

INNOSPEC INC.  
Form 10-Q  
November 02, 2010  
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**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 September 30, 2010**

**Commission file number 1-13879**

**INNOSPEC INC.**

**(Exact name of registrant as specified in its charter)**

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**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

**98-0181725**  
(IRS Employer  
Identification No.)

**8375 South Willow Street**

**Littleton**

**Colorado**  
(Address of principal executive offices)

**80124**  
(Zip Code)

**Registrant's telephone number, including area code: (303)-792-5554**

(Former name, former address and former fiscal year, if changed since last report)

**Innospec Manufacturing Park, Oil Sites Road,**

**Ellesmere Port, Cheshire,**

**United Kingdom**

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

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

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

**Class**  
Common Stock, par value \$0.01

**Outstanding as of October 29, 2010**  
23,815,918

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**CAUTIONARY STATEMENT RELATIVE TO FORWARD-LOOKING STATEMENTS**

This Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts included or incorporated herein may constitute forward-looking statements. Such forward-looking statements include statements (covered by words like expects, anticipates, may, believes or similar words or expressions), for example, which relate to operating performance, events or developments that we expect or anticipate will or may occur in the future (including, without limitation, any of the Company's guidance in respect of sales, gross margins, net income, growth potential and other measures of financial performance). Although forward-looking statements are believed by management to be reasonable when made, caution should be exercised not to place undue reliance on such statements because they are subject to certain risks, uncertainties and assumptions, including in respect of the general business environment, regulatory actions or changes. If the risks or uncertainties materialize or assumptions prove incorrect or change, our actual performance or results may differ materially from those expressed or implied by such forward-looking statements and assumptions. Additional information regarding risks, uncertainties and assumptions relating to the Company and affecting our business operations and prospects are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, and other reports filed with the U.S. Securities and Exchange Commission. You are urged to carefully review and consider the cautionary statements and other disclosures made in those filings, specifically those under the heading Risk Factors. 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)**

| (in millions, except share and per share data)               | Three Months Ended<br>September 30 |           | Nine Months Ended<br>September 30 |          |
|--|------------------------------------|-----------|-----------------------------------|----------|
|  | 2010                               | 2009      | 2010                              | 2009     |
| Net sales (Note 2)   | \$ 174.0                           | \$ 149.2  | \$ 505.9                          | \$ 434.3 |
| Cost of goods sold   | (118.6)                            | (102.0)   | (343.6)                           | (296.1)  |
| Gross profit (Note 2)  | 55.4                               | 47.2      | 162.3                             | 138.2    |
| Operating expenses   |                                    |           |                                   |          |
| Selling, general and administrative                          | (28.2)                             | (42.9)    | (78.8)                            | (97.3)   |
| Research and development                                     | (4.5)                              | (4.2)     | (13.0)                            | (11.4)   |
| Restructuring charge   |                                    |           | (8.5)                             | (1.7)    |
| Amortization of intangible assets (Note 4)                   | (1.2)                              | (1.2)     | (3.5)                             | (3.5)    |
| Impairment of Octane Additives business goodwill (Note 5)    | (0.6)                              | (0.6)     | (1.7)                             | (1.7)    |
| Profit on disposal   |                                    |           | 0.2                               |          |
|  | (34.5)                             | (48.9)    | (105.3)                           | (115.6)  |
| Operating income/(loss) (Note 2)                             | 20.9                               | (1.7)     | 57.0                              | 22.6     |
| Other net income   | 11.6                               | 7.1       | 0.7                               | 0.3      |
| Interest expense   | (1.3)                              | (1.5)     | (3.8)                             | (4.9)    |
| Interest income  | 0.1                                | 0.1       | 0.3                               | 0.2      |
| Income before income taxes                                   | 31.3                               | 4.0       | 54.2                              | 18.2     |
| Income taxes (Note 6)  | (1.3)                              | (6.7)     | (4.8)                             | (11.5)   |
| Net income/(loss)  | \$ 30.0                            | \$ (2.7)  | \$ 49.4                           | \$ 6.7   |
| Earnings/(loss) per share (Note 7):                          |                                    |           |                                   |          |
| Basic  | \$ 1.26                            | \$ (0.11) | \$ 2.08                           | \$ 0.28  |
| Diluted  | \$ 1.20                            | \$ (0.11) | \$ 1.98                           | \$ 0.27  |
| Weighted average shares outstanding (in thousands) (Note 7): |                                    |           |                                   |          |
| Basic  | 23,805                             | 23,663    | 23,757                            | 23,635   |
| Diluted  | 25,002                             | 23,663    | 24,931                            | 24,709   |
| Dividend declared per common share:                          | \$                                 | \$        | \$                                | \$ 0.05  |

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



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

| (in millions, except share and per share data)                        | September 30<br>2010<br>(Unaudited) | December 31<br>2009 |
|---|-------------------------------------|---------------------|
| <b>Assets</b>   |                                     |                     |
| Current assets  |                                     |                     |
| Cash and cash equivalents   | \$ 98.8                             | \$ 68.6             |
| Short term investments  | 2.7                                 |                     |
| Accounts receivable (less allowance of \$2.3 and \$2.3, respectively) | 92.7                                | 89.8                |
| Inventories   |                                     |                     |
| Finished goods  | 69.9                                | 81.5                |
| Work in progress  | 2.5                                 | 1.5                 |
| Raw materials   | 43.6                                | 37.6                |
| Total inventories   | 116.0                               | 120.6               |
| Prepaid expenses  | 3.8                                 | 3.9                 |
| Total current assets  | 314.0                               | 282.9               |
| Property, plant and equipment   | 127.1                               | 124.8               |
| Less accumulated depreciation   | (78.3)                              | (74.2)              |
| Net property, plant and equipment                                     | 48.8                                | 50.6                |
| Goodwill Octane Additives (Note 5)                                    | 5.1                                 | 6.8                 |
| Goodwill Other (Note 5)   | 139.1                               | 139.2               |
| Intangible assets (Note 4)  | 20.2                                | 23.7                |
| Deferred finance costs  | 0.8                                 | 1.9                 |
| Deferred income taxes   | 30.2                                | 36.9                |
| Other non-current assets  | 2.5                                 | 1.1                 |
| Total assets  | \$ 560.7                            | \$ 543.1            |

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

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**INNOSPEC INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (CONTINUED)**

| (in millions, except share and per share data)   | September 30<br>2010<br>(Unaudited) | December 31<br>2009 |
|--|-------------------------------------|---------------------|
| <b>Liabilities and Stockholders' Equity</b>  |                                     |                     |
| <b>Current liabilities</b>   |                                     |                     |
| Accounts payable   | \$ 42.5                             | \$ 50.2             |
| Current portion of accrued liabilities   | 74.5                                | 104.4               |
| Accrued income taxes   | 1.2                                 | 6.3                 |
| Short-term borrowing (Note 9)  | 15.0                                | 10.0                |
| Current portion of plant closure provisions (Note 10)                                  | 4.4                                 | 3.9                 |
| Current portion of unrecognized tax benefits (Note 6)                                  | 3.5                                 | 5.0                 |
| Current portion of deferred income   | 0.1                                 | 0.1                 |
| <b>Total current liabilities</b>   | <b>141.2</b>                        | <b>179.9</b>        |
| Accrued liabilities, net of current portion  | 22.7                                |                     |
| Long-term debt, net of current portion (Note 9)  | 33.0                                | 41.0                |
| Plant closure provisions, net of current portion (Note 10)                             | 23.3                                | 24.5                |
| Unrecognized tax benefits, net of current portion (Note 6)                             | 8.1                                 | 14.4                |
| Pension liability (Note 3)   | 113.1                               | 124.2               |
| Other non-current liabilities  | 0.6                                 | 0.7                 |
| Deferred income, net of current portion  | 1.0                                 | 0.8                 |
| Commitments and contingencies (Note 13)  |                                     |                     |
| <b>Stockholders' Equity</b>  |                                     |                     |
| Common stock, \$0.01 par value, authorized 40,000,000 shares, issued 29,554,500 shares | 0.3                                 | 0.3                 |
| Additional paid-in capital   | 286.1                               | 285.8               |
| Treasury stock (5,738,582 and 5,890,447 shares at cost, respectively)                  | (62.3)                              | (64.2)              |
| Retained earnings  | 186.2                               | 136.8               |
| Accumulated other comprehensive loss   | (192.6)                             | (201.1)             |
| <b>Total stockholders' equity</b>  | <b>217.7</b>                        | <b>157.6</b>        |
| <b>Total liabilities and stockholders' equity</b>                                      | <b>\$ 560.7</b>                     | <b>\$ 543.1</b>     |

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



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**INNOSPEC INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

| (in millions)   | Nine Months Ended<br>September 30 |                |
|---|-----------------------------------|----------------|
|   | 2010                              | 2009           |
| <b><u>Cash Flows from Operating Activities</u></b>                                |                                   |                |
| Net income  | \$ 49.4                           | \$ 6.7         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |                |
| Depreciation and amortization   | 11.6                              | 13.7           |
| Impairment of Octane Additives business goodwill (Note 5)                         | 1.7                               | 1.7            |
| Deferred income taxes   | (0.3)                             | (2.0)          |
| (Profit) on disposal of property, plant and equipment                             | (0.2)                             |                |
| Changes in working capital:   |                                   |                |
| Accounts receivable and prepaid expenses  | (3.3)                             | 5.5            |
| Inventories   | 4.2                               | 19.5           |
| Accounts payable and accrued liabilities  | (15.7)                            | 19.1           |
| Excess tax deficiency/(benefit) from stock based payment arrangements             |                                   | (0.1)          |
| Income taxes and other current liabilities  | (3.8)                             | 3.1            |
| Movement on plant closure provisions  | (0.6)                             |                |
| Movement on pension liability   | 8.4                               | 0.2            |
| Stock option compensation   | 0.5                               | 0.6            |
| Movement on other non-current assets and liabilities                              | (9.5)                             | (11.3)         |
| Net cash provided by operating activities   | 42.4                              | 56.7           |
| <b><u>Cash Flows from Investing Activities</u></b>                                |                                   |                |
| Capital expenditures  | (6.3)                             | (4.6)          |
| Proceeds on disposal of property, plant and equipment                             | 0.2                               |                |
| Purchase of short term investments  | (6.0)                             |                |
| Sale of short term investments  | 3.3                               |                |
| Net cash (used in) investing activities   | (8.8)                             | (4.6)          |
| <b><u>Cash Flows from Financing Activities</u></b>                                |                                   |                |
| Net receipt/(repayment) of revolving credit facility                              | 7.0                               | (7.0)          |
| Repayment of term loan  | (10.0)                            | (55.0)         |
| Receipt of term loan  |                                   | 50.0           |
| Refinancing costs   |                                   | (3.6)          |
| Excess tax (deficiency)/benefit from stock based payment arrangements             |                                   | 0.1            |
| Dividend paid   |                                   | (1.2)          |
| Issue of treasury stock   | 0.1                               | 0.2            |
| Repurchase of common stock  | (0.2)                             |                |
| Net cash (used in) financing activities   | (3.1)                             | (16.5)         |
| Effect of exchange rate changes on cash   | (0.3)                             | 0.7            |
| Net change in cash and cash equivalents   | 30.2                              | 36.3           |
| Cash and cash equivalents at beginning of period                                  | 68.6                              | 13.9           |
| <b><u>Cash and cash equivalents at end of period</u></b>                          | <b>\$ 98.8</b>                    | <b>\$ 50.2</b> |

