

INNOSPEC INC.
Form 10-Q
August 08, 2007
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2007

Commission file number 1-13879

INNOSPEC INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

98-0181725
(IRS Employer
Identification No.)

Innospec Manufacturing Park

Oil Sites Road

Ellesmere Port

Cheshire

United Kingdom
(Address of principal executive offices)

CH65 4EY
(Zip Code)

Registrant's telephone number, including area code: 011-44-151-355-3611

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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 is a large accelerated filer, an accelerated filer or a non accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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 practical date.

Class	Outstanding as of July 31, 2007
Common Stock, par value \$0.01	24,101,872

Table of Contents

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1	<u>Financial Statements</u>	3
	<u>Consolidated Statements of Income</u>	3
	<u>Consolidated Balance Sheets</u>	4
	<u>Consolidated Balance Sheets (continued)</u>	5
	<u>Consolidated Statements of Cash Flows</u>	6
	<u>Consolidated Statement of Stockholders' Equity</u>	7
	<u>Consolidated Statements of Comprehensive Income</u>	7
	<u>Notes to unaudited Interim Consolidated Financial Statements</u>	8
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three and Six Months Ended June 30, 2007 and 2006</u>	20
	<u>Results of Operations</u>	20
	<u>Cash Flows Discussion</u>	28
	<u>Liquidity and Financial Condition</u>	28
	<u>Critical Accounting Estimates</u>	29
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	30
Item 4	<u>Controls and Procedures</u>	30

PART II OTHER INFORMATION

Item 1	<u>Legal Proceedings</u>	31
Item 1A	<u>Risk Factors</u>	31
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	31
Item 3	<u>Defaults Upon Senior Securities</u>	32
Item 4	<u>Submission of Matters to a Vote of Security Holders</u>	32
Item 5	<u>Other Information</u>	32
Item 6	<u>Exhibits</u>	32
	<u>Signatures</u>	33
	<u>Exhibit 31.1</u>	34
	<u>Exhibit 31.2</u>	35
	<u>Exhibit 32.1</u>	36
	<u>Exhibit 32.2</u>	37

Table of Contents

CAUTIONARY STATEMENT RELATIVE TO FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements which address operating performance, events or developments that we expect or anticipate will occur in the future. Although such statements are believed by management to be reasonable when made, caution should be exercised not to place undue reliance on forward-looking statements, which are subject to certain risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, actual results may differ materially from those expressed or implied by such forward-looking statements and assumptions. Risks, assumptions and uncertainties include, without limitation, changes in the terms of trading with significant customers or gain or loss thereof, our ability to continue to achieve organic growth in our Fuel Specialties and Performance Chemicals businesses, our ability to successfully integrate any acquisitions in those business segments, the effects of changing government regulations and economic and market conditions, competition and changes in demand and business and legal risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations and market risks related to changes in interest rates and foreign exchange rates, government investigations, material fines or other penalties resulting from the Company's voluntary disclosure to the Office of Foreign Assets Control of the U.S. Department of the Treasury or other regulatory actions and other risks, uncertainties and assumptions identified in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 and those identified in the Company's other reports filed with the Securities and Exchange Commission. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1 Financial Statements****INNOSPEC INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

(millions of dollars except share and per share data)	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2007	2006	2007	2006
Net sales (Note 2)	\$ 141.4	\$ 119.4	\$ 286.7	\$ 243.7
Cost of goods sold	(93.6)	(77.3)	(189.2)	(155.1)
Gross profit (Note 2)	47.8	42.1	97.5	88.6
Operating expenses				
Selling, general and administrative	(24.4)	(22.1)	(49.5)	(44.2)
Research and development	(3.4)	(2.7)	(6.6)	(5.2)
Restructuring charge	(1.3)	(2.1)	(2.0)	(3.0)
Amortization of intangible assets (Note 4)	(4.6)	(3.2)	(7.7)	(6.3)
Impairment of Octane Additives business goodwill (Note 5)	(3.3)	(7.7)	(7.7)	(19.0)
Prepaid disposal costs		(0.4)		(0.4)
	(37.0)	(38.2)	(73.5)	(78.1)
Operating income (Note 2)	10.8	3.9	24.0	10.5
Other net income	1.5	1.6	1.6	1.7
Interest expense (net)	(1.1)	(2.0)	(2.7)	(3.4)
Income before income taxes	11.2	3.5	22.9	8.8
Income taxes (Note 6)	(4.4)	(2.5)	(10.1)	(7.2)
Net income	\$ 6.8	\$ 1.0	\$ 12.8	\$ 1.6
Earnings per share (Note 7):				
Basic	\$ 0.28	\$ 0.04	\$ 0.54	\$ 0.07
Diluted	\$ 0.27	\$ 0.04	\$ 0.52	\$ 0.06
Weighted average shares outstanding (in thousands) (Note 7):				
Basic	24,002	24,382	23,899	24,520
Diluted	24,875	25,587	24,846	25,660
Dividend declared per common share (Note 8):	\$	\$	\$ 0.045	\$ 0.040

