

INNOSPEC INC.  
Form 10-Q  
May 06, 2015  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2015**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-13879**

**INNOSPEC INC.**

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

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

**98-0181725**  
**(I.R.S. Employer**  
**Identification No.)**

**8310 South Valley Highway**

**Suite 350**

**Englewood**

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

**80112**  
**(Zip Code)**

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

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

Edgar Filing: INNOSPEC INC. - Form 10-Q

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 practicable date.

| <b>Class</b>                   | <b>Outstanding as of April 30, 2015</b> |
|--------------------------------|---|
| Common Stock, par value \$0.01 | 24,240,306                              |

**Table of Contents****TABLE OF CONTENTS**

|         |   |    |
|---------|---|----|
| PART I  | <b><u>FINANCIAL INFORMATION</u></b>   | 4  |
| Item 1  | <b><u>Financial Statements</u></b>  | 4  |
|         | <b><u>Consolidated Statements of Income</u></b>   | 4  |
|         | <b><u>Consolidated Statements of Comprehensive Income</u></b>   | 5  |
|         | <b><u>Consolidated Balance Sheets</u></b>   | 6  |
|         | <b><u>Consolidated Balance Sheets (continued)</u></b>   | 7  |
|         | <b><u>Consolidated Statements of Cash Flows</u></b>   | 8  |
|         | <b><u>Consolidated Statements of Stockholders' Equity</u></b>   | 9  |
|         | <b><u>Notes to the Unaudited Interim Consolidated Financial Statements</u></b>  | 10 |
| Item 2  | <b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three Months Ended March 31, 2015</u></b> | 21 |
|         | <b><u>Critical Accounting Estimates</u></b>   | 21 |
|         | <b><u>Results of Operations</u></b>   | 21 |
|         | <b><u>Liquidity and Financial Condition</u></b>   | 25 |
| Item 3  | <b><u>Quantitative and Qualitative Disclosures about Market Risk</u></b>  | 26 |
| Item 4  | <b><u>Controls and Procedures</u></b>   | 27 |
| PART II | <b><u>OTHER INFORMATION</u></b>   | 28 |
| Item 1  | <b><u>Legal Proceedings</u></b>   | 28 |
| Item 1A | <b><u>Risk Factors</u></b>  | 28 |
| Item 2  | <b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>   | 28 |
| Item 3  | <b><u>Defaults Upon Senior Securities</u></b>   | 28 |
| Item 4  | <b><u>Mine Safety Disclosures</u></b>   | 28 |
| Item 5  | <b><u>Other Information</u></b>   | 28 |
| Item 6  | <b><u>Exhibits</u></b>  | 29 |
|         | <b><u>SIGNATURES</u></b>  | 30 |

**Table of Contents**

**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, estimates, anticipates, may, believes, feels or similar words or expressions), for example, which relate to earnings, growth potential, operating performance, events or developments that we expect or anticipate will or may occur in the future. Although forward-looking statements are believed by management to be reasonable when made, they are subject to certain risks, uncertainties and assumptions, and our actual performance or results may differ materially from these forward-looking statements. Additional information regarding risks, uncertainties and assumptions relating to Innospec and affecting our business operations and prospects are described in Innospec's Annual Report on Form 10-K for the year ended December 31, 2014, and other reports filed with the U.S. Securities and Exchange Commission. You are urged to review our discussion of risks and uncertainties that could cause actual results to differ from forward-looking statements under the heading Risk Factors in such reports. Innospec 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 ContentsPART I FINANCIAL INFORMATION**Item 1 Financial Statements****INNOSPEC INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

| <b>(in millions, except share and per share data)</b> | <b>Three Months Ended March 31</b> |             |
|---|------------------------------------|-------------|
|   | <b>2015</b>                        | <b>2014</b> |
| Net sales   | \$ 269.2                           | \$ 220.7    |
| Cost of goods sold                                    | (187.4)                            | (155.0)     |
| Gross profit  | 81.8                               | 65.7        |
| Operating expenses:                                   |                                    |             |
| Selling, general and administrative                   | (48.7)                             | (42.0)      |
| Research and development                              | (6.2)                              | (5.7)       |
| Adjustment to fair value of contingent consideration  | (3.5)                              | 0.0         |
| Total operating expenses                              | (58.4)                             | (47.7)      |
| Operating income                                      | 23.4                               | 18.0        |
| Other net income                                      | 1.5                                | 1.9         |
| Interest expense, net                                 | (1.0)                              | (0.9)       |
| Income before income taxes                            | 23.9                               | 19.0        |
| Income taxes  | (6.0)                              | (2.1)       |
| Net income  | \$ 17.9                            | \$ 16.9     |
| Earnings per share:                                   |                                    |             |
| Basic   | \$ 0.74                            | \$ 0.69     |
| Diluted   | \$ 0.72                            | \$ 0.69     |
| Weighted average shares outstanding (in thousands):   |                                    |             |
| Basic   | 24,301                             | 24,362      |
| Diluted   | 24,808                             | 24,635      |

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

Table of Contents

**INNOSPEC INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

| (in millions)  | <b>Three Months Ended</b> |             |
|--|---------------------------|-------------|
|  | <b>March 31</b>           |             |
|  | <b>2015</b>               | <b>2014</b> |
| Net income   | \$ 17.9                   | \$ 16.9     |
| Other comprehensive income/(loss):   |                           |             |
| Changes in cumulative translation adjustment   | (8.0)                     | (1.2)       |
| Amortization of prior service credit, net of tax of \$0.1, and \$0.1, respectively     | (0.2)                     | (0.3)       |
| Amortization of actuarial net losses, net of tax of \$(0.3), and \$(0.3), respectively | 1.0                       | 1.1         |
| Total other comprehensive loss   | (7.2)                     | (0.4)       |
| Total comprehensive income   | \$ 10.7                   | \$ 16.5     |