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Amortization of deferred finance costs of \$1.1 million (2009 \$1.5 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)

| (in millions)                                    | Common<br>Stock | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders<br>Equity |
|--|-----------------|----------------------------------|-------------------|----------------------|---|---------------------------------|
| Balance at December 31, 2009                     | \$ 0.3          | \$ 285.8                         | \$ (64.2)         | \$ 136.8             | \$ (201.1)                                    | \$ 157.6                        |
| Net income                                       |                 |                                  |                   | 49.4                 |   | 49.4                            |
| Net CTA change (1)                               |                 |                                  |                   |                      | (3.7)   | (3.7)                           |
| Derivatives (2)                                  |                 |                                  |                   |                      | (0.3)   | (0.3)                           |
| Treasury stock re-issued                         |                 | (0.2)                            | 1.9               |                      |   | 1.7                             |
| Stock option compensation                        |                 | 0.5                              |                   |                      |   | 0.5                             |
| Amortization of net actuarial losses, net of tax |                 |                                  |                   |                      | 2.9   | 2.9                             |
| Gain on pension plan amendment, net of tax       |                 |                                  |                   |                      | 12.3  | 12.3                            |
| Amortization of prior service credit, net of tax |                 |                                  |                   |                      | (0.4)   | (0.4)                           |
| Deferred income taxes (3)                        |                 |                                  |                   |                      | (2.3)   | (2.3)                           |
| Balance at September 30, 2010                    | \$ 0.3          | \$ 286.1                         | \$ (62.3)         | \$ 186.2             | \$ (192.6)                                    | \$ 217.7                        |

- (1) Changes in cumulative translation adjustment.  
(2) Changes in unrealized losses on derivative instruments, net of tax.  
(3) Impact on deferred income taxes of a change in the associated tax rate on the unrecognized actuarial net losses of \$228.7 million (\$164.6 million net of deferred taxes) previously recognized in other comprehensive loss.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

| (in millions)   | Three Months Ended<br>September 30 |          | Nine Months Ended<br>September 30 |        |
|---|------------------------------------|----------|-----------------------------------|--------|
|   | 2010                               | 2009     | 2010                              | 2009   |
| Net income/(loss) for the period  | \$ 30.0                            | \$ (2.7) | \$ 49.4                           | \$ 6.7 |
| Changes in cumulative translation adjustment  | 0.2                                | (7.0)    | (3.7)                             | (0.7)  |
| Changes in unrealized gains/(losses) on derivative instruments, net of tax of \$(0.4) million, \$(0.2) million, \$0.1 million and \$(1.0) million, respectively | 0.9                                | 0.4      | (0.3)                             | 2.5    |
| Amortization of net actuarial losses, net of tax of \$(0.4) million, \$nil, \$(1.0) million and \$nil, respectively   | 1.0                                |          | 2.9                               |        |
| Gain on pension plan amendment, net of tax of \$nil, \$nil, \$(4.8) million and \$nil, respectively   |                                    |          | 12.3                              |        |
| Amortization of prior service credit, net of tax of \$0.1 million, \$nil, \$0.2 million and \$nil, respectively   | (0.2)                              |          | (0.4)                             |        |
| Deferred income taxes   | (2.3)                              |          | (2.3)                             |        |
| Total comprehensive income/(loss)   | \$ 29.6                            | \$ (9.3) | \$ 57.9                           | \$ 8.5 |

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

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**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 adjustments (consisting of normal, recurring adjustments, unless otherwise disclosed) have been made which are necessary for the financial statements to be fairly stated. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K filed on February 19, 2010.

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).

***NOTE 2 SEGMENTAL REPORTING***

Innospec divides its business into three distinct segments for both management and reporting purposes: Fuel Specialties, Active Chemicals and Octane Additives. The Fuel Specialties and Active Chemicals businesses both operate in markets where we actively seek growth opportunities albeit their end customers are different. The Octane Additives business has been characterized by substantial declining demand.

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

The Company evaluates the performance of its segments based on operating income. The following table analyzes sales and other financial information by the Company's reportable segments:

| (in millions)                                    | Three Months Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|--|------------------------------------|----------|-----------------------------------|----------|
|  | 2010                               | 2009     | 2010                              | 2009     |
| <b>Net sales</b>                                 |                                    |          |                                   |          |
| Fuel Specialties                                 | \$ 113.9                           | \$ 100.1 | \$ 330.9                          | \$ 305.7 |
| Active Chemicals                                 | 38.2                               | 36.6     | 113.7                             | 97.7     |
| Octane Additives                                 | 21.9                               | 12.5     | 61.3                              | 30.9     |
|  | \$ 174.0                           | \$ 149.2 | \$ 505.9                          | \$ 434.3 |
| <b>Gross profit</b>                              |                                    |          |                                   |          |
| Fuel Specialties                                 | \$ 37.4                            | \$ 32.9  | \$ 107.8                          | \$ 105.1 |
| Active Chemicals                                 | 8.3                                | 8.7      | 24.8                              | 20.8     |
| Octane Additives                                 | 9.7                                | 5.6      | 29.7                              | 12.3     |
|  | \$ 55.4                            | \$ 47.2  | \$ 162.3                          | \$ 138.2 |
| <b>Operating income/(loss)</b>                   |                                    |          |                                   |          |
| Fuel Specialties                                 | \$ 18.7                            | \$ 16.0  | \$ 57.9                           | \$ 57.3  |
| Active Chemicals                                 | 4.3                                | 3.7      | 12.0                              | 7.7      |
| Octane Additives                                 | 6.4                                | (14.7)   | 24.7                              | (24.1)   |
| Pension charge                                   | (2.5)                              | (1.7)    | (8.4)                             | (4.7)    |
| Corporate costs                                  | (5.4)                              | (4.4)    | (19.2)                            | (10.2)   |
|  | 21.5                               | (1.1)    | 67.0                              | 26.0     |
| Restructuring charge                             |                                    |          | (8.5)                             | (1.7)    |
| Impairment of Octane Additives business goodwill | (0.6)                              | (0.6)    | (1.7)                             | (1.7)    |
| Profit on disposal                               |                                    |          | 0.2                               |          |
| Total operating income/(loss)                    | 20.9                               | (1.7)    | 57.0                              | 22.6     |
| Other net income                                 | 11.6                               | 7.1      | 0.7                               | 0.3      |
| Interest expense                                 | (1.3)                              | (1.5)    | (3.8)                             | (4.9)    |
| Interest income                                  | 0.1                                | 0.1      | 0.3                               | 0.2      |
| Income before income taxes                       | \$ 31.3                            | \$ 4.0   | \$ 54.2                           | \$ 18.2  |

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

| Three Months Ended<br>September 30 | Nine Months Ended<br>September 30 |
|------------------------------------|-----------------------------------|
|------------------------------------|-----------------------------------|

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| (in millions)       | 2010   | 2009   | 2010   | 2009   |
|---------------------|--------|--------|--------|--------|
| <i>Depreciation</i> |        |        |        |        |
| Fuel Specialties    | \$ 0.6 | \$ 0.6 | \$ 1.8 | \$ 1.7 |
| Active Chemicals    | 1.2    | 1.4    | 3.5    | 3.8    |
| Octane Additives    | 0.2    | 0.4    | 0.6    | 1.5    |
| Corporate           | 0.4    | 0.4    | 1.1    | 1.7    |
|                     | \$ 2.4 | \$ 2.8 | \$ 7.0 | \$ 8.7 |
| <i>Amortization</i> |        |        |        |        |
| Fuel Specialties    | \$ 0.6 | \$ 0.6 | \$ 1.7 | \$ 1.7 |
| Active Chemicals    | 0.3    | 0.3    | 1.0    | 1.0    |
| Octane Additives    | 0.3    | 0.3    | 0.8    | 0.8    |
|                     | \$ 1.2 | \$ 1.2 | \$ 3.5 | \$ 3.5 |

**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 (the Plan) covering a number of its current and former employees. The components of the net periodic cost were as follows:

| (in millions)                                 | Three Months Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|---|------------------------------------|----------|-----------------------------------|----------|
|   | 2010                               | 2009     | 2010                              | 2009     |
| Service cost                                  | \$ (0.2)                           | \$ (1.0) | \$ (1.4)                          | \$ (2.8) |
| Interest cost on projected benefit obligation | (10.1)                             | (10.8)   | (30.5)                            | (28.6)   |
| Expected return on plan assets                | 8.8                                | 10.1     | 26.8                              | 26.7     |
| Amortization of prior service credit          | 0.3                                |          | 0.6                               |          |
| Amortization of net actuarial losses          | (1.3)                              |          | (3.9)                             |          |
|   | \$ (2.5)                           | \$ (1.7) | \$ (8.4)                          | \$ (4.7) |

The Company closed the Plan to future service accrual with effect from March 31, 2010 and accordingly we recorded a non-cash curtailment charge of \$8.2 million in the first quarter of 2010. During the second quarter of 2010 the Company implemented a pension increase exchange (PIE) program for current pensioners, effective April 1, 2010, which reduced the projected benefit obligation (PBO) by \$17.1 million. This reduction in PBO resulted in a prior service credit which is being amortized using the straight-line method over the remaining life expectancy of Plan pensioners of 15 years commencing April 1, 2010. The PIE program provided pensioners with the option of receiving a one-off immediate increase to their pension in lieu of future non-statutory increases. The Company expects its annual cash contribution to pension plans to increase from \$9.6 million in 2009 to between \$15 million and \$20 million in 2010 primarily to fund the Plan deficit.

At September 30, 2010, the Company has a pension liability of \$113.1 million recorded in its balance sheet.

**NOTE 4 INTANGIBLE ASSETS**

| (in millions)                            | Nine Months Ended<br>September 30 |          |
|--|-----------------------------------|----------|
|  | 2010                              | 2009     |
| Gross cost at January 1 and September 30 | \$ 108.9                          | \$ 109.0 |
| Accumulated amortization at January 1    | (85.2)                            | (80.7)   |
| Amortization charge                      | (3.5)                             | (3.5)    |
| Accumulated amortization at September 30 | (88.7)                            | (84.2)   |
| Net book amount at September 30          | \$ 20.2                           | \$ 24.8  |

Ethyl



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An intangible asset of \$28.4 million was recognized in the second quarter of 2007 in respect of Ethyl foregoing their entitlement effective April 1, 2007 to a share of the future income stream under the sales and marketing agreements to market and sell tetra ethyl lead. In 2008 contract provisions no longer deemed necessary of \$6.3 million were offset against the intangible asset. The amount attributed to the Octane Additives business segment is being amortized straight-line to December 31, 2012 and the amount attributed to the Fuel Specialties business segment is being amortized straight-line to December 31, 2017. An amortization charge of \$1.5 million was recognized in the first nine months of 2010 (2009 \$1.5 million).

