investing Activities	(63,441)	(44,854)
Cash Flows From Financing Activities		
Revolving debt and bank overdrafts, net	1,893	(7,221)
Other debt repayments	(5,714)	(5,714)
Dividends paid	(10,160)	(9,225)
Company stock repurchased	(12,000)	(1,500)
Stock option exercises	3,274	2,518
Other, net	(4,432)	(1,586)
Net Cash Used In Financing Activities	(27,139)	(22,728)
Effect of Exchange Rate Changes on Cash	(5,364)	4,730
Net Decrease in Cash and Cash Equivalents	(42,158)	(1,925)
Cash and Cash Equivalents at Beginning of Period	298,894	225,743
Cash and Cash Equivalents at End of Period	\$256,736	\$223,818
Supplemental Cash Flow Information		

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Cash payments of income taxes, net of refunds/payments	\$19,739	\$18,288
Cash payments of interest	\$6,444	\$7,101

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2018

Unaudited

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by Stepan Company (the Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate and make the information presented not misleading. In the opinion of management, all adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company's financial position as of June 30, 2018, results of operations for the three and six months ended June 30, 2018 and 2017, and cash flows for the six months ended June 30, 2018 and 2017, have been included. These financial statements and related footnotes should be read in conjunction with the financial statements and related footnotes included in the Company's 2017 Annual Report on Form 10-K.

2. RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to noncontrolling interests for the six months ended June 30, 2018 and 2017:

	Total	Stepan Company	Noncontrolling Interests'
(In thousands)	Equity	Equity	Equity ⁽³⁾
Balance at January 1, 2018	\$740,914	\$740,096	\$ 818
Net income	63,639	63,648	(9)
Dividends	(10,160)	(10,160)	
Common stock purchases ⁽¹⁾	(15,184)	(15,184)	
Stock option exercises	3,274	3,274	
Defined benefit pension adjustments, net of tax	1,505	1,505	
Translation adjustments	(26,242)	(26,227)	(15)
Derivative instrument activity, net of tax	(5)	(5)	
Other ⁽²⁾	4,293	4,293	

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Balance at June 30, 2018 \$762,034 \$761,240 \$ 794

	Total	Stepan Company	Noncontrolling Interests ³
(In thousands)	Equity	Equity	Equity ⁽³⁾
Balance at January 1, 2017	\$635,916	\$634,604	\$ 1,312
Net income	59,808	59,795	13
Dividends	(9,225)	(9,225)	—
Common stock purchases ⁽¹⁾	(3,191)	(3,191)	—
Stock option exercises	2,518	2,518	—
Defined benefit pension adjustments, net of tax	1,132	1,132	—
Translation adjustments	16,451	16,418	33
Derivative instrument activity, net of tax	(5)	(5)	—
Other ⁽²⁾	5,295	5,295	—
Balance at June 30, 2017	\$708,699	\$707,341	\$ 1,358

⁽¹⁾ Includes the value of Company shares purchased in the open market and from the Company's retirement plans and the value of Company common shares tendered by employees to settle statutory withholding taxes related to distributions of deferred performance awards and deferred management incentive compensation and exercises of stock appreciation rights.

⁽²⁾ Primarily comprised of activity related to stock-based compensation and deferred compensation. Beginning in 2018, also includes beginning retained earnings adjustment as a result of the Company's first quarter 2018 adoption of ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory.

⁽³⁾ Reflects the noncontrolling interest in the Company's China joint venture.

3. FAIR VALUE MEASUREMENTS

The following were the financial instruments held by the Company at June 30, 2018, and December 31, 2017, and the methods and assumptions used to estimate the instruments' fair values:

Cash and cash equivalents

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

Derivative assets and liabilities

Derivative assets and liabilities included the foreign currency exchange contracts discussed in Note 4. Fair value and carrying value were the same because the contracts were recorded at fair value. The fair values of the foreign currency contracts were calculated as the difference between the applicable forward foreign exchange rates at the reporting date and the contracted foreign exchange rates multiplied by the contracted notional amounts. See the table that follows the financial instrument descriptions for the reported fair values of derivative assets and liabilities.

Long-term investments

Long-term investments included the mutual fund assets the Company held to fund a portion of its deferred compensation liabilities and all of its non-qualified supplemental executive defined contribution obligations (see the defined contribution plans section of Note 8). Fair value and carrying value were the same because the mutual fund assets were recorded at fair value. Fair values for the mutual funds were calculated using the published market price per unit at the reporting date multiplied by the number of units held at the reporting date. See the table that follows the financial instrument descriptions for the reported fair value of long-term investments.

Debt obligations

The fair value of debt with original maturities greater than one year comprised the combined present values of scheduled principal and interest payments for each of the various loans, individually discounted at rates equivalent to those which could be obtained by the Company for new debt issues with durations equal to the average life to maturity of each loan. The fair values of the remaining Company debt obligations approximated their carrying values due to the short-term nature of the debt. The Company's fair value measurements for debt fall within level 2 of the fair value hierarchy.

At June 30, 2018, and December 31, 2017, the fair values and related carrying values of debt, including current maturities, were as follows (the fair value and carrying value amounts are presented without regard to unamortized debt issuance costs of \$1,067,000 and \$987,000 as of June 30, 2018 and December 31, 2017, respectively):

	June 30,	December 31,
(In thousands)	2018	2017
Fair value	\$284,254	\$293,272
Carrying value	287,883	291,786

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The following tables present financial assets and liabilities measured on a recurring basis at fair value as of June 30, 2018, and December 31, 2017, and the level within the fair value hierarchy in which the fair value measurements fall:

(In thousands)	June 30,		Level	Level
	2018	Level 1	2	3
Mutual fund assets	\$27,229	\$27,229	\$—	\$—
Derivative assets:				
Foreign currency contracts	295	—	295	—
Total assets at fair value	\$27,524	\$27,229	\$295	\$—
Derivative liabilities:				
Foreign currency contracts	\$441	\$—	\$	