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

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

| <b>(in millions, except share and per share data)</b>                                  | <b>March 31,<br/>2015<br/>(Unaudited)</b> | <b>December 31,<br/>2014</b> |
|--|---|------------------------------|
| <b>Assets</b>  |   |                              |
| Current assets:  |   |                              |
| Cash and cash equivalents  | \$ 46.5                                   | \$ 41.6                      |
| Short-term investments   | 5.2                                       | 4.7                          |
| Trade and other accounts receivable (less allowances of \$3.7 and \$3.9, respectively) | 147.7                                     | 164.3                        |
| Inventories (less allowances of \$9.8 and \$10.2, respectively):                       |   |                              |
| Finished goods   | 114.4                                     | 127.0                        |
| Work in progress   | 2.0                                       | 1.2                          |
| Raw materials  | 59.6                                      | 56.7                         |
| Total inventories  | 176.0                                     | 184.9                        |
| Current portion of deferred tax assets   | 8.4                                       | 8.4                          |
| Prepaid expenses   | 6.6                                       | 8.3                          |
| Prepaid income taxes   | 1.0                                       | 2.0                          |
| Total current assets   | 391.4                                     | 414.2                        |
| Property, plant and equipment:   |   |                              |
| Gross cost   | 185.7                                     | 187.0                        |
| Less accumulated depreciation  | (105.7)                                   | (106.2)                      |
| Net property, plant and equipment  | 80.0                                      | 80.8                         |
| Goodwill   | 275.9                                     | 276.1                        |
| Other intangible assets  | 178.6                                     | 181.1                        |
| Deferred finance costs   | 0.9                                       | 1.1                          |
| Deferred tax assets, net of current portion  | 0.7                                       | 0.7                          |
| Pension asset  | 48.9                                      | 45.2                         |
| Other non-current assets   | 0.4                                       | 0.7                          |
| Total assets   | \$ 976.8                                  | \$ 999.9                     |

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

Table of Contents

**INNOSPEC INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS - (Continued)**

| (in millions, except share and per share data)   | March 31,<br>2015<br>(Unaudited) | December 31,<br>2014 |
|--|----------------------------------|----------------------|
| <u>Liabilities and Stockholders Equity</u>   |                                  |                      |
| Current liabilities:   |                                  |                      |
| Accounts payable   | \$ 59.4                          | \$ 87.6              |
| Accrued liabilities  | 71.9                             | 77.2                 |
| Current portion of long-term debt  | 0.2                              | 0.4                  |
| Current portion of finance leases  | 0.6                              | 0.5                  |
| Current portion of plant closure provisions  | 4.9                              | 5.7                  |
| Current portion of accrued income taxes  | 4.8                              | 5.6                  |
| Current portion of acquisition-related contingent consideration                        | 47.3                             | 45.7                 |
| Current portion of deferred income   | 0.2                              | 0.2                  |
| <b>Total current liabilities</b>   | <b>189.3</b>                     | <b>222.9</b>         |
| Long-term debt, net of current portion   | 139.0                            | 139.0                |
| Finance leases, net of current portion   | 2.3                              | 1.7                  |
| Plant closure provisions, net of current portion                                       | 29.4                             | 28.4                 |
| Unrecognized tax benefits, net of current portion                                      | 6.3                              | 6.2                  |
| Deferred tax liabilities, net of current portion                                       | 25.3                             | 23.0                 |
| Pension liability  | 9.3                              | 10.4                 |
| Acquisition-related contingent consideration   | 51.4                             | 49.5                 |
| Deferred income, net of current portion  | 0.8                              | 0.9                  |
| Other non-current liabilities  | 1.6                              | 2.0                  |
| <b>Total liabilities</b>   | <b>454.7</b>                     | <b>484.0</b>         |
| Stockholders equity:   |                                  |                      |
| Common stock, \$0.01 par value, authorized 40,000,000 shares, issued 29,554,500 shares | 0.3                              | 0.3                  |
| Additional paid-in capital   | 308.9                            | 308.8                |
| Treasury stock (5,291,396 and 5,263,481 shares at cost, respectively)                  | (83.3)                           | (78.7)               |
| Retained earnings  | 409.7                            | 391.8                |
| Accumulated other comprehensive loss   | (113.5)                          | (106.3)              |
| <b>Total stockholders equity</b>   | <b>522.1</b>                     | <b>515.9</b>         |
| <b>Total liabilities and stockholders equity</b>                                       | <b>\$ 976.8</b>                  | <b>\$ 999.9</b>      |

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



Table of Contents

**INNOSPEC INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

| (in millions)   | <b>Three Months Ended</b> |             |
|---|---------------------------|-------------|
|   | <b>March 31</b>           |             |
|   | <b>2015</b>               | <b>2014</b> |
| <b><u>Cash Flows from Operating Activities</u></b>                                    |                           |             |
| Net income  | \$ 17.9                   | \$ 16.9     |
| Adjustments to reconcile net income to net cash provided by operating activities:     |                           |             |
| Depreciation and amortization   | 8.5                       | 7.4         |
| Adjustment to fair value of contingent consideration                                  | 3.5                       | 0.0         |
| Deferred taxes  | 1.1                       | 0.4         |
| Excess tax benefit from stock-based payment arrangements                              | (0.7)                     | (0.2)       |
| Cash contributions to defined benefit pension plans                                   | (2.7)                     | (2.9)       |
| Non-cash expense of defined benefit pension plans                                     | 0.2                       | 1.0         |
| Stock option compensation   | 0.9                       | 0.6         |
| Changes in assets and liabilities, net of effects of acquired and divested companies: |                           |             |
| Trade and other accounts receivable   | 14.1                      | 14.2        |
| Inventories   | 6.4                       | (1.1)       |
| Prepaid expenses  | 1.5                       | 1.5         |
| Accounts payable and accrued liabilities  | (33.1)                    | (21.4)      |
| Accrued income taxes  | 0.2                       | 8.0         |
| Plant closure provisions  | 0.5                       | 0.3         |
| Unrecognized tax benefits   | 0.1                       | (4.0)       |
| Other non-current assets and liabilities  | (0.2)                     | 0.2         |
| Net cash provided by operating activities   | 18.2                      | 20.9        |
| <b><u>Cash Flows from Investing Activities</u></b>                                    |                           |             |
| Capital expenditures  | (3.4)                     | (2.3)       |
| Internally developed software   | (2.7)                     | (1.5)       |
| Purchase of short-term investments  | (1.8)                     | (1.2)       |
| Sale of short-term investments  | 1.1                       | 2.0         |
| Net cash used in investing activities   | (6.8)                     | (3.0)       |
| <b><u>Cash Flows from Financing Activities</u></b>                                    |                           |             |
| Repayments of revolving credit facility   | 0.0                       | (8.0)       |
| Repayments of term loans  | (0.2)                     | (0.3)       |
| Excess tax benefit from stock-based payment arrangements                              | 0.7                       | 0.2         |
| Issue of treasury stock   | 0.7                       | 0.3         |
| Repurchase of common stock  | (6.3)                     | (0.2)       |
| Net cash used in financing activities   | (5.1)                     | (8.0)       |