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

The remaining intangible assets of \$86.8 million relate to those recognized in the acquisition accounting in respect of Finetex (now merged into Innospec Active Chemicals LLC), Innospec Widnes Limited (previously known as Aroma Fine Chemicals Limited), Innospec Fuel Specialties LLC (previously known as Octel Starreon LLC) and Veritel Chemicals BV. These assets are being amortized straight-line over periods of up to 13 years with the exception of the Veritel asset which was fully amortized as at December 31, 2007. An amortization charge of \$2.0 million was recognized in the first nine months of 2010 (2009 \$2.0 million).

**NOTE 5 GOODWILL**

| (in millions)  | Nine Months Ended<br>September 30 |          |
|--|-----------------------------------|----------|
|  | 2010                              | 2009     |
| At January 1   |                                   |          |
| Gross cost   | \$ 674.3                          | \$ 673.9 |
| Accumulated Octane Additives business goodwill impairment losses | (229.8)                           | (227.6)  |
|  | 444.5                             | 446.3    |
| Impairment of Octane Additives business goodwill                 | (1.7)                             | (1.7)    |
| Exchange effect  | (0.1)                             | 0.5      |
| At September 30  | \$ 442.7                          | \$ 445.1 |
| Gross cost   | \$ 674.2                          | \$ 674.4 |
| Accumulated Octane Additives business goodwill impairment losses | (231.5)                           | (229.3)  |
|  | 442.7                             | 445.1    |
| Accumulated amortization at January 1                            | (298.5)                           | (298.1)  |
| Exchange effect  |                                   | (0.4)    |
| Accumulated amortization at September 30                         | (298.5)                           | (298.5)  |
| Net book amount at September 30                                  | \$ 144.2                          | \$ 146.6 |
| Octane Additives business goodwill                               | \$ 5.1                            | \$ 7.3   |
| Other  | 139.1                             | 139.3    |
|  | \$ 144.2                          | \$ 146.6 |

**Impairment of Octane Additives business goodwill**

Our Octane Additives business is the world's only producer of tetra ethyl lead ( TEL ). The Octane Additives business comprises sales of TEL for use in automotive gasoline and trading in respect of our environmental remediation business. Worldwide use of TEL has declined since 1973

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following the enactment of the U.S. Clean Air Act of 1970 and similar legislation in other countries. The trend of countries exiting the leaded gasoline market has resulted in an average rate of decline in volume terms in demand for TEL in the last five years of approximately 35% per annum.

In light of the continuing decline in the Octane Additives market globally, as the Company makes sales of Octane Additives in each quarter, the remaining sales and corresponding cash flows that can be derived from the Octane Additives business are reduced, and accordingly the fair value of the Octane Additives reporting unit is reduced. As a result, the Company determined that quarterly impairment reviews be performed from January 1, 2004 and any impairment charge arising be recognized in the relevant quarter. Given the quantum and predictability of the remaining future cash flows from the Octane Additives business, the Company expects goodwill impairment charges to be recognized in the income statement on an approximate straight-line basis to December 31, 2012.

**Table of Contents****INNOSPEC INC. AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 6 TAXATION**

A roll-forward of unrecognized tax benefits and associated accrued interest and penalties is as follows:

| (in millions)                                | Interest and<br>Penalties | Unrecognized<br>Tax Benefits | Total   |
|--|---------------------------|------------------------------|---------|
| Opening balance at January 1, 2010           | \$ 3.8                    | \$ 15.6                      | \$ 19.4 |
| Additions for tax positions of prior periods | 0.1                       | 2.0                          | 2.1     |
| Settlements                                  | (2.5)                     | (7.4)                        | (9.9)   |
| Closing balance at September 30, 2010        | 1.4                       | 10.2                         | 11.6    |
| Current                                      | (1.0)                     | (2.5)                        | (3.5)   |
| Non-current                                  | \$ 0.4                    | \$ 7.7                       | \$ 8.1  |

All of the \$11.6 million of unrecognized tax benefits would impact our effective tax rate if recognized.

We recognize accrued interest and penalties associated with uncertain tax positions as part of income taxes in our consolidated statements of income.

On January 11, 2010, Innospec Limited (a United Kingdom subsidiary of the Company) and the United Kingdom tax authorities ( HMRC ) entered into an agreement settling certain tax positions ( the Agreement ). The Agreement provided for the payment of £3.9 million (\$6.3 million) which was paid on January 21, 2010. The Agreement finalized all but one outstanding United Kingdom issue between the Company and HMRC. On July 16, 2010, Innospec Limited and HMRC reached an agreement on the outstanding United Kingdom issue excluded from the Agreement which resulted in a reduction of \$5.0 million in unrecognized tax benefits in the second quarter of 2010 and no additional tax cost.

As previously disclosed, the Company has been assessing the possible tax implications arising from the settlement of the United Nations Oil for Food Program ( OFFP ) and the U.S. Foreign Corrupt Practices Act ( FCPA ) investigations. The Company determined in the first quarter of 2010 that an element of the \$42.7 million settlement accruals would be tax deductible and accordingly recorded a \$2.0 million addition to unrecognized tax benefits. On September 30, 2010, Innospec Limited and HMRC reached an agreement in relation to the investigations which provided for an additional payment of \$0.7 million and resulted in a reduction of \$4.9 million in unrecognized tax benefits in the third quarter of 2010. The tax implications in other jurisdictions are still to be resolved. Accordingly, the eventual outcome of these matters and any relevant tax implications is inherently uncertain and the outcome may have a favorable or adverse material impact on the Company's results of operations, financial position and cash flows.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As at September 30, 2010, the Company's subsidiaries in the U.S. are subject to state tax audits in various states. The Company does not anticipate that adjustments arising out of these state tax audits would result in a material change to its financial position as at September 30, 2010.

The Company and its U.S. subsidiaries remain open to examination by the IRS for years 1998 onwards due to the net operating losses in the period 1998 to 2002, although no examination is currently underway. The Company's subsidiaries in other foreign tax jurisdictions are open to examination including France (2007 onwards), Germany (2005 onwards), Switzerland (2007 onwards) and the United Kingdom (2007 onwards).



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## INNOSPEC INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**NOTE 7 EARNINGS/(LOSS) PER SHARE**

Basic earnings/(loss) per share is based on the weighted average number of common shares outstanding during the period. Diluted earnings per share includes the effect of options that are dilutive and outstanding during the period. Per share amounts are computed as follows:

|  | Three Months Ended<br>September 30 |                  | Nine Months Ended<br>September 30 |                |
|--|------------------------------------|------------------|-----------------------------------|----------------|
|  | 2010                               | 2009             | 2010                              | 2009           |
| <b>Numerator (millions of dollars):</b>            |                                    |                  |                                   |                |
| Net income/(loss) available to common stockholders | \$ 30.0                            | \$ (2.7)         | \$ 49.4                           | \$ 6.7         |
| <b>Denominator (in thousands):</b>                 |                                    |                  |                                   |                |
| Weighted average common shares outstanding         | 23,805                             | 23,663           | 23,757                            | 23,635         |
| Dilutive effect of stock options and awards        | 1,197                              |                  | 1,174                             | 1,074          |
| Denominator for diluted earnings per share         | 25,002                             | 23,663           | 24,931                            | 24,709         |
| <b>Net income/(loss) per share, basic:</b>         | <b>\$ 1.26</b>                     | <b>\$ (0.11)</b> | <b>\$ 2.08</b>                    | <b>\$ 0.28</b> |
| <b>Net income/(loss) per share, diluted:</b>       | <b>\$ 1.20</b>                     | <b>\$ (0.11)</b> | <b>\$ 1.98</b>                    | <b>\$ 0.27</b> |

In the three and nine months ended September 30, 2010, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were 63,645 and 64,600, respectively (2009 63,576 and 134,984, respectively).

**NOTE 8 STOCKHOLDERS EQUITY AND SHARE BASED COMPENSATION PLANS**

At September 30, 2010, the Company had authorized common stock of 40,000,000 shares (December 31, 2009 40,000,000). Issued shares at September 30, 2010, were 29,554,500 (December 31, 2009 29,554,500) and treasury stock amounted to 5,738,582 shares (December 31, 2009 5,890,447).

The Company has five active stock option plans, two of which provide for the grant of stock options to key employees, one provides for the grant of stock options to non-employee directors, and another provides for the grant of stock options to key executives on a matching basis. A fifth plan is a savings plan which provides for the grant of stock options to all Company employees provided they commit to make regular savings over a pre-defined period which can then be used to purchase common stock upon vesting of the options. The stock options have vesting periods ranging from 24 months to 6 years and in all cases stock options granted expire within 10 years of the date of grant. The aggregate number of shares of common stock reserved for issuance which can be granted under the plans is 1,790,000.

The fair value of these options is calculated using the Black-Scholes model. In some cases certain performance related options are dependent upon external factors such as the Company's share price. The fair value of these options is calculated using a Monte Carlo model.

The following assumptions were used to determine the fair value of options calculated using the Black-Scholes model:

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|                         | 2010    | 2009    |
|-------------------------|---------|---------|
| Dividend yield          | 1.0%    | 2.5%    |
| Expected life           | 5 years | 5 years |
| Volatility              | 82.3%   | 76.5%   |
| Risk free interest rate | 1.36%   | 1.24%   |

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The following table summarizes the transactions of the Company's stock option plans for the three and nine months ended September 30, 2010:

|                                   | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price |
|-----------------------------------|---------------------|--|
| Outstanding at July 1, 2010       | 1,211,506           | \$ 2.73                                  |
| Exercised                         | (22,052)            | \$ 2.99                                  |
| Forfeitures                       | (1,065)             | \$ 22.27                                 |
| Outstanding at September 30, 2010 | 1,188,389           | \$ 2.70                                  |

|                                   | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Fair<br>Value |
|-----------------------------------|---------------------|--|--------------------------------------|
| Outstanding at January 1, 2010    | 1,159,885           | \$ 2.45                                  |                                      |
| Grants at discount                | 187,016             | \$                                       | \$ 8.10                              |
| Grants at market value            | 63,518              | \$ 10.49                                 | \$ 7.08                              |
| Exercised                         | (161,476)           | \$ 0.99                                  |                                      |
| Forfeitures                       | (60,554)            | \$ 2.39                                  |                                      |
| Outstanding at September 30, 2010 | 1,188,389           | \$ 2.70                                  |                                      |

The following table summarizes information about options outstanding at September 30, 2010:

| Range of<br>Exercise<br>Price | Number<br>Outstanding | Weighted<br>Average<br>Remaining<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price | Number<br>Exercisable<br>and Fully<br>Vested | Weighted<br>Average<br>Remaining<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price |
|-------------------------------|-----------------------|--|--|--|--|--|
| \$ 0 - \$ 5                   | 1,001,249             | 8.44   | \$ 0.63                                  | 46,540                                       | 5.77   | \$                                       |
| \$ 5 - \$10                   | 63,460                | 4.28   | \$ 9.20                                  | 63,460                                       | 4.28   | \$ 9.20                                  |
| \$10 - \$15                   | 64,818                | 9.29   | \$ 10.51                                 | 1,300  | 3.62   | \$ 11.50                                 |
| \$20 - \$25                   | 41,388                | 7.40   | \$ 20.32                                 |  |  | \$                                       |
| \$25 - \$30                   | 17,474                | 6.40   | \$ 27.09                                 | 17,474                                       | 6.40   | \$ 27.09                                 |
|                               | 1,188,389             |  |  | 128,774                                      |  |  |

The aggregate intrinsic value of fully vested stock options is \$1.0 million. Of the 128,774 stock options that are exercisable, 13,340 have performance conditions attached. The total compensation cost for the first nine months of 2010 was \$2.2 million (2009 \$0.6 million, including a



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gain of \$2.4 million related to stock options forfeited upon resignation of the Company's former CEO). The total compensation cost related to nonvested stock options not yet recognized at September 30, 2010 is \$3.5 million and this cost is expected to be recognized over the weighted-average period of 1.98 years.