The accompanying footnotes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents**INNOSPEC INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(millions of dollars except share and per share data)	June 30 2007 (Unaudited)	December 31 2006
Assets		
Current assets		
Cash and cash equivalents	\$ 34.8	\$ 101.9
Accounts receivable (less allowance of \$2.0 and \$2.5, respectively)	85.4	78.3
Inventories		
Finished goods	97.4	83.7
Work in progress	18.6	25.2
Raw materials	17.2	11.1
Total inventories	133.2	120.0
Prepaid expenses	7.5	5.1
Total current assets	260.9	305.3
Property, plant and equipment	112.9	105.5
Less accumulated depreciation	(47.0)	(39.0)
Net property, plant and equipment	65.9	66.5
Goodwill Octane Additives (Note 5)	17.1	24.8
Goodwill Other (Note 5)	139.1	139.0
Intangible assets (Note 4)	51.0	30.2
Deferred finance costs	1.0	1.6
Deferred income taxes	6.1	1.6
	\$ 541.1	\$ 569.0

The accompanying footnotes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents

INNOSPEC INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (CONTINUED)

(millions of dollars except share and per share data)	June 30 2007 (Unaudited)	December 31 2006
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	\$ 54.6	\$ 50.0
Accrued liabilities	45.3	55.5
Accrued income taxes	5.0	14.7
Short-term borrowings (Note 9)	20.0	15.1
Current portion of plant closure provisions (Note 10)	5.4	5.6
Current portion of unrecognized tax benefits (Note 6)	8.9	
Current portion of deferred income	0.1	2.0
Total current liabilities	139.3	142.9
Long-term debt, net of current portion (Note 9)	100.0	133.0
Plant closure provisions, net of current portion (Note 10)	22.2	22.2
Unrecognized tax benefits, net of current portion (Note 6)	26.7	
Pension liability (Note 3)	21.6	22.5
Other liabilities	1.5	22.4
Deferred income, net of current portion	0.5	0.9
Minority interest	0.1	0.1
Commitments and contingencies (Note 11)		
Stockholders Equity		
Common stock, \$0.01 par value, authorized 40,000,000 shares, issued 29,554,500 shares	0.1	0.1
Additional paid-in capital	280.4	281.7
Treasury stock (5,455,200 and 5,749,494 shares at cost, respectively)	(49.4)	(44.7)
Retained earnings	105.5	97.9
Accumulated other comprehensive income	(107.4)	(110.0)
Total stockholders equity	229.2	225.0
	\$ 541.1	\$ 569.0

The accompanying footnotes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents

INNOSPEC INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(millions of dollars)	Six Months Ended June 30	
	2007	2006
Cash Flows from Operating Activities		
Net income	\$ 12.8	\$ 1.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14.7	13.1
Impairment of Octane Additives business goodwill (Note 5)	7.7	19.0
Deferred income taxes	(0.7)	0.4
Prepaid disposal costs		0.4
Changes in working capital:		
Accounts receivable and prepaid expenses	(8.8)	(9.6)
Inventories	(12.6)	(16.0)
Accounts payable and accrued liabilities	(6.6)	(16.1)
Income taxes and other current liabilities	(2.0)	12.3
Movement on plant closure provisions	(0.3)	(2.5)
Movement on pension (liability)/prepayment	(0.9)	(1.5)
Stock option compensation charge	1.3	0.8
Movements on other non-current liabilities		(1.2)
Movement on deferred income	(2.4)	
Net cash provided by operating activities	2.2	0.7
Cash Flows from Investing Activities		
Capital expenditures	(4.9)	(2.2)
Prepaid disposal costs		(0.2)
Disposal of unconsolidated investment		2.6
Acquisition of intangible asset (Note 4)	(28.4)	
Other		0.1
Net cash (used in)/provided by investing activities	(33.3)	0.3
Cash Flows from Financing Activities		
Receipt of short-term borrowings		1.0
Repayment of short-term borrowings	(15.1)	
Receipt of long-term borrowings	45.0	4.0
Repayment of long-term borrowings	(58.0)	
Increase in deferred finance costs		(0.3)
Dividend paid	(1.1)	(1.0)
Issue of treasury stock	3.1	1.4
Repurchase of common stock	(10.0)	(9.7)
Minority interest		0.1
Net cash (used in) financing activities	(36.1)	(4.5)
Effect of exchange rate changes on cash	0.1	0.4
Net change in cash and cash equivalents	(67.1)	(3.1)
Cash and cash equivalents at beginning of period	101.9	68.9