Edgar Filing: INNOSPEC INC. - Form 10-Q

|  |         |         |
|--|---------|---------|
| Effect of foreign currency exchange rate changes on cash | (1.4)   | 0.0     |
| Net change in cash and cash equivalents                  | 4.9     | 9.9     |
| Cash and cash equivalents at beginning of period         | 41.6    | 80.2    |
| Cash and cash equivalents at end of period               | \$ 46.5 | \$ 90.1 |

Amortization of deferred finance costs of \$0.2 million (2014 \$0.2 million) are included in depreciation and amortization in the cash flow statement but in interest expense in the income statement.

The accompanying notes 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, 2014                             | \$ 0.3          | \$ 308.8                         | \$ (78.7)         | \$ 391.8             | \$ (106.3)                                    | \$ 515.9                        |
| Net income   |                 |                                  |                   | 17.9                 |   | 17.9                            |
| Changes in cumulative translation adjustment             |                 |                                  |                   |                      | (8.0)   | (8.0)                           |
| Treasury stock re-issued                                 |                 | (1.5)                            | 1.7               |                      |   | 0.2                             |
| Treasury stock repurchased                               |                 |                                  | (6.3)             |                      |   | (6.3)                           |
| Excess tax benefit from stock-based payment arrangements |                 | 0.7                              |                   |                      |   | 0.7                             |
| Stock option compensation                                |                 | 0.9                              |                   |                      |   | 0.9                             |
| Amortization of prior service credit, net of tax         |                 |                                  |                   |                      | (0.2)   | (0.2)                           |
| Amortization of actuarial net losses, net of tax         |                 |                                  |                   |                      | 1.0   | 1.0                             |
| Balance at March 31, 2015                                | \$ 0.3          | \$ 308.9                         | \$ (83.3)         | \$ 409.7             | \$ (113.5)                                    | \$ 522.1                        |

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

Table of Contents

**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO THE 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 under the Securities Exchange Act of 1934. Accordingly, they do not include all the information and notes 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 17, 2015.

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

We have reclassified certain prior period amounts to conform to the current period presentation.

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

**Table of Contents****NOTE 2 SEGMENTAL REPORTING**

Innospec divides its business into three segments for management and reporting purposes: Fuel Specialties, Performance Chemicals and Octane Additives. The Fuel Specialties and Performance Chemicals segments operate in markets where we actively seek growth opportunities although their ultimate customers are different. As expected, the Octane Additives segment continues to decline as our one remaining customer transitions to unleaded fuel.

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)                          | <b>Three Months Ended</b> |                 |
|--|---------------------------|-----------------|
|  | <b>March 31</b>           |                 |
|  | <b>2015</b>               | <b>2014</b>     |
| <b>Net sales:</b>                      |                           |                 |
| Fuel Specialties                       | \$ 199.4                  | \$ 164.2        |
| Performance Chemicals                  | 57.6                      | 56.1            |
| Octane Additives                       | 12.2                      | 0.4             |
|  | <b>\$ 269.2</b>           | <b>\$ 220.7</b> |
| <b>Gross profit:</b>                   |                           |                 |
| Fuel Specialties                       | \$ 61.5                   | \$ 52.0         |
| Performance Chemicals                  | 14.5                      | 13.6            |
| Octane Additives                       | 5.8                       | 0.1             |
|  | <b>\$ 81.8</b>            | <b>\$ 65.7</b>  |
| <b>Operating income:</b>               |                           |                 |
| Fuel Specialties                       | \$ 23.5                   | \$ 25.8         |
| Performance Chemicals                  | 6.4                       | 6.5             |
| Octane Additives                       | 5.1                       | (1.2)           |
| Pension charge                         | 0.0                       | (0.8)           |
| Corporate costs                        | (8.1)                     | (12.3)          |
| Fair value of contingent consideration | (3.5)                     | 0.0             |
| Total operating income                 | <b>\$ 23.4</b>            | <b>\$ 18.0</b>  |

Restructuring charges separately disclosed in prior periods have been reclassified to corporate costs. We have reclassified the prior period amounts to conform to the current period presentation.

The pension charge relates to the United Kingdom defined benefit pension plan which is closed to future service accrual. The charges related to our other much smaller pension arrangements in the U.S. and overseas are included in the segment and income statement captions consistent with the related employees' costs.



**Table of Contents**

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

| (in millions)         | Three Months Ended<br>March 31 |        |
|-----------------------|--------------------------------|--------|
|                       | 2015                           | 2014   |
| <b>Depreciation:</b>  |                                |        |
| Fuel Specialties      | \$ 1.9                         | \$ 1.2 |
| Performance Chemicals | 0.8                            | 0.9    |
| Octane Additives      | 0.1                            | 0.1    |
| Corporate             | 0.4                            | 0.6    |
|                       | \$ 3.2                         | \$ 2.8 |
| <b>Amortization:</b>  |                                |        |
| Fuel Specialties      | \$ 3.2                         | \$ 2.2 |
| Performance Chemicals | 1.0                            | 1.3    |
| Corporate             | 0.9                            | 0.9    |
|                       | \$ 5.1                         | \$ 4.4 |

**NOTE 3 EARNINGS PER SHARE**

Basic earnings 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>March 31 |         |
|---|--------------------------------|---------|
|   | 2015                           | 2014    |
| <b>Numerator (in millions):</b>             |                                |         |
| Net income available to common stockholders | \$ 17.9                        | \$ 16.9 |
| <b>Denominator (in thousands):</b>          |                                |         |
| Weighted average common shares outstanding  | 24,301                         | 24,362  |
| Dilutive effect of stock options and awards | 507                            | 273     |
| Denominator for diluted earnings per share  | 24,808                         | 24,635  |
| <b>Net income per share, basic:</b>         | \$ 0.74                        | \$ 0.69 |
| <b>Net income per share, diluted:</b>       | \$ 0.72                        | \$ 0.69 |

In the three months ended March 31, 2015, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were 33,734 (three months ended March 31, 2014 - 8,049).