No stock options awards have been modified in 2010. On February 13, 2009, we extended the vesting period for 132,470 grants made under a key employee performance related stock option plan from February 13, 2009 to February 13, 2011, and modified the performance criteria to reflect the longer vesting period. Additional compensation cost of \$0.2 million is required to be recognized for these modified stock options in the period February 13, 2009 to February 13, 2011.

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

The total intrinsic value of options exercised in the first nine months of 2010 was \$3.4 million (2009 \$0.4 million). The amount of cash received from the exercise of stock option awards in the first nine months of 2010 was \$0.2 million (2009 \$0.2 million). The Company's policy is to issue shares from Treasury stock to holders of stock options who exercise those options. During the first nine months of 2010 the new total fair value of shares vested was \$4.4 million (2009 \$1.1 million).

The total options vested in the first nine months of 2010 were 174,298 (2009 176,848).

An additional long-term incentive plan is in place to reward selected executives for delivering exceptional performance. Under this plan a discretionary bonus will be payable to eligible executives if the Innospec share performance out-performs that of competitors, as measured by the Russell 2000 Index, by a minimum of 10% over the five years from January 2008 to December 2012. The amount of bonus which can be earned will be a set cash amount for each one percentage point of out-performance. The maximum bonus under this plan will be payable for an out-performance versus the Russell 2000 Index of 30%. The maximum bonus under this plan, in respect of the current participants, is \$8 million (2009 \$8 million). No bonus is payable under this plan if the Innospec share price does not out-perform the Russell 2000 Index by more than 10% over the five year period, or the Russell 2000 Index falls in value over the same period. The fair value of these liability cash-settled stock appreciation rights is calculated on a quarterly basis using a Monte Carlo model and summarized as follows:

| (in millions)           | 2010   | 2009   |
|-------------------------|--------|--------|
| Balance at January 1    | \$ 0.2 | \$ 0.1 |
| Compensation charge     | 0.2    | 0.1    |
| Balance at September 30 | \$ 0.4 | \$ 0.2 |

The following assumptions were used in the Monte Carlo model:

|                         | 2010  | 2009  |
|-------------------------|-------|-------|
| Dividend yield          | 0.7%  | 0.7%  |
| Volatility              | 86.5% | 77.2% |
| Risk free interest rate | 0.64% | 1.45% |

**NOTE 9 DEBT**

Long-term debt consists of the following:

| (in millions)        | September 30<br>2010 | December 31<br>2009 |
|----------------------|----------------------|---------------------|
| Senior term loan     | \$ 40.0              | \$ 50.0             |
| Revolving credit     | 8.0                  | 1.0                 |
|                      | 48.0                 | 51.0                |
| Less current portion | (15.0)               | (10.0)              |

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|    |      |    |      |
|----|------|----|------|
| \$ | 33.0 | \$ | 41.0 |
|----|------|----|------|

On February 6, 2009, we entered into a three-year finance facility which provides for borrowings by us of up to \$150 million including a term loan of \$50 million and revolving credit facility of \$100 million. The revolving credit facility can be drawn down until the finance facility expires on February 6, 2012. On February 5, 2010, \$10 million of the term loan was repaid in accordance with the repayment schedule. The remaining balance on the term loan is repayable as follows: \$15 million on February 7, 2011 and \$25 million on February 6, 2012.

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

The Company's finance facility contains restrictive clauses which may constrain our activities and limit our operational and financial flexibility. The facility obliges the lenders to comply with a request for utilization of finance unless there is an event of default outstanding. Events of default are defined in the finance facility and include a material adverse change to our business, properties, assets, financial condition or results of operations. The facility contains a number of restrictions that limit our ability, amongst other things, and subject to certain limited exceptions, to incur additional indebtedness, pledge our assets as security, guarantee obligations of third parties, make investments, undergo a merger or consolidation, dispose of assets, or materially change our line of business.

In addition, the facility also contains terms which, if breached, would result in the loan becoming repayable on demand. It requires, among other matters, compliance with two financial covenant ratios. These requirements are (1) the ratio of net debt to EBITDA shall not be greater than 2.5:1 and (2) the ratio of EBITDA to net interest shall not be less than 4.0:1. EBITDA is a non GAAP measure of liquidity defined in the finance facility. Management believes that the Company has not breached these covenants throughout the period to September 30, 2010, and expects to not breach these covenants for the next 12 months. The finance facility is secured by a number of fixed and floating charges over certain assets of the Company and its subsidiaries.

The following table presents the projected annual maturities for the next two years after September 30, 2010:

| (in millions) | Term<br>Loan | Revolving<br>Credit<br>Facility | Total   |
|---------------|--------------|---------------------------------|---------|
| 2011          | \$ 15.0      | \$                              | \$ 15.0 |
| 2012          | 25.0         | 8.0                             | 33.0    |
|               | \$ 40.0      | \$ 8.0                          | \$ 48.0 |

**NOTE 10 PLANT CLOSURE PROVISIONS**

The liability for estimated closure costs of Innospec's Octane Additives manufacturing facilities includes costs for personnel reductions (severance), decontamination and environmental remediation activities (remediation) when demand for TEL diminishes. Severance provisions have also been made in relation to Corporate personnel and personnel in each of the three business segments.

Movements in the provisions are summarized as follows:

| (in millions)         | Q3 YTD 2010 |                        |             |         | Q3<br>YTD<br>2009 |
|-----------------------|-------------|------------------------|-------------|---------|-------------------|
|                       | Severance   | Other<br>Restructuring | Remediation | Total   | Total             |
| Total at January 1    | \$ 1.3      | \$ 1.0                 | \$ 26.1     | \$ 28.4 | \$ 26.9           |
| Charge for the period | 0.3         |                        | 1.6         | 1.9     | 3.1               |
| Expenditure           | (0.4)       | (0.3)                  | (2.0)       | (2.7)   | (3.1)             |
| Exchange effect       |             |                        | 0.1         | 0.1     | 0.1               |
| Total at September 30 | 1.2         | 0.7                    | 25.8        | 27.7    | 27.0              |
| Due within one year   | (0.2)       | (0.7)                  | (3.5)       | (4.4)   | (5.4)             |

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|                         |        |    |         |         |         |
|-------------------------|--------|----|---------|---------|---------|
| Balance at September 30 | \$ 1.0 | \$ | \$ 22.3 | \$ 23.3 | \$ 21.6 |
|-------------------------|--------|----|---------|---------|---------|

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**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Amounts due within one year refer to provisions where expenditure is expected to arise within one year of the balance sheet date. Severance charges are recognized in the income statement as restructuring costs along with other restructuring costs. Remediation costs are recognized in cost of goods sold.

**Severance**

A charge of \$0.3 million was recognized in respect of a reduction in EMEA headcount.

**Remediation**

The remediation provision represents the fair value of the Company's liability for asset retirement obligations. The accretion expense recognized in the first nine months of 2010 was \$1.6 million.

The Company records environmental liabilities when they are probable and costs can be estimated reasonably. The Company has to anticipate the program of work required and the associated future costs, and has to comply with environmental legislation in the relevant countries. The Company views the costs of vacating our Ellesmere Port site as a contingent liability because there is no present intention to exit the site. The Company has further determined that, due to the uncertain product life of TEL, particularly in the market for aviation gasoline, there exists such uncertainty as to the timing of such cash flows that it is not possible to estimate these flows sufficiently reliably to recognize a provision.

***NOTE 11 FAIR VALUE MEASUREMENTS***

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes a mid-market pricing convention for valuing the majority of its assets and liabilities measured and reported at fair value. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements and endeavors to utilize the best available information. Accordingly, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs. The Company gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. In the nine months ended September 30, 2010, the Company evaluated the fair value hierarchy levels assigned to its assets and liabilities, and concluded that there should be no transfers into or out of Level 1, 2 and 3.

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The following table presents the carrying amount and fair values of the Company's assets and liabilities measured on a recurring basis at September 30, 2010 and December 31, 2009:

| (in millions)                                      | September 30,<br>2010 |               | December 31,<br>2009 |               |
|--|-----------------------|---------------|----------------------|---------------|
|  | Carrying<br>Amount    | Fair<br>Value | Carrying<br>Amount   | Fair<br>Value |
| <b>Assets</b>                                      |                       |               |                      |               |
| <b>Non-derivatives:</b>                            |                       |               |                      |               |
| Cash and cash equivalents                          | \$ 98.8               | \$ 98.8       | \$ 68.6              | \$ 68.6       |
| Short term investments                             | 2.7                   | 2.7           |                      |               |
| <b>Non-financial assets (Level 3 measurement):</b> |                       |               |                      |               |
| Goodwill Octane Additives                          | 5.1                   | 5.1           | 6.8                  | 6.8           |
| <b>Derivatives (Level 1 measurement):</b>          |                       |               |                      |               |
| Commodity swaps                                    | 1.4                   | 1.4           | 1.6                  | 1.6           |
| Foreign currency forward exchange contracts        | 1.5                   | 1.5           |                      |               |
| <b>Liabilities</b>                                 |                       |               |                      |               |
| <b>Non-derivatives:</b>                            |                       |               |                      |               |
| Long-term debt (including current portion)         | \$ 48.0               | \$ 48.0       | \$ 51.0              | \$ 51.0       |
| <b>Derivatives (all Level 1 measurement):</b>      |                       |               |                      |               |
| Interest rate swaps                                | 0.6                   | 0.6           | 0.4                  | 0.4           |
| Foreign currency forward exchange contracts        |                       |               | 0.3                  | 0.3           |

For assets and liabilities measured at fair value on a recurring basis using Level 3 inputs, the following reconciles the opening and closing positions:

| (in millions)                                       | Goodwill Octane<br>Additives |
|---|------------------------------|
| <b>Assets</b>                                       |                              |
| Balance at January 1, 2010                          | \$ 6.8                       |
| <b>Total gains or losses (realized/unrealized):</b> |                              |
| Included in earnings                                | (1.7)                        |
| Included in other comprehensive income              |                              |
| Balance at September 30, 2010                       | \$ 5.1                       |

The cumulative gains and losses on the interest rate swaps and commodity swaps are summarized as follows:

| (in millions)        | 2010   | 2009     |
|----------------------|--------|----------|
| Balance at January 1 | \$ 1.2 | \$ (2.0) |
| Change in fair value | (0.4)  | 3.3      |

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|                         |        |        |
|-------------------------|--------|--------|
| Balance at September 30 | \$ 0.8 | \$ 1.3 |
|-------------------------|--------|--------|

On June 12, 2009, the Company entered into \$50.0 million of interest rate swaps which amortize and mature between February 2010 and February 2012. The interest rate swaps have been designated as a cash flow hedge against \$40.0 million of underlying floating rate debt obligations, that stood at \$48.0 million at September 30, 2010, and qualify for hedge accounting as at September 30, 2010 and December 31, 2009.