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Cash and cash equivalents at end of period

\$ 34.8

\$ 65.8

Amortization of deferred finance costs of \$0.6 million (2006 \$0.4 million) are included in depreciation and amortization in the cash flow statement but in interest in the income statement.

The accompanying footnotes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents**INNOSPEC INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

(Unaudited)

(millions of dollars)	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
Balance at December 31, 2006	\$ 0.1	\$ 281.7	\$ (44.7)	\$ 97.9	\$ (110.0)	\$ 225.0
Net income				12.8		12.8
Dividend (\$0.045 per share)				(1.1)		(1.1)
Net CTA change (1)					1.6	1.6
Treasury stock re-issued		(0.4)	5.3			4.9
Treasury stock repurchased			(10.0)			(10.0)
Stock option compensation charge		(0.9)				(0.9)
Cumulative effect of adoption of FIN 48 (Note 6)				(3.1)		(3.1)
Amortization of net actuarial losses				(1.0)	1.0	
Balance at June 30, 2007	\$ 0.1	\$ 280.4	\$ (49.4)	\$ 105.5	\$ (107.4)	\$ 229.2

(1) Changes in cumulative translation adjustment.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(millions of dollars)	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Net income for the period	\$ 6.8	\$ 1.0	\$ 12.8	\$ 1.6
Changes in cumulative translation adjustment	0.6	2.9	1.6	3.6
Changes in unrealized exchange gains on derivative instruments, net of tax	0.1	0.3		0.6
Total comprehensive income	\$ 7.5	\$ 4.2	\$ 14.4	\$ 5.8

The accompanying footnotes are an integral part of these unaudited interim consolidated financial statements.

Table of Contents

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes necessary for a comprehensive presentation of financial position, results of operations and cash flows.

It is our opinion, however, that all material adjustments (consisting of normal recurring accruals) have been made which are necessary for a fair financial statement presentation. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2006 Annual Report on Form 10-K filed on March 16, 2007.

The results for the interim period are not necessarily indicative of the results to be expected for the full year.

When we use the terms the Corporation, Company, Registrant, we, us and our, unless otherwise indicated or the context otherwise requires, we are referring to Innospec Inc. and its consolidated subsidiaries (Innospec).

On June 18, 2007 the Company announced that the Board of Directors of Innospec Inc. had approved a 2-for-1 stock split to be effected in the form of a 100 per cent stock dividend. Shareholders of record as of July 6, 2007 received one additional share of Innospec Inc. common stock for every share they owned on that date. The shares were distributed on July 20, 2007. The consolidated financial statements have been retrospectively adjusted for this stock split.

NOTE 2 SEGMENTAL REPORTING

The Company divides its business into three distinct segments for both management and reporting purposes: Fuel Specialties, Performance Chemicals and Octane Additives. The Fuel Specialties and Performance Chemicals businesses both operate in markets where we actively seek growth opportunities albeit their end customers are very different. The Octane Additives business operates in markets which are mature with generally declining demand.

Table of Contents**INNOSPEC INC. AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table analyzes sales and other financial information by the Company's reportable segments:

(millions of dollars)	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Net sales				
Fuel Specialties	\$ 86.0	\$ 67.0	\$ 171.8	\$ 137.2
Performance Chemicals	34.0	29.6	68.0	58.2
Octane Additives	21.4	22.8	46.9	48.3
	\$ 141.4	\$ 119.4	\$ 286.7	\$ 243.7
Gross profit				
Fuel Specialties	\$ 29.0	\$ 24.6	\$ 58.9	\$ 50.0
Performance Chemicals	5.8	4.2	13.2	9.9
Octane Additives	13.0	13.3	25.4	28.7
	\$ 47.8	\$ 42.1	\$ 97.5	\$ 88.6
Operating income				
Fuel Specialties	\$ 14.4	\$ 10.9	\$ 28.7	\$ 23.6
Performance Chemicals	1.0	(0.2)	3.6	1.6
Octane Additives	6.9	8.1	14.4	18.3
FAS 158/87 pension (charge)	(1.2)		(2.3)	
Corporate costs	(5.7)	(4.7)	(10.7)	(10.6)
	\$ 15.4	\$ 14.1	\$ 33.7	\$ 32.9
Restructuring charge	(1.3)	(2.1)	(2.0)	(3.0)
Impairment of Octane Additives business goodwill	(3.3)	(7.7)	(7.7)	(19.0)
Prepaid disposal costs		(0.4)		(0.4)
	\$ 10.8	\$ 3.9	\$ 24.0	\$ 10.5