**Table of Contents****NOTE 4 GOODWILL**

The following table summarizes goodwill at the balance sheet dates:

| <b>(in millions)</b>          | <b>March 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|-------------------------------|---------------------------|------------------------------|
| Gross cost <sup>(1)</sup>     | \$ 512.4                  | \$ 512.6                     |
| Accumulated impairment losses | (236.5)                   | (236.5)                      |
| Net book amount               | \$ 275.9                  | \$ 276.1                     |

<sup>(1)</sup> Gross cost for 2015 and 2014 is net of \$298.5 million of historical accumulated amortization. The movement in gross cost for the period is due to foreign currency translation.

**NOTE 5 OTHER INTANGIBLE ASSETS**

The following table summarizes the other intangible assets movement year on year:

| <b>(in millions)</b>                            | <b>Three Months Ended<br/>March 31</b> |             |
|---|--|-------------|
|   | <b>2015</b>                            | <b>2014</b> |
| Gross cost at January 1                         | \$ 247.6                               | \$ 175.5    |
| Capitalization of internally developed software | 2.7                                    | 1.5         |
| Exchange effect                                 | (0.1)                                  | 0.0         |
| Gross cost at March 31                          | 250.2                                  | 177.0       |
| Accumulated amortization at January 1           | (66.5)                                 | (48.7)      |
| Amortization expense                            | (5.1)                                  | (4.4)       |
| Exchange effect                                 | 0.0                                    | 0.1         |
| Accumulated amortization at March 31            | (71.6)                                 | (53.0)      |
| Net book amount at March 31                     | \$ 178.6                               | \$ 124.0    |

**Capitalization of internally developed software**

We are continuing with the implementation of our new, company-wide, information system platform. At March 31, 2015, we had capitalized \$30.5 million (2014 \$20.1 million) in relation to this internally developed software.

**Amortization expense**

| <b>(in millions)</b>          | <b>Three Months Ended</b> |                 |
|-------------------------------|---------------------------|-----------------|
|                               | <b>March 31</b>           |                 |
|                               | <b>2015</b>               | <b>2014</b>     |
| Product rights                | \$ (0.9)                  | \$ (1.0)        |
| Brand names                   | (0.3)                     | (0.1)           |
| Technology                    | (0.9)                     | (0.6)           |
| Customer relationships        | (1.7)                     | (1.3)           |
| Patents                       | 0.0                       | (0.1)           |
| Non-compete agreements        | (0.2)                     | (0.2)           |
| Marketing related             | (0.2)                     | (0.2)           |
| Internally developed software | (0.9)                     | (0.9)           |
| <b>Total</b>                  | <b>\$ (5.1)</b>           | <b>\$ (4.4)</b> |

**Table of Contents****NOTE 6 PENSION PLANS**

The Company maintains a defined benefit pension plan (the Plan ) covering a number of its current and former employees in the United Kingdom, although it does also have other much smaller pension arrangements in the U.S. and overseas. The Plan is closed to future service accrual but has a large number of deferred and current pensioners.

| (in millions)                                 | Three Months Ended<br>March 31 |          |
|---|--------------------------------|----------|
|   | 2015                           | 2014     |
| <b>Plan net pension credit/(charge):</b>      |                                |          |
| Service cost                                  | \$ (0.4)                       | \$ (0.4) |
| Interest cost on projected benefit obligation | (7.0)                          | (8.7)    |
| Expected return on plan assets                | 8.4                            | 9.3      |
| Amortization of prior service credit          | 0.3                            | 0.4      |
| Amortization of actuarial net losses          | (1.3)                          | (1.4)    |
|   | \$ 0.0                         | \$ (0.8) |

The amortization of prior service credit and actuarial net losses is a reclassification out of accumulated other comprehensive loss into selling, general and administrative expenses.

The Company also maintains an unfunded defined benefit pension plan covering a number of its current and former employees in Germany (the German plan ). The German plan is closed to new entrants and has no assets. The net pension charge for the German plan was \$0.2 million in the first quarter of 2015 (\$0.2 million - 2014).

**NOTE 7 INCOME TAXES**

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

| (in millions)                                | Unrecognized    | Interest and | Total  |
|--|-----------------|--------------|--------|
|  | Tax<br>Benefits | Penalties    |        |
| Opening balance at January 1, 2015           | \$ 5.7          | \$ 0.5       | \$ 6.2 |
| Additions for tax positions of prior periods | 0.0             | 0.1          | 0.1    |
| Closing balance at March 31, 2015            | 5.7             | 0.6          | 6.3    |
| Current                                      | 0.0             | 0.0          | 0.0    |
| Non-current                                  | \$ 5.7          | \$ 0.6       | \$ 6.3 |

All of the unrecognized tax benefits, interest and penalties, would impact our effective tax rate if recognized.



**Table of Contents**

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

The Company or one of its subsidiaries files income tax returns with the U.S. federal government, and various state and foreign jurisdictions. One of the Company's U.S. subsidiaries received notification in March 2015 of a federal income tax examination by the IRS in respect of 2013. It is currently anticipated that adjustments, if any, arising out of this tax audit would not result in a material change to the Company's financial position as at March 31, 2015.

The Company and its U.S. subsidiaries remain open to examination by the IRS for years 2011 onwards. The Company's subsidiaries in foreign tax jurisdictions are open to examination including France (2013 onwards), Germany (2010 onwards), Switzerland (2013 onwards) and the United Kingdom (2013 onwards).