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

The carrying amount of long-term debt drawn under the three-year finance facility approximates fair value based on the period of time to maturity.

The commodity swaps are used to manage the Company's cash flow exposure to raw material cost volatility. They have been designated as cash flow hedges and all the commodity swaps qualify for hedge accounting as at September 30, 2010 and December 31, 2009.

The interest rate and commodity hedges were determined to be effective and consequently the net unrealized gain of \$0.8 million at September 30, 2010 (2009 net unrealized gain of \$1.3 million) has been recorded in other comprehensive income. Ineffectiveness was determined to be immaterial during the nine months ended September 30, 2010, and year ended December 31, 2009, and accordingly no gain or loss was recognized in earnings in either period. The Company expects a net unrealized gain of \$0.5 million at September 30, 2010 to be reclassified into earnings in the next 12 months, and the remaining \$0.3 million to be reclassified into earnings in the following 12 months.

Foreign currency forward exchange contracts primarily relate to contracts entered into to hedge future known transactions or hedge balance sheet net cash positions. The movements in the carrying amounts and fair values of these contracts are largely due to changes in exchange rates against the U.S. dollar.

**NOTE 12 DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT**

The Company has limited involvement with derivative instruments and does not trade them. The Company does use derivatives to manage certain interest rate, foreign currency rate and raw material cost exposures.

The Company uses interest rate swaps, floors, collar and cap agreements to reduce the impact of changes in interest rates on its floating rate debt. The swap agreements are contracts to exchange floating rate for fixed interest payments periodically over the life of the agreements without the exchange of the underlying notional amounts. The notional amounts are used to calculate interest to be paid or received and do not represent the amount of exposure to credit loss.

The Company has determined to hedge a proportion of the outstanding floating rate debt obligation. As at September 30, 2010 the Company had the following interest rate instruments in effect (notional amounts in millions):

| (in millions)      | Notional<br>Amount | Strike<br>Rate | Expiry Date      |
|--------------------|--------------------|----------------|------------------|
| Interest rate swap | \$ 7.5             | 1.4435%        | February 7, 2011 |
|                    | \$ 7.5             | 1.4500%        | February 7, 2011 |
|                    | \$ 15.0            | 1.8250%        | February 6, 2012 |
|                    | \$ 10.0            | 1.8700%        | February 6, 2012 |

The notional amount under the first two swaps above reduced from \$12.5 million to \$7.5 million on February 5, 2010.

The Company has hedged the cost of certain raw materials with commodity swaps. As at September 30, 2010 and December 31, 2009 the Company had the following summarized commodity swaps:

| (in millions) | September 30, 2010 |               | December 31, 2009  |               |
|---------------|--------------------|---------------|--------------------|---------------|
|               | Carrying<br>Amount | Fair<br>Value | Carrying<br>Amount | Fair<br>Value |

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|                                |  |        |        |        |        |
|--------------------------------|--|--------|--------|--------|--------|
| Notional quantity 1,350 tonnes |  |        |        | \$ 1.6 | \$ 1.6 |
| Notional quantity 3,300 tonnes |  | \$ 1.4 | \$ 1.4 |        |        |

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

These derivative instruments have been classified as cash flow hedging relationships. Their effectiveness has been tested and determined to be effective as at September 30, 2010 and December 31, 2009. The impact on the income statement for the nine months ended September 30, 2010 is summarized below:

| (in millions)           | Gain/(Loss)<br>Recognized in<br>OCI on<br>Derivative | Location of Gain/(Loss) Reclassified<br>from Accumulated OCI into Income | Amount of Gain/(Loss)<br>Reclassified from<br>Accumulated OCI<br>into Income |
|-------------------------|--|--|--|
| Interest rate contracts | \$ (0.6)   | Interest income/(expense)  | \$0.4  |
| Commodity contracts     | 0.6  | Cost of goods sold   | (0.8)  |
|                         |  |  | (0.4)  |
| Taxation                |  | Income taxes   | 0.1  |
|                         | \$   |  | \$(0.3)  |

We enter into various foreign currency forward exchange contracts to minimize currency exposure from expected future cash flows. The contracts have maturity dates of up to 3 years at the date of inception. These foreign currency forward exchange contracts have not been designated as hedging instruments, and their impact on the income statement for the nine months ended September 30, 2010 is summarized below:

| (in millions)                               | Location of Gain/(Loss)<br>Recognized in Income | Amount of Gain/(Loss)<br>Recognized in Income for the<br>Nine Months Ended<br>September 30, 2010 |
|---|---|--|
| Foreign currency forward exchange contracts | Other income/(expense)                          | \$ (0.4)   |

The Company sells a range of Fuel Specialties, Active Chemicals and Octane Additives to major oil refineries and chemical companies throughout the world. Credit limits, ongoing credit evaluation and account monitoring procedures are used to minimize bad debt risk. Collateral is not generally required.

**NOTE 13 COMMITMENTS AND CONTINGENCIES****Resolution of the United Nations Oil for Food Program ( OFFP ) and U.S. Foreign Corrupt Practices Act ( FCPA ) investigations and U.S. Cuban Assets Control Regulations ( CACR ) matters**

As we have previously disclosed, the Company has been the subject of investigations by U.S. and United Kingdom government authorities into legacy transactions conducted by the Company and its subsidiaries in potential violation of the OFFP, the FCPA, the CACR and United Kingdom anti-corruption laws. The Company and its officers and directors fully cooperated during the investigations with the U.S. Securities and Exchange Commission ( SEC ), the U.S. Department of Justice ( DOJ ), the U.S. Office of Foreign Assets Control ( OFAC ) and the United Kingdom Serious Fraud Office ( SFO ) (collectively, Government Authorities ).

In the first quarter of 2010, the Company entered into a \$40.2 million settlement with the Government Authorities to resolve all matters relating to the investigations. As part of this settlement the Company (i) pled guilty in the U.S. District Court for the District of Columbia to a twelve

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count indictment alleging wire fraud under the OFFP and violations of the FCPA in relation to illegal payments made to government officials in Iraq and Indonesia, (ii) agreed to pay a criminal fine of between \$7.7 million and \$14.1 million contingent on future trading and to retain an independent corporate compliance monitor for at least three (3) years, subject to conditions which would allow for a reduction or extension of the term, (iii) agreed to disgorge \$11.2 million to settle a civil action brought by the SEC alleging Securities Exchange Act of 1934 and FCPA violations for failing

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

to maintain proper internal controls and books and records violations, (iv) agreed to a civil penalty of \$2.2 million to settle OFAC allegations of violations of the CACR, and (v) pled guilty in the Southwark Crown Court, England, to criminal charges of conspiracy to corrupt relating to the SFO investigation with a Crown Court penalty of \$12.7 million. These fines, penalties and disgorgements are expected to be payable over a period of four years and the first payments aggregating to \$10.0 million were made to each of the DOJ, SEC, OFAC and Southwark Crown Court in April 2010. In September 2010 a payment of \$2.5 million was made to the DOJ which comprises a portion of the fine which is contingent on future trading. As at September 30, 2010, the expected schedule of payments is as follows:

| (in millions)                         | Government<br>Authorities | Compliance<br>Monitor | Total   |
|---------------------------------------|---------------------------|-----------------------|---------|
| Fines, penalties and disgorgements    | \$ 40.2                   | \$                    | \$ 40.2 |
| Probable future expenses              |                           | 3.9                   | 3.9     |
| Less discounting to net present value | (0.7)                     |                       | (0.7)   |
|                                       | 39.5                      | 3.9                   | 43.4    |
| Amounts paid:                         |                           |                       |         |
| - fixed                               | (10.0)                    |                       | (10.0)  |
| - contingent on future trading        | (2.5)                     |                       | (2.5)   |
| Exchange effect                       | 0.3                       |                       | 0.3     |
|                                       | 27.3                      | 3.9                   | 31.2    |
| Due within one year                   | (7.2)                     | (1.3)                 | (8.5)   |
|                                       | \$ 20.1                   | \$ 2.6                | \$ 22.7 |

For accounting purposes only we are required under GAAP to discount elements of the fines, penalties and disgorgements to their net present value. As at December 31, 2009, the Company had recorded total accruals for settlement of these matters of \$42.7 million. The Company accrued and has spent in excess of \$35 million in associated legal and other professional expenses with a provision of \$1.1 million remaining as at September 30, 2010. The Company accrued \$3.9 million in the first quarter of 2010 in respect of probable future compliance monitor expenses.

**NewMarket Corporation complaint**

On July 23, 2010, NewMarket Corporation and its subsidiary, Afton Chemical Corporation (collectively, NewMarket ), filed a civil complaint against the Company and its subsidiary, Alcor Chemie Vertriebs GmbH ( Alcor ), in the U.S. District Court for the Eastern District of Virginia. The complaint makes certain claims against the Company and Alcor with respect to alleged violations of provisions of the Robinson-Patman Act, the Virginia Antitrust Act and the Virginia Business Conspiracy Act as a result of alleged actions involving officials in Iraq and Indonesia pertaining to securing sales of the Company's tetra ethyl lead (TEL) fuel additive, to the apparent detriment of the plaintiffs and their sales of a competing non-lead based fuel additive. The complaint seeks treble damages of an unspecified amount, plus attorneys' fees, costs and expenses. The factual allegations underlying the complaint appear to relate to the same matters that were the subject of the Company's recently-disclosed resolution with the DOJ, SEC, OFAC and SFO. On September 22, 2010, the Company filed a motion to dismiss. On October 4, 2010, NewMarket filed an amended complaint incorporating the Sherman Act and related claims in addition to its previous claims. The Company filed its response to the amended complaint and a separate motion to dismiss on October 29, 2010. The Company believes both the complaint and amended complaint are without merit and intends to defend them vigorously, but because of uncertainties associated with the ultimate outcome of these complaints and the costs to the Company of responding to them, we cannot assure

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**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

you that the ultimate costs and damages, if any, that may be imposed upon us will not have a material adverse effect on our results of operations, financial position and cash flows. As at September 30, 2010 we had accrued \$0.5 million in respect of probable future legal expenses and provided no additional accruals in respect of this matter.

**Other legal matters**

We are not involved in any other administrative or judicial proceedings arising under provisions enacted that regulate the discharge of materials into the environment or enacted for the purpose of protecting the environment involving a governmental authority as a party, which involves potential monetary sanctions which the Company reasonably believes will result in monetary sanctions of more than \$100,000.

We are involved from time to time in claims and legal proceedings that result from, and are incidental to, the conduct of our business including business and commercial litigation, employee and product liability claims. There are no other material pending legal proceedings to which the Company or any of its subsidiaries is a party, or of which any of their property is subject, other than ordinary, routine litigation incidental to their respective businesses, although an adverse resolution of a number of these items could have a material adverse effect on our results of operations for a particular year or quarter.