The following table presents a summary of the depreciation and amortization charges incurred by the Company's reportable segments.

(millions of dollars)	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Depreciation				
Fuel Specialties	\$ 0.5	\$ 0.4	\$ 1.0	\$ 0.8
Performance Chemicals	0.7	1.4	2.1	2.4
Octane Additives	0.8	0.7	1.6	1.4
Corporate	0.9	0.9	1.7	1.8

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Total	\$ 2.9	\$ 3.4	\$ 6.4	\$ 6.4
Amortization				
Fuel Specialties	\$ 0.6	\$ 0.3	\$ 0.9	\$ 0.6
Performance Chemicals	0.4	0.4	0.7	0.7
Octane Additives	3.6	2.5	6.1	5.0
Total	\$ 4.6	\$ 3.2	\$ 7.7	\$ 6.3

Table of Contents**INNOSPEC INC. AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 3 PENSION PLANS**

The Company maintains a contributory defined benefit pension plan covering a number of its former and current United Kingdom employees. The components of the net periodic cost were as follows:

(millions of dollars)	Three Months Ended June 30		Six Months Ended June 30	
	2007	2006	2007	2006
Service cost	\$ (1.3)	\$ (1.2)	\$ (2.6)	\$ (2.4)
Interest cost on projected benefit obligation	(11.3)	(9.8)	(22.5)	(19.2)
Expected return on plan assets	11.9	11.0	23.8	21.6
Amortization of net actuarial losses	(0.5)		(1.0)	
	\$ (1.2)	\$	\$ (2.3)	\$

At June 30, 2007, the Company has a pension liability of \$21.6 million recorded in its balance sheet in accordance with FAS 158.

NOTE 4 INTANGIBLE ASSETS

(millions of dollars)	Six Months Ended June 30	
	2007	2006
Gross cost at January 1	\$ 86.9	\$ 86.9
Acquisitions	28.4	
Exchange effect		(0.1)
Gross cost at June 30	115.3	86.8
Amortization at January 1	(56.7)	(43.9)
Amortization charge	(7.7)	(6.3)
Exchange effect	0.1	0.1
Amortization at June 30	(64.3)	(50.1)
Net book amount at June 30	\$ 51.0	\$ 36.7

Acquisition of intangible asset

On October 1, 1998, Innospec entered into sales and marketing agreements (TMA's) with Ethyl Corporation (Ethyl) to market and sell tetra ethyl lead (TEL) in all areas of the world except North America and the European Economic Area for the period lasting until December 31, 2009, subject to renewal thereafter. This relationship was extended effective January 1, 2000 when two of our Swiss subsidiaries entered into similar TMA's with Ethyl's Swiss subsidiaries. In April 2000, Ethyl made a payment to Innospec of \$38.6 million as a prepayment for services to be provided under the Swiss TMA's. Effective July 1, 2001, another of our Swiss subsidiaries entered into a TMA with Veritel Chemicals BV (Veritel) and Ethyl agreed to participate in this TMA with the scope of all the TMA's being extended to include the European Economic Area.

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No separate legal entity or joint venture was established as a consequence of the TMAs. All marketing and sales effort made under these arrangements were made in the name of Innospec. Innospec produced all TEL marketed under the TMAs and also provided marketing and other services. Ethyl provided bulk distribution services, marketing and other services. In addition, Ethyl was required to hold approximately one third of the inventories sold under these arrangements or deposit an equivalent dollar amount with Innospec. At March 31,

Table of Contents

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2007, Ethyl held no TEL inventories in respect of the TMAs and accordingly had deposited \$12.0 million with us. The net proceeds under the TMAs were paid to Innospec and Ethyl as compensation for services and based on an agreed-upon formula, with Innospec receiving 68% of the total compensation for services provided and Ethyl receiving 32%. Ethyl's 32% share of the net proceeds was advanced to Ethyl by us when payment was received from the TMA