The Company is in a position to control whether or not to repatriate foreign earnings and we currently do not expect to make a repatriation in the foreseeable future. No taxes have been provided for on the unremitted earnings of our overseas subsidiaries as any tax basis differences relating to investments in these overseas subsidiaries are considered to be permanent in duration. The amount of unremitted earnings at December 31, 2014 was approximately \$743 million. If these earnings are remitted, additional taxes could result after offsetting foreign income taxes paid although the calculation of the additional taxes is not practicable to compute at this time.

**NOTE 8 LONG-TERM DEBT**

Long-term debt consists of the following:

| <b>(in millions)</b>      | <b>March 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|---------------------------|---------------------------|------------------------------|
| Revolving credit facility | \$ 139.0                  | \$ 139.0                     |
| Other long-term debt      | 0.2                       | 0.4                          |
|                           | 139.2                     | 139.4                        |
| Less current portion      | (0.2)                     | (0.4)                        |
|                           | \$ 139.0                  | \$ 139.0                     |

**NOTE 9 PLANT CLOSURE PROVISIONS**

The liability for estimated closure costs of Innospec's manufacturing facilities includes costs for decontamination and environmental remediation activities ( remediation ). The principal site giving rise to remediation liabilities is the manufacturing site at Ellesmere Port in the United Kingdom. There are also remediation liabilities on a much smaller scale in respect of our other manufacturing sites in the U.S. and Europe.

Movements in the provisions are summarized as follows:

**Three Months Ended  
March 31**

Edgar Filing: INNOSPEC INC. - Form 10-Q

| <b>(in millions)</b>      | <b>2015</b>    | <b>2014</b>    |
|---------------------------|----------------|----------------|
| Total at January 1        | \$ 34.1        | \$ 32.4        |
| Charge for the period     | 1.1            | 0.7            |
| Utilized in the period    | (0.5)          | (0.4)          |
| Exchange effect           | (0.4)          | 0.0            |
| <b>Total at March 31</b>  | <b>34.3</b>    | <b>32.7</b>    |
| Due within one year       | (4.9)          | (5.4)          |
| <b>Due after one year</b> | <b>\$ 29.4</b> | <b>\$ 27.3</b> |

**Table of Contents**

Amounts due within one year refer to provisions where expenditure is expected to arise within one year of the balance sheet date.

**NOTE 10 FAIR VALUE MEASUREMENTS**

The following table presents the carrying amount and fair values of the Company's assets and liabilities measured on a recurring basis:

| (in millions)   | March 31, 2015  |            | December 31, 2014 |            |
|---|-----------------|------------|-------------------|------------|
|   | Carrying Amount | Fair Value | Carrying Amount   | Fair Value |
| <b>Assets</b>   |                 |            |                   |            |
| <b>Non-derivatives:</b>                                 |                 |            |                   |            |
| Cash and cash equivalents                               | \$ 46.5         | \$ 46.5    | \$ 41.6           | \$ 41.6    |
| Short-term investments                                  | 5.2             | 5.2        | 4.7               | 4.7        |
| <b>Liabilities</b>                                      |                 |            |                   |            |
| <b>Non-derivatives:</b>                                 |                 |            |                   |            |
| Long-term debt (including current portion)              | \$ 139.2        | \$ 139.2   | \$ 139.4          | \$ 139.4   |
| Finance leases (including current portion)              | 2.9             | 2.9        | 2.2               | 2.2        |
| <b>Derivatives (Level 1 measurement):</b>               |                 |            |                   |            |
| Other non-current liabilities:                          |                 |            |                   |            |
| Foreign currency forward exchange contracts             | 1.5             | 1.5        | 1.8               | 1.8        |
| <b>Non-financial liabilities (Level 3 measurement):</b> |                 |            |                   |            |
| Acquisition-related contingent consideration            | 98.7            | 98.7       | 95.2              | 95.2       |
| Stock equivalent units                                  | 5.2             | 5.2        | 7.2               | 7.2        |

The following methods and assumptions were used to estimate the fair values of financial instruments:

*Cash and cash equivalents, and short-term investments:* The carrying amount approximates fair value because of the short-term maturities of such instruments.

*Long-term debt and finance leases:* Long-term debt principally comprises the revolving credit facility, which was entered into in December 2011. Finance leases relate to certain fixed assets in our oilfield specialties business. The carrying amount of long-term debt and finance leases approximates to the fair value.

*Derivatives:* The fair value of derivatives relating to interest rate swaps, foreign currency forward exchange contracts and commodity swaps are derived from current settlement prices and comparable contracts using current assumptions. 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.

*Acquisition-related contingent consideration:* Contingent consideration payable in cash is discounted to its fair value. Where contingent consideration is dependent upon pre-determined financial targets, an estimate of the fair value of the likely consideration payable is made on a quarterly basis.



## **Table of Contents**

*Stock equivalent units:* The fair values of stock equivalent units are calculated at each balance sheet date using either the Black-Scholes or Monte Carlo method.

### ***NOTE 11 DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT***

The Company enters into various foreign currency forward exchange contracts to minimize currency exchange rate exposure from expected future cash flows. As at March 31, 2015 the contracts have maturity dates of up to eighteen months 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 first three months of 2015 was a gain of \$1.9 million.

### ***NOTE 12 COMMITMENTS AND CONTINGENCIES***

#### **Legal matters**

While 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 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. It is possible, however, that an adverse resolution of an unexpectedly large number of such individual claims or proceedings could in the aggregate have a material adverse effect on the results of operations for a particular year or quarter.

#### **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 includes guarantees of non-U.S. excise taxes and customs duties. As at March 31, 2015, such guarantees which are not recognized as liabilities in the consolidated financial statements amounted to \$3.7 million.

Under the terms of the guarantee arrangements, generally the Company would be required to perform should the affiliated company fail to fulfil 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 13 STOCK-BASED COMPENSATION PLANS***

The Company grants stock options and stock equivalent units ( SEUs ) from time to time as a long-term performance incentive. In certain cases the grants are subject to performance conditions such as the Company's stock price. Where performance conditions apply the Monte Carlo simulation model is used to determine the fair values. Otherwise the Black-Scholes model is used to determine the fair values.