Whilst it is not possible to predict with certainty the outcome of any legal proceedings, it is our opinion, based on our current knowledge, that we will not suffer any material adverse effect on our results of operations, financial position or cash flows as a result of any actual or threatened litigation.

**Guarantees**

The Company and certain of the Company's consolidated subsidiaries are contingently liable for certain obligations of affiliated companies primarily in the form of guarantees of debt and performance under contracts entered into as a normal business practice. This included guarantees of non-U.S. excise taxes and customs duties. As at September 30, 2010, such contingent liabilities amounted to \$5.6 million.

Under the terms of the guarantee arrangements, generally the Company would be required to perform should the affiliated company fail to fulfill its obligations under the arrangements. In some cases, the guarantee arrangements have recourse provisions that would enable the Company to recover any payments made under the terms of the guarantees from securities held of the guaranteed parties' assets.

The Company and its affiliates have numerous long-term sales and purchase commitments in their various business activities, which are expected to be fulfilled with no adverse consequences material to the Company.

**NOTE 14 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In January 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-06, *Improving Disclosures about Fair Value Measurements* (ASU 2010-06). This ASU amends ASC Subtopic 820-10 to require new disclosures regarding transfers in and out of Level 1 and Level 2, as well as activity in Level 3, fair value measurements. ASU 2010-06 further requires additional disclosures about valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. ASU 2010-06 is effective for financial statements issued by the Company for interim and annual periods beginning after December 15, 2009, except for disclosures about purchases, sales, issuances, and settlements in the roll-forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010. The Company adopted ASU 2010-06 for the quarter ended March 31, 2010 and subsequent periods. Adoption did not have a material impact on its consolidated financial statements.

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**ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three and Nine Months Ended September 30, 2010**

This discussion should be read in conjunction with our unaudited interim consolidated financial statements and the notes thereto.

***CRITICAL ACCOUNTING ESTIMATES***

Our objective is to clearly present our financial information in a manner that enhances the understanding of our sources of earnings and cash flows together with our financial position. We aim to achieve this by disclosing information required by the SEC together with further information that provides insight into our businesses.

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses Innospec's consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. Management evaluates on an on-going basis its estimates and judgments. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The policies and estimates that the Company considers the most critical in terms of complexity and subjectivity of assessment are those related to contingencies, environmental liabilities, goodwill, intangible assets (net of amortization), pensions, and deferred tax asset valuation allowance and uncertain income tax positions. These policies have been discussed in the Company's 2009 Annual Report on Form 10-K.

**Table of Contents****RESULTS OF OPERATIONS**

| (in millions)                                    | Three Months Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|--|------------------------------------|----------|-----------------------------------|----------|
|  | 2010                               | 2009     | 2010                              | 2009     |
| <b>Net sales</b>                                 |                                    |          |                                   |          |
| Fuel Specialties                                 | \$ 113.9                           | \$ 100.1 | \$ 330.9                          | \$ 305.7 |
| Active Chemicals                                 | 38.2                               | 36.6     | 113.7                             | 97.7     |
| Octane Additives                                 | 21.9                               | 12.5     | 61.3                              | 30.9     |
|  | \$ 174.0                           | \$ 149.2 | \$ 505.9                          | \$ 434.3 |
| <b>Gross profit</b>                              |                                    |          |                                   |          |
| Fuel Specialties                                 | \$ 37.4                            | \$ 32.9  | \$ 107.8                          | \$ 105.1 |
| Active Chemicals                                 | 8.3                                | 8.7      | 24.8                              | 20.8     |
| Octane Additives                                 | 9.7                                | 5.6      | 29.7                              | 12.3     |
|  | \$ 55.4                            | \$ 47.2  | \$ 162.3                          | \$ 138.2 |
| <b>Operating income/(loss)</b>                   |                                    |          |                                   |          |
| Fuel Specialties                                 | \$ 18.7                            | \$ 16.0  | \$ 57.9                           | \$ 57.3  |
| Active Chemicals                                 | 4.3                                | 3.7      | 12.0                              | 7.7      |
| Octane Additives                                 | 6.4                                | (14.7)   | 24.7                              | (24.1)   |
| Pension charge                                   | (2.5)                              | (1.7)    | (8.4)                             | (4.7)    |
| Corporate costs                                  | (5.4)                              | (4.4)    | (19.2)                            | (10.2)   |
|  | 21.5                               | (1.1)    | 67.0                              | 26.0     |
| Restructuring charge                             |                                    |          | (8.5)                             | (1.7)    |
| Impairment of Octane Additives business goodwill | (0.6)                              | (0.6)    | (1.7)                             | (1.7)    |
| Profit on disposal                               |                                    |          | 0.2                               |          |
| Total operating income/(loss)                    | 20.9                               | (1.7)    | 57.0                              | 22.6     |
| Other net income                                 | 11.6                               | 7.1      | 0.7                               | 0.3      |
| Interest expense                                 | (1.3)                              | (1.5)    | (3.8)                             | (4.9)    |
| Interest income                                  | 0.1                                | 0.1      | 0.3                               | 0.2      |
| Income before income taxes                       | \$ 31.3                            | \$ 4.0   | \$ 54.2                           | \$ 18.2  |



**Table of Contents****Three Months Ended September 30, 2010:**

| (in millions, except ratios) | 2010      | 2009      | Change   |      |
|------------------------------|-----------|-----------|----------|------|
| <b>Net sales:</b>            |           |           |          |      |
| Fuel Specialties             | \$ 113.9  | \$ 100.1  | \$ 13.8  | +14% |
| Active Chemicals             | 38.2      | 36.6      | 1.6      | +4%  |
| Octane Additives             | 21.9      | 12.5      | 9.4      | +75% |
|                              | \$ 174.0  | \$ 149.2  | \$ 24.8  | +17% |
| <b>Gross profit:</b>         |           |           |          |      |
| Fuel Specialties             | \$ 37.4   | \$ 32.9   | \$ 4.5   | +14% |
| Active Chemicals             | 8.3       | 8.7       | (0.4)    | -5%  |
| Octane Additives             | 9.7       | 5.6       | 4.1      | +73% |
|                              | \$ 55.4   | \$ 47.2   | \$ 8.2   | +17% |
| <b>Gross margin (%)</b>      |           |           |          |      |
| Fuel Specialties             | 32.8      | 32.9      | -0.1     |      |
| Active Chemicals             | 21.7      | 23.8      | -2.1     |      |
| Octane Additives             | 44.3      | 44.8      | -0.5     |      |
| Aggregate                    | 31.8      | 31.6      | +0.2     |      |
| <b>Operating expenses:</b>   |           |           |          |      |
| Fuel Specialties             | \$ (18.1) | \$ (16.3) | \$ (1.8) | +11% |
| Active Chemicals             | (3.7)     | (4.7)     | 1.0      | -21% |
| Octane Additives             | (3.0)     | (20.0)    | 17.0     | -85% |
| Pension charge               | (2.5)     | (1.7)     | (0.8)    | +47% |
| Corporate costs              | (5.4)     | (4.4)     | (1.0)    | +23% |
|                              | \$ (32.7) | \$ (47.1) | \$ 14.4  | -31% |

**Fuel Specialties**

*Net sales:* the table below details the components which comprise the year on year change in net sales spread across the markets in which we operate.

| Change (%)            | Americas | EMEA | ASPAC | Avtel | Total |
|-----------------------|----------|------|-------|-------|-------|
| Volume                | +7       | +11  | +52   | +34   | +17   |
| Price and product mix | +8       | +6   | -22   | -9    | +2    |
| Exchange rates        | n/a      | -11  | -1    | n/a   | -5    |
|                       | +15      | +6   | +29   | +25   | +14   |

*Gross margin:* the year on year decrease of 0.1 percentage points reflects the competitive pressure on margins as raw material costs have continued to rise in the quarter, offset by an increased proportion of higher margin Avtel sales.

*Operating expenses:* the year on year increase of 11% was less than the 14% sales growth as we continued to leverage the infrastructure of this business. In addition, there were 3% higher research and development expenses to support this developing business and increased legal and other

professional expenses.

**Table of Contents****Active Chemicals**

*Net sales:* the table below details the components which comprise the year on year change in net sales spread across the markets in which we operate.

| Change (%)            | Americas | EMEA | ASPAC | Total |
|-----------------------|----------|------|-------|-------|
| Volume                | +14      | -14  | +13   | n/a   |
| Price and product mix | +10      | +10  | +21   | +11   |
| Exchange rates        | -2       | -9   | -5    | -7    |
|                       | +22      | -13  | +29   | +4    |

*Gross margin:* the year on year decrease of 2.1 percentage points reflects the competitive pressure on margins as raw material costs have continued to rise in the quarter, and the adverse impact from lower utilization and manufacturing efficiencies in our plants.

*Operating expenses:* the year on year decrease was \$1.0 million or 21%. The decrease was achieved despite the 4% sales growth and 25% increase in research and development expenses to support this developing business, primarily due to the higher costs incurred last year complying with Registration, Evaluation and Authorization of Chemical Substances Regulations ( REACH ) in the European Union.

**Octane Additives**

*Net sales:* increased by 75% due to improved volumes (up 55 percentage points), as a result of the timing of shipments to major customers, and an improved sales mix (up 20 percentage points). In both 2010 and 2009 sales were focused in the Middle East and Africa.

*Gross margin:* the year on year decrease of 0.5 percentage points primarily reflects the decrease in TEL production volumes in the current quarter on the fixed cost base on the TEL manufacturing site.

*Operating expenses:* excluding the impact in 2009 of the \$18.3 million accrual for the OFFP and FCPA settlement, the year on year increase in operating expenses was \$1.3 million, or 76%, primarily in respect of increased legal and other professional expenses.

**Other Income Statement Captions**

*Pension charge:* this non-cash charge increased by \$0.8 million to \$2.5 million primarily reflecting the requirement in 2010 to amortize net actuarial losses, offset by the near elimination of the service cost since the Company closed the pension plan to future service accrual with effect from March 31, 2010.

*Corporate costs:* increased to \$5.4 million from \$4.4 million a year ago primarily due to higher personnel-related costs and the increased cost of alternative pension arrangements following the closure of the pension plan to future service accrual with effect from March 31, 2010.

*Amortization of intangible assets:* was \$1.2 million in both 2010 and 2009.

*Impairment of Octane Additives business goodwill:* was \$0.6 million in both 2010 and 2009.

*Other net income:* of \$11.6 million in 2010 relates to net foreign exchange gains on foreign currency forward exchange contracts and translation of net assets denominated in non-functional currencies in our European businesses. In 2009 other net income of \$7.1 million related to net foreign currency gains of \$7.0 million and sundry other income of \$0.1 million.

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*Interest expense (net)*: has decreased from \$1.4 million to \$1.2 million due to the lower level of debt in 2010.

*Income taxes*: the effective tax rate, once adjusted for Octane Additives business goodwill impairment and the \$18.3 million accrual in 2009 for the OFFP and FCPA settlement, is 4.1% compared to 29.3% in 2009. The decrease of 25.2 percentage points is due to the positive impact of taxable profits in different geographical locations and the adjustment of income tax provisions as a result of the settlement in the third quarter of 2010 of a United Kingdom tax position. This was in addition to a \$1.1 million net deferred tax credit in the third quarter of 2010, primarily in respect of pension plan unrecognized actuarial net losses, following the United Kingdom's 1% reduction in the corporation tax rate from 28% to 27% in April 2011 enacted in July 2010.

| (in millions)   | 2010    | 2009    |
|---|---------|---------|
| Income before income taxes                                | \$ 31.3 | \$ 4.0  |
| Add back OFFP/FCPA settlement accrual                     |         | 18.3    |
| Add back Impairment of Octane Additives business goodwill | 0.6     | 0.6     |
|   | \$ 31.9 | \$ 22.9 |
| Income taxes  | \$ 1.3  | \$ 6.7  |
| Adjusted effective tax rate                               | 4.1%    | 29.3%   |

**Nine Months Ended September 30, 2010:**

| (in millions, except ratios) | 2010      | 2009      | Change   |       |
|------------------------------|-----------|-----------|----------|-------|
| <b>Net sales:</b>            |           |           |          |       |
| Fuel Specialties             | \$ 330.9  | \$ 305.7  | \$ 25.2  | +8%   |
| Active Chemicals             | 113.7     | 97.7      | 16.0     | +16%  |
| Octane Additives             | 61.3      | 30.9      | 30.4     | +98%  |
|                              | \$ 505.9  | \$ 434.3  | \$ 71.6  | +16%  |
| <b>Gross profit:</b>         |           |           |          |       |
| Fuel Specialties             | \$ 107.8  | \$ 105.1  | \$ 2.7   | +3%   |
| Active Chemicals             | 24.8      | 20.8      | 4.0      | +19%  |
| Octane Additives             | 29.7      | 12.3      | 17.4     | +141% |
|                              | \$ 162.3  | \$ 138.2  | \$ 24.1  | +17%  |
| <b>Gross margin (%)</b>      |           |           |          |       |
| Fuel Specialties             | 32.6      | 34.4      | -1.8     |       |
| Active Chemicals             | 21.8      | 21.3      | +0.5     |       |
| Octane Additives             | 48.5      | 39.8      | +8.7     |       |
| Aggregate                    | 32.1      | 31.8      | +0.3     |       |
| <b>Operating expenses:</b>   |           |           |          |       |
| Fuel Specialties             | \$ (48.2) | \$ (46.1) | \$ (2.1) | +5%   |
| Active Chemicals             | (11.8)    | (12.1)    | 0.3      | -2%   |
| Octane Additives             | (4.2)     | (35.6)    | 31.4     | -88%  |
| Pension charge               | (8.4)     | (4.7)     | (3.7)    | +79%  |
| Corporate costs              | (19.2)    | (10.2)    | (9.0)    | +88%  |

|           |            |         |      |
|-----------|------------|---------|------|
| \$ (91.8) | \$ (108.7) | \$ 16.9 | -16% |
|-----------|------------|---------|------|

**Table of Contents****Fuel Specialties**

*Net sales:* the table below details the components which comprise the year on year change in net sales spread across the markets in which we operate.

| Change (%)            | Americas | EMEA | ASPAC | Avtel | Total |
|-----------------------|----------|------|-------|-------|-------|
| Volume                | +3       | +10  | +103  | -2    | +17   |
| Price and product mix | -1       | -1   | -53   | +8    | -7    |
| Exchange rates        | n/a      | -5   | -1    | n/a   | -2    |
|                       | +2       | +4   | +49   | +6    | +8    |

*Gross margin:* the year on year decrease of 1.8 percentage points reflects the competitive pressure on margins as raw material costs have increased in 2010. This was offset by the impact of higher margins within our Avtel business from increased TEL production volumes on the fixed cost base on the TEL manufacturing site.

*Operating expenses:* the year on year increase of 5% was less than the 8% sales growth as we continued to leverage the infrastructure of this business. In addition, there were 10% higher research and development expenses to support this developing business and increased legal and other professional expenses.

**Active Chemicals**

*Net sales:* the table below details the components which comprise the year on year change in net sales spread across the markets in which we operate.

| Change (%)            | Americas | EMEA | ASPAC | Total |
|-----------------------|----------|------|-------|-------|
| Volume                | +13      | -3   | +11   | +5    |
| Price and product mix | +9       | +16  | +15   | +13   |
| Exchange rates        | n/a      | -3   | -1    | -2    |
|                       | +22      | +10  | +25   | +16   |

*Gross margin:* the year on year increase of 0.5 percentage points reflects the improved performance from our Personal Care and Polymers businesses, which suffered from poor demand in 2009, despite the competitive pressure on margins as raw material costs have increased in 2010.

*Operating expenses:* the year on year decrease was \$0.3 million or 2%. The decrease was achieved despite the 16% sales growth and 33% increase in research and development expenses to support this developing business, primarily due to the higher costs incurred last year complying with REACH.

**Octane Additives**

*Net sales:* increased by 98% due to improved volumes (up 82 percentage points), as a result of the timing of shipments to major customers, and an improved sales mix (up 16 percentage points). In both 2010 and 2009 sales were focused in the Middle East and Africa.

*Gross margin:* the year on year increase of 8.7 percentage points primarily reflects the increased TEL production volumes on the fixed cost base on the TEL manufacturing site.

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*Operating expenses:* excluding the impact of the \$12.9 million OFFP and FCPA legal and other professional expenses and \$18.3 million accrual for the OFFP and FCPA settlement in 2009, and \$3.0 million adjustment to the related settlement accrual in 2010, the year on year increase in operating expenses was \$2.8 million, or 64%, primarily due to increased selling costs and higher legal and other professional expenses.

**Table of Contents****Other Income Statement Captions**

*Pension charge:* this non-cash charge increased by \$3.7 million to \$8.4 million primarily reflecting the requirement in 2010 to amortize net actuarial losses, offset by the near elimination of the service cost since the Company closed the pension plan to future service accrual with effect from March 31, 2010.

*Corporate costs:* increased by \$9.0 million due to a \$3.9 million charge in the first quarter of 2010 for probable future independent corporate compliance monitor expenses over the next three years. In 2009 corporate costs included a \$2.4 million gain on stock options forfeited upon resignation of the Company's former CEO. Excluding these items, corporate costs were \$15.3 million, compared with \$12.6 million a year ago, in part due to higher personnel-related costs and the increased cost of alternative pension arrangements following the closure of the pension plan to future service accrual with effect from March 31, 2010.

*Restructuring charge:* is comprised of the following:

| (in millions)                            | 2010   | 2009   |
|--|--------|--------|
| Pension curtailment                      | \$ 8.2 | \$     |
| Reduction in EMEA headcount              | 0.3    | 0.3    |
| Separation agreement with the former CEO |        | 1.3    |
| Site clearance                           |        | 0.1    |
|  | \$ 8.5 | \$ 1.7 |

The Company closed a defined benefit pension plan to future service accrual with effect from March 31, 2010 and accordingly we recorded a non-cash curtailment charge of \$8.2 million in the first quarter.

*Amortization of intangible assets:* was \$3.5 million in both 2010 and 2009.

*Impairment of Octane Additives business goodwill:* was \$1.7 million in both 2010 and 2009.

*Profit on disposal:* in April 2010 the Company recognized \$0.2 million profit following the disposal of surplus real estate.

*Other net income:* of \$0.7 million in 2010 relates to \$0.6 million of net foreign exchange gains and sundry other income of \$0.1 million. In 2009 other net income of \$0.3 million related to net foreign exchange gains.

*Interest expense (net):* has decreased from \$4.7 million to \$3.5 million, due to the lower level of debt in 2010, and the accelerated write off of \$0.2 million of unamortized deferred finance costs in 2009.

*Income taxes:* the effective tax rate, once adjusted for Octane Additives business goodwill impairment and the \$18.3 million accrual in 2009 for the OFFP and FCPA settlement, is 8.6% compared to 30.1% in 2009. The decrease of 21.5 percentage points is due to the positive impact of taxable profits in different geographical locations and the adjustment of income tax provisions as a result of settlements in the second and third quarters of 2010 of United Kingdom tax positions. This was in addition to the revised assumption in the first quarter of 2010 that an element of the OFFP and FCPA settlement accruals should be tax deductible; and a \$1.1 million net deferred tax credit in the third quarter of 2010, primarily in respect of pension plan unrecognized actuarial net losses, following the United Kingdom's 1% reduction in the corporation tax rate from 28% to 27% in April 2011 enacted in July 2010.



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| (in millions)   | 2010    | 2009    |
|---|---------|---------|
| Income before income taxes                                | \$ 54.2 | \$ 18.2 |
| Add back OFFP/FCPA settlement accrual                     |         | 18.3    |
| Add back Impairment of Octane Additives business goodwill | 1.7     | 1.7     |
|   | \$ 55.9 | \$ 38.2 |
| Income taxes  | \$ 4.8  | \$ 11.5 |
| Adjusted effective tax rate                               | 8.6%    | 30.1%   |

**LIQUIDITY AND FINANCIAL CONDITION****Working Capital**

| (in millions)   | September 30,<br>2010 | December 31,<br>2009 |
|---|-----------------------|----------------------|
| Total current assets                                  | \$ 314.0              | \$ 282.9             |
| Total current liabilities                             | (141.2)               | (179.9)              |
| Working capital                                       | 172.8                 | 103.0                |
| Less cash and cash equivalents                        | (98.8)                | (68.6)               |
| Less short term investments                           | (2.7)                 |                      |
| Add back accrued income taxes                         | 1.2                   | 6.3                  |
| Add back short-term borrowing                         | 15.0                  | 10.0                 |
| Add back current portion of plant closure provisions  | 4.4                   | 3.9                  |
| Add back current portion of unrecognized tax benefits | 3.5                   | 5.0                  |
| Add back current portion of deferred income           | 0.1                   | 0.1                  |
| Adjusted working capital                              | \$ 95.5               | \$ 59.7              |

In the first nine months of 2010 adjusted working capital increased by \$35.8 million (defined by the Company as accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities rather than total current assets less total current liabilities). The net \$2.8 million increase in accounts receivable and prepaid expenses was primarily due to increased trading in our Fuel Specialties and Active Chemicals businesses. Inventories declined by \$4.6 million due to strong revenues in our Octane Additives business depleting inventory levels. The \$37.6 million decrease in accounts payable and accrued liabilities primarily reflects the reclassification into long-term accrued liabilities of \$22.7 million following settlement of the OFFP and FCPA investigations; and payments aggregating to \$12.5 million made to each of the DOJ, SEC, OFAC and Southwark Crown Court. The remaining decrease of \$2.4 million reflects payments subsequent to the year end in the normal course of business in respect of external suppliers and personnel-related compensation. We continue to expect net cash to decrease in future quarters based on the need to build working capital from recent low levels, increase our capital expenditures, and the timing of other cash flows.

**Cash**

At September 30, 2010 and December 31, 2009 we had cash and cash equivalents of \$98.8 million and \$68.6 million, respectively.

**Short term investments**

At September 30, 2010 and December 31, 2009 we had short term investments of \$2.7 million and \$nil, respectively.