**Table of Contents****Stock option plans**

The following table summarizes the transactions of the Company's stock option plans for the three months ended March 31, 2015:

|                                  | <b>Number of<br/>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Grant-Date<br/>Fair Value</b> |
|----------------------------------|------------------------------|--|---|
| Outstanding at December 31, 2014 | 728,640                      | \$ 19.55   |   |
| Granted - at discount            | 54,717                       | \$ 0.00  | \$ 36.18  |
| - at market value                | 23,550                       | \$ 43.95   | \$ 9.89   |
| Exercised                        | (113,920)                    | \$ 6.25  |   |
| Forfeited                        | (3,931)                      | \$ 16.49   |   |
| Outstanding at March 31, 2015    | 689,056                      | \$ 20.96   |   |

At March 31, 2015, there were 115,793 stock options that were exercisable, of which 39,000 had performance conditions attached.

The stock option compensation cost for the first three months of 2015 was \$0.9 million (2014 \$0.6 million). The total intrinsic value of options exercised in the first three months of 2015 was \$2.0 million (2014 \$0.5 million).

The total compensation cost related to non-vested stock options not yet recognized at March 31, 2015 was \$5.7 million and this cost is expected to be recognized over the weighted-average period of 2.34 years.

**Stock equivalent units**

The following table summarizes the transactions of the Company's SEUs for the three months ended March 31, 2015:

|                                  | <b>Number<br/>of SEUs</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Grant-Date<br/>Fair Value</b> |
|----------------------------------|---------------------------|--|---|
| Outstanding at December 31, 2014 | 286,563                   | \$ 3.41  |   |
| Granted - at discount            | 69,280                    | \$ 0.00  | \$ 36.65  |
| - at market value                | 6,336                     | \$ 43.95   | \$ 9.89   |
| Exercised                        | (81,695)                  | \$ 2.31  |   |
| Forfeited                        | (1,495)                   | \$ 29.56   |   |
| Outstanding at March 31, 2015    | 278,989                   | \$ 3.67  |   |

At March 31, 2015 there were 73,890 SEUs that are exercisable, of which 63,838 had performance conditions attached.

The charges for SEUs are spread over the life of the award subject to a revaluation to fair value each quarter. The revaluation may result in a charge or a credit to the income statement in the quarter dependent upon our share price and other performance criteria.

**Table of Contents**

The SEU compensation cost for the first three months of 2015 was \$1.0 million (2014 - \$0.6 million). The total intrinsic value of SEUs exercised in the first three months of 2015 was \$1.9 million (2014 - \$3.0 million).

The weighted-average remaining vesting period of non-vested SEUs is 2.03 years.

**Additional exceptional long-term incentive plan**

A maximum of \$3.0 million of our cash-settled long-term incentives is accounted for as share-based compensation and the fair value is calculated on a quarterly basis using a Monte Carlo model. The fair values at each of the balance sheet dates are summarized as follows:

| (in millions)                      | 2015   | 2014   |
|------------------------------------|--------|--------|
| Balance at January 1               | \$ 0.1 | \$ 0.0 |
| Compensation charge for the period | 0.1    | 0.1    |
| Balance at March 31                | \$ 0.2 | \$ 0.1 |

The following assumptions were used in the Monte Carlo model at March 31:

|                                      | 2015   | 2014   |
|--------------------------------------|--------|--------|
| Dividend yield                       | 1.19%  | 1.11%  |
| Volatility of Innospec's share price | 25.91% | 36.04% |
| Risk free interest rate              | 0.89%  | 0.90%  |

**NOTE 14 RECLASSIFICATIONS OUT OF ACCUMULATED OTHER COMPREHENSIVE LOSS**

Reclassifications out of accumulated other comprehensive loss for the first three months of 2015 were:

| (in millions)<br>Details about AOCL Components | Amount<br>Reclassified<br>from AOCL | Affected Line Item in the<br>Statement where<br>Net Income is Presented |
|--|-------------------------------------|---|
| <b>Defined benefit pension plan items:</b>     |                                     |   |
| Amortization of prior service credit           | \$ (0.3)                            | See <sup>(1)</sup> below  |
| Amortization of actuarial net losses           | 1.3                                 | See <sup>(1)</sup> below  |
|  | 1.0                                 | Total before tax  |
|  | (0.2)                               | Income tax expense  |
|  | 0.8                                 | Net of tax  |
| <b>Total reclassifications</b>                 | <b>\$ 0.8</b>                       | <b>Net of tax</b>   |

- (1) These items are included in the computation of net periodic pension cost. See Note 6 of the Notes to the Consolidated Financial Statements for additional information.

**Table of Contents**

Changes in accumulated other comprehensive loss for the first three months of 2015, net of tax, were:

| (in millions)  | Defined<br>Benefit<br>Pension Plan<br>Items | Cumulative<br>Translation<br>Adjustments | Total      |
|--|---|--|------------|
| Balance at December 31, 2014                               | \$ (57.3)                                   | \$ (49.0)                                | \$ (106.3) |
| Other comprehensive income/(loss) before reclassifications | 0.0   | (8.0)                                    | (8.0)      |
| Amounts reclassified from AOCL                             | 0.8   | 0.0                                      | 0.8        |
| Total other comprehensive income/(loss)                    | 0.8   | (8.0)                                    | (7.2)      |
| Balance at March 31, 2015                                  | \$ (56.5)                                   | \$ (57.0)                                | \$ (113.5) |

**NOTE 15 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In April 2015, the FASB issued ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs* ( ASU 2015-03 ), which requires debt issuance costs related to a recognized debt liability to be presented on the balance sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. The ASU is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The Company is evaluating the effect that ASU 2015-03 will have on its consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers* ( ASU 2014-09 ), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. ASU 2014-09 is effective for annual periods, and interim periods within those years, beginning after December 15, 2016. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

**NOTE 16 RELATED PARTY TRANSACTIONS**

Mr. Robert I. Paller has been a non-executive director of the Company since November 1, 2009. The Company has retained and continues to retain Smith, Gambrell & Russell, LLP ( SGR ), a law firm with which Mr. Paller holds a position. In the first three months of 2015 the Company incurred fees from SGR of \$0.2 million (2014 \$0.1 million). As at March 31, 2015, the amount due to SGR from the Company was \$0.1 million (December 31, 2014 - \$0.1 million).