**Table of Contents****Debt**

On February 6, 2009, we entered into a three-year finance facility which provides for borrowings by us of up to \$150 million including a term loan of \$50 million and revolving credit facility of \$100 million. The revolving credit facility can be drawn down until the finance facility expires on February 6, 2012.

The Company's finance facility contains restrictive clauses which may constrain our activities and limit our operational and financial flexibility. The facility obliges the lenders to comply with a request for utilization of finance unless there is an event of default outstanding. Events of default are defined in the finance facility and include a material adverse change to our business, properties, assets, financial condition or results of operations. The facility contains a number of restrictions that limit our ability, amongst other things, and subject to certain limited exceptions, to incur additional indebtedness, pledge our assets as security, guarantee obligations of third parties, make investments, undergo a merger or consolidation, dispose of assets, or materially change our line of business.

In addition, the facility also contains terms which, if breached, would result in the loan becoming repayable on demand. It requires, among other matters, compliance with two financial covenant ratios. These requirements are (1) the ratio of net debt to EBITDA shall not be greater than 2.5:1 and (2) the ratio of EBITDA to net interest shall not be less than 4.0:1. EBITDA is a non GAAP measure of liquidity defined in the finance facility. Management believes that the Company has not breached these covenants throughout the period to September 30, 2010, and expects to not breach these covenants for the next 12 months. The finance facility is secured by a number of fixed and floating charges over certain assets of the Company and its subsidiaries.

As at September 30, 2010, the Company had \$48.0 million of debt outstanding under its finance facility and was in compliance with all financial covenants therein. The debt maturity profile as at September 30, 2010, including the finance facility, is set out below:

|  |         |
|--|---------|
| <b>(in millions)</b>                   |         |
| 2011                                   | \$ 15.0 |
| 2012                                   | 33.0    |
|  | 48.0    |
| Current portion of long-term debt      | (15.0)  |
| Long-term debt, net of current portion | \$ 33.0 |

**ITEM 3 Quantitative and Qualitative Disclosures About Market Risk**

The Company operates manufacturing and blending facilities, offices and laboratories around the world. The Company sells a range of Fuel Specialties, Active Chemicals and Octane Additives to customers around the world. The Company uses floating rate debt to finance these global operations. Consequently, the Company is subject to business risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations, and market risk related to changes in interest rates and foreign currency exchange rates. The political and economic risks are mitigated by the stability of the countries in which the Company's largest operations are located. Credit limits, ongoing credit evaluation and account monitoring procedures are used to minimize bad debt risk. Collateral is not generally required.

The Company uses derivatives, including interest rate swaps, commodity swaps and foreign currency forward exchange contracts, in the normal course of business to manage market risks. The derivatives used in hedging activities are considered risk management tools and are not used for trading purposes. In addition, the Company enters into derivative instruments with a diversified group of major financial institutions in order to manage the exposure to non-performance of such instruments. The Company's objective in managing exposure to changes in interest rates is to limit the impact of such changes on earnings and cash flows and to lower overall borrowing costs. The Company's objective in managing the exposure to changes in foreign currency exchange rates is to reduce volatility on earnings and cash flows associated with such changes.



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The Company offers fixed prices for some long-term sales contracts. As manufacturing and raw materials costs are subject to variability the Company uses commodity swaps to hedge the cost of some raw materials thus reducing volatility on earnings and cash flows. The derivatives are considered risk management tools and are not used for trading purposes. The Company's objective is to manage its exposure to fluctuating costs of raw materials.

The Company's exposure to market risk has been discussed in the Company's 2009 Annual Report on Form 10-K and there have been no significant changes since that time.

### **ITEM 4 Controls and Procedures Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report the Company carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended).

Based upon this evaluation of disclosure controls and procedures, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of September 30, 2010.

### **Changes in Internal Controls over Financial Reporting**

The Company is continuously seeking to improve the efficiency and effectiveness of its operations and of its internal controls. This results in refinements to processes throughout the Company. However, there has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1 Legal Proceedings**

Resolution of the United Nations Oil for Food Program ( OFFFP ) and U.S. Foreign Corrupt Practices Act ( FCPA ) investigations and U.S. Cuban Assets Control Regulations ( CACR ) matters

As we have previously disclosed, the Company has been the subject of investigations by U.S. and United Kingdom government authorities into legacy transactions conducted by the Company and its subsidiaries in potential violation of the OFFFP, the FCPA, the CACR and United Kingdom anti-corruption laws. The Company and its officers and directors fully cooperated during the investigations with the U.S. Securities and Exchange Commission ( SEC ), the U.S. Department of Justice ( DOJ ), the U.S. Office of Foreign Assets Control ( OFAC ) and the United Kingdom Serious Fraud Office ( SFO ) (collectively, Government Authorities ).

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In the first quarter of 2010, the Company entered into a \$40.2 million settlement with the Government Authorities to resolve all matters relating to the investigations. As part of this settlement the Company (i) pled guilty in the U.S. District Court for the District of Columbia to a twelve count indictment alleging wire fraud under the OFFP and violations of the FCPA in relation to illegal payments made to government officials in Iraq and Indonesia, (ii) agreed to pay a criminal fine of between \$7.7 million and \$14.1 million contingent on future trading and to retain an independent corporate compliance monitor for at least three (3) years, subject to conditions which would allow for a reduction or extension of the term, (iii) agreed to disgorge \$11.2 million to settle a civil action brought by the SEC alleging Securities Exchange Act of 1934 and FCPA violations for failing to maintain proper internal controls and books and records violations, (iv) agreed to a civil penalty of \$2.2 million to settle OFAC allegations of violations of the CACR, and (v) pled guilty in the Southwark Crown Court, England, to criminal charges of conspiracy to corrupt relating to the SFO investigation with a Crown Court penalty of \$12.7 million. These fines, penalties and disgorgements are expected to be payable over a period of four years and the first payments aggregating to \$10.0 million were made to each of the DOJ, SEC, OFAC and Southwark Crown Court in April 2010. In September 2010 a payment of \$2.5 million was made to the DOJ which comprises a portion of the fine which is contingent on future trading. As at September 30, 2010, the expected schedule of payments is as follows:

| (in millions)                         | Government<br>Authorities | Compliance<br>Monitor | Total   |
|---------------------------------------|---------------------------|-----------------------|---------|
| Fines, penalties and disgorgements    | \$ 40.2                   | \$                    | \$ 40.2 |
| Probable future expenses              |                           | 3.9                   | 3.9     |
| Less discounting to net present value | (0.7)                     |                       | (0.7)   |
|                                       | 39.5                      | 3.9                   | 43.4    |
| Amounts paid:                         |                           |                       |         |
| - fixed                               | (10.0)                    |                       | (10.0)  |
| - contingent on future trading        | (2.5)                     |                       | (2.5)   |
| Exchange effect                       | 0.3                       |                       | 0.3     |
|                                       | 27.3                      | 3.9                   | 31.2    |
| Due within one year                   | (7.2)                     | (1.3)                 | (8.5)   |
|                                       | \$ 20.1                   | \$ 2.6                | \$ 22.7 |

For accounting purposes only we are required under GAAP to discount elements of the fines, penalties and disgorgements to their net present value. As at December 31, 2009, the Company had recorded total accruals for settlement of these matters of \$42.7 million. The Company accrued and has spent in excess of \$35 million in associated legal and other professional expenses with a provision of \$1.1 million remaining as at September 30, 2010. The Company accrued \$3.9 million in the first quarter of 2010 in respect of probable future compliance monitor expenses.

**NewMarket Corporation complaint**

On July 23, 2010, NewMarket Corporation and its subsidiary, Afton Chemical Corporation (collectively, NewMarket ), filed a civil complaint against the Company and its subsidiary, Alcor Chemie Vertriebs GmbH ( Alcor ), in the U.S. District Court for the Eastern District of Virginia. The complaint makes certain claims against the Company and Alcor with respect to alleged violations of provisions of the Robinson-Patman Act, the Virginia Antitrust Act and the Virginia Business Conspiracy Act as a result of alleged actions involving officials in Iraq and Indonesia pertaining to securing sales of the Company's tetra ethyl lead (TEL) fuel additive, to the apparent detriment of the plaintiffs and their sales of a competing non-lead based fuel additive. The complaint seeks treble damages of an unspecified amount, plus attorneys' fees, costs and expenses. The factual allegations underlying the complaint appear to relate to the same matters that were the subject of the Company's recently-disclosed resolution with the DOJ, SEC, OFAC and SFO. On September 22, 2010, the Company filed a motion to dismiss. On October 4, 2010, NewMarket filed an amended complaint incorporating the Sherman Act and

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related claims in addition to its previous claims. The Company filed its response to the amended complaint and a separate motion to dismiss on October 29, 2010. The Company believes both the complaint and amended complaint are without merit and intends to defend them vigorously, but because of uncertainties associated with the ultimate outcome of these complaints and the costs to the Company of responding to them, we cannot assure you that the ultimate costs and damages, if any, that may be imposed upon us will not have a material adverse effect on our results of operations, financial position and cash flows. As at September 30, 2010 we had accrued \$0.5 million in respect of probable future legal expenses and provided no additional accruals in respect of this matter.

### **Patent actions**

The Company is actively opposing certain third party patents in various regions of the world. The actions are part of the Company's ongoing management of its intellectual property portfolio. The Company does not believe that any of these actions will have a material effect on the financial condition or results of operations of the Company.

### **Other legal matters**

We are not involved in any other administrative or judicial proceedings arising under provisions enacted that regulate the discharge of materials into the environment or enacted for the purpose of protecting the environment involving a governmental authority as a party, which involves potential monetary sanctions which the Company reasonably believes will result in monetary sanctions of more than \$100,000.

We are involved from time to time in claims and legal proceedings that result from, and are incidental to, the conduct of our business including business and commercial litigation, employee and product liability claims. There are no other material pending legal proceedings to which the Company or any of its subsidiaries is a party, or of which any of their property is subject, other than ordinary, routine litigation incidental to their respective businesses, although an adverse resolution of a number of these items could have a material adverse effect on our results of operations for a particular year or quarter.

Whilst it is not possible to predict with certainty the outcome of any legal proceedings, it is our opinion based on our current knowledge that we will not suffer any material adverse effect on our results of operations, financial position or cash flows as a result of any actual or threatened litigation.

## **ITEM 1A Risk Factors**

Information regarding risk factors appears in Item 1A of the Company's 2009 Annual Report on Form 10-K and in Part II Item 1A of the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, and there have been no material changes in the risk factors facing the Company since that time.

## **ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds**

(c) No purchases of equity securities by the issuer or affiliated purchasers were made during the quarter.

Repurchases of common stock are held as treasury shares unless reissued under equity compensation plans.

The Company has not, within the last three years, made any sales of unregistered securities.

## **ITEM 3 Defaults Upon Senior Securities**

None.

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**ITEM 4    Removed and Reserved**

Not applicable.

**ITEM 5    Other Information**

None.

**ITEM 6    Exhibits**

- 31.1        Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2        Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1        Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2        Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 2, 2010

By

/s/ PATRICK S. WILLIAMS  
**Patrick S. Williams**  
**President and Chief Executive Officer**

Date: November 2, 2010

By

/s/ IAN P. CLEMINSON  
**Ian P. Cleminson**  
**Executive Vice President and Chief Financial Officer**

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