**Table of Contents****Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three Months Ended March 31, 2015**

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

**CRITICAL ACCOUNTING ESTIMATES**

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, pensions, deferred tax and uncertain income tax positions, business combinations, goodwill, property, plant and equipment and other intangible assets (net of amortization). These policies have been discussed in the Company's 2014 Annual Report on Form 10-K.

**RESULTS OF OPERATIONS**

The following table provides operating income by reporting segment:

| (in millions)                          | Three Months Ended<br>March 31 |          |
|--|--------------------------------|----------|
|  | 2015                           | 2014     |
| <b>Net sales:</b>                      |                                |          |
| Fuel Specialties                       | \$ 199.4                       | \$ 164.2 |
| Performance Chemicals                  | 57.6                           | 56.1     |
| Octane Additives                       | 12.2                           | 0.4      |
|  | \$ 269.2                       | \$ 220.7 |
| <b>Gross profit:</b>                   |                                |          |
| Fuel Specialties                       | \$ 61.5                        | \$ 52.0  |
| Performance Chemicals                  | 14.5                           | 13.6     |
| Octane Additives                       | 5.8                            | 0.1      |
|  | \$ 81.8                        | \$ 65.7  |
| <b>Operating income:</b>               |                                |          |
| Fuel Specialties                       | \$ 23.5                        | \$ 25.8  |
| Performance Chemicals                  | 6.4                            | 6.5      |
| Octane Additives                       | 5.1                            | (1.2)    |
| Pension charge                         | 0.0                            | (0.8)    |
| Corporate costs                        | (8.1)                          | (12.3)   |
| Fair value of contingent consideration | (3.5)                          | 0.0      |
| Total operating income                 | \$ 23.4                        | \$ 18.0  |



**Table of Contents**

| (in millions, except ratios) | Three Months Ended<br>March 31 |           |           |       |
|------------------------------|--------------------------------|-----------|-----------|-------|
|                              | 2015                           | 2014      | Change    |       |
| <b>Net sales:</b>            |                                |           |           |       |
| Fuel Specialties             | \$ 199.4                       | \$ 164.2  | \$ 35.2   | +21%  |
| Performance Chemicals        | 57.6                           | 56.1      | 1.5       | +3%   |
| Octane Additives             | 12.2                           | 0.4       | 11.8      | n/a   |
|                              | \$ 269.2                       | \$ 220.7  | \$ 48.5   | +22%  |
| <b>Gross profit:</b>         |                                |           |           |       |
| Fuel Specialties             | \$ 61.5                        | \$ 52.0   | \$ 9.5    | +18%  |
| Performance Chemicals        | 14.5                           | 13.6      | 0.9       | +7%   |
| Octane Additives             | 5.8                            | 0.1       | 5.7       | n/a   |
|                              | \$ 81.8                        | \$ 65.7   | \$ 16.1   | +25%  |
| <b>Gross margin (%):</b>     |                                |           |           |       |
| Fuel Specialties             | 30.8                           | 31.7      | -0.9      |       |
| Performance Chemicals        | 25.2                           | 24.2      | +1.0      |       |
| Octane Additives             | 47.5                           | 25.0      | +22.5     |       |
| Aggregate                    | 30.4                           | 29.8      | +0.6      |       |
| <b>Operating expenses:</b>   |                                |           |           |       |
| Fuel Specialties             | \$ (38.0)                      | \$ (26.2) | \$ (11.8) | +45%  |
| Performance Chemicals        | (8.1)                          | (7.1)     | (1.0)     | +14%  |
| Octane Additives             | (0.7)                          | (1.3)     | 0.6       | n/a   |
| Pension charge               | 0.0                            | (0.8)     | 0.8       | -100% |
| Corporate costs              | (8.1)                          | (12.3)    | 4.2       | -34%  |
|                              | \$ (54.9)                      | \$ (47.7) | \$ (7.2)  | +15%  |

**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 (%)            | Three Months Ended March 31, 2015 |      |       |       |       |
|-----------------------|-----------------------------------|------|-------|-------|-------|
|                       | Americas                          | EMEA | ASPAC | AvTel | Total |
| Volume                | +7                                | +2   | +27   | -53   | +4    |
| Acquisitions          | +48                               | 0    | 0     | 0     | +24   |
| Price and product mix | +1                                | +4   | -14   | +9    | 0     |
| Exchange rates        | 0                                 | -18  | -2    | 0     | -7    |
|                       | +56                               | -12  | +11   | -44   | +21   |

Americas saw an increase in volumes as a result of higher demand, while benefiting from a slightly improved price and product mix. Acquisitions in the Americas, relating to Independence Oilfield Chemicals LLC, generated additional sales compared to the prior year. EMEA volumes increased from the prior year together with an improved price and product mix as a result of higher sales of higher margin products. Volumes were higher in ASPAC together with an adverse price and product mix related to one-off cost of goods sold variances. AvTel volumes were lower due to the timing of shipments to customers as opposed to any change in the long-term outlook for that market, while the price and product mix benefited from a

**Table of Contents**

favorable customer mix. EMEA and ASPAC were adversely impacted by exchange rate movements year over year, driven primarily by a weakening of the European Union euro and the British pound sterling against the U.S. dollar.

*Gross margin:* the year on year decrease of 0.9 percentage points primarily reflected the lower margins currently achieved from our oilfield specialties businesses.

*Operating expenses:* the year on year increase of 45%, or \$11.8 million, was due to \$10.1 million of additional costs for the Independence business; together with a \$1.9 million increase in selling expenses related to higher sales volumes in the Americas; and a \$0.2 million decrease in other expenses.

**Performance 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 (%)            | Three Months Ended March 31, 2015 |      |       |       |
|-----------------------|-----------------------------------|------|-------|-------|
|                       | Americas                          | EMEA | ASPAC | Total |
| Volume                | +12                               | +31  | -11   | +16   |
| Price and product mix | -1                                | -9   | -6    | -5    |
| Exchange rates        | -1                                | -19  | -3    | -8    |
|                       | +10                               | +3   | -20   | +3    |

Volumes in the Americas and EMEA were higher, primarily due to increased Personal Care volumes. ASPAC volumes were lower across all our markets. Weaker pricing drove an adverse price and product mix for all our regions. A weakening of the European Union euro and the British pound sterling against the U.S. dollar resulted in an adverse exchange variance for all our regions.

*Gross margin:* the year on year increase of 1.0 percentage points, primarily driven by a greater proportion of sales from our higher margin Personal Care business.

*Operating expenses:* the year on year increase of 14%, or \$1.0 million, was driven by higher research and development costs, additional headcount to support our Personal Care growth and the phasing of expenditure year over year.

**Octane Additives**

*Net sales:* the year on year increase of \$11.8 million was primarily due to the timing of shipments with our one remaining customer.

*Gross margin:* the year on year increase of 22.5 percentage points is primarily a reflection of the higher sales in 2015.

*Operating expenses:* the year on year decrease of \$0.6 million was due to the efficient management of the cost base.

**Other Income Statement Captions**

*Pension charge:* is non-cash, and was \$0.0 million in 2015 compared to a \$0.8 million net charge in 2014, primarily driven by a lower interest cost on the projected benefit obligation.

**Table of Contents**

*Corporate costs:* the year on year decrease of 34%, or \$4.2 million, related to \$3.1 million lower legal, professional and other expenses; \$1.4 million lower insurance claims; partly offset by \$0.3 million higher personnel-related compensation, primarily due to higher accruals for share-based compensation.

*Other net income/(expense):* other net income of \$1.5 million primarily related to net gains of \$1.9 million on foreign currency forward exchange contracts. In 2014, other net income of \$1.9 million primarily related to gains of \$1.5 million on translation of net assets denominated in non-functional currencies in our European businesses.

*Interest expense, net:* was \$1.0 million in 2015 and \$0.9 million in 2014.

*Income taxes:* the effective tax rate was 25.1% and 11.1% for the first three months of 2015 and 2014, respectively. The adjusted effective tax rate, once adjusted for income tax provisions was 24.7% in 2015 compared with 22.6% in 2014. The 2.1% increase in the adjusted effective tax rate was primarily due to the first quarter of 2015 benefiting to a lesser extent from the positive impact of taxable profits in different geographical locations as compared to the first quarter of 2014. The Company believes that this adjusted effective tax rate, a non-GAAP financial measure, provides useful information to investors and may assist them in evaluating the Company's underlying performance and identifying operating trends. In addition, management uses this non-GAAP financial measure internally to evaluate the performance of the Company's operations and for planning and forecasting in subsequent periods.

| <b>(in millions)</b>               | <b>Three Months Ended</b> |             |
|------------------------------------|---------------------------|-------------|
|                                    | <b>March 31</b>           |             |
|                                    | <b>2015</b>               | <b>2014</b> |
| Income before income taxes         | \$ 23.9                   | \$ 19.0     |
| Income taxes                       | \$ 6.0                    | \$ 2.1      |
| Adjustment of income tax positions | (0.1)                     | 2.2         |
|                                    | \$ 5.9                    | \$ 4.3      |
| GAAP effective tax rate            | 25.1%                     | 11.1%       |
| Adjusted effective tax rate        | 24.7%                     | 22.6%       |

**Table of Contents****LIQUIDITY AND FINANCIAL CONDITION****Working Capital**

The Company believes that adjusted working capital, a non-GAAP financial measure, (defined by the Company as trade and other accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities rather than total current assets less total current liabilities) provides useful information to investors in evaluating the Company's underlying performance and identifying operating trends. Management uses this non-GAAP financial measure internally to allocate resources and evaluate the performance of the Company's operations. Items excluded from the adjusted working capital calculation are listed in the table below and represent factors which do not fluctuate in line with the day to day working capital needs of the business.

| <b>(in millions)</b>   | <b>March 31,<br/>2015</b> | <b>December 31,<br/>2014</b> |
|--|---------------------------|------------------------------|
| Total current assets   | \$ 391.4                  | \$ 414.2                     |
| Total current liabilities  | (189.3)                   | (222.9)                      |
| Working capital  | 202.1                     | 191.3                        |
| Less cash and cash equivalents   | (46.5)                    | (41.6)                       |
| Less short-term investments  | (5.2)                     | (4.7)                        |
| Less current portion of deferred tax assets                              | (8.4)                     | (8.4)                        |
| Less prepaid income taxes  | (1.0)                     | (2.0)                        |
| Add back current portion of accrued income taxes                         | 4.8                       | 5.6                          |
| Add back current portion of long-term debt                               | 0.2                       | 0.4                          |
| Add back current portion of finance leases                               | 0.6                       | 0.5                          |
| Add back current portion of plant closure provisions                     | 4.9                       | 5.7                          |
| Add back current portion of acquisition-related contingent consideration | 47.3                      | 45.7                         |
| Add back current portion of deferred income                              | 0.2                       | 0.2                          |
| Adjusted working capital   | \$ 199.0                  | \$ 192.7                     |

In 2015 our adjusted working capital increased by \$6.3 million, driven primarily by the timing of shipments in our Octane Additives business just prior to the quarter end which led to an increase in trade accounts receivable for that segment.

We had a \$16.6 million decrease in trade and other accounts receivable in 2015, which is primarily related to the collection of receivables in our Fuel Specialties segment following high sales in the fourth quarter of 2014, partly offset by higher receivables in our Octane Additives segment. Days sales outstanding in our Fuel Specialties segment decreased from 52 days to 42 days (44 days March 31, 2014) and remained unchanged at 48 days (52 days March 31, 2014) in our Performance Chemicals segment.

We had an \$8.9 million decrease in inventories in 2015, which is primarily related to lower inventories in our Fuel Specialties segment following high sales in the fourth quarter of 2014 and lower inventories in our Performance Chemicals segment due to lower production levels and lower cost raw materials. Days sales in inventory in our Fuel Specialties segment increased from 76 days to 80 days (79 days March 31, 2014) and decreased in our Performance

Chemicals segment from 99 days to 80 (83 days March 31, 2014) days.

Prepaid expenses decreased \$1.7 million in the first quarter of 2015 (\$1.4 million 2014) from \$8.3 million to \$6.6 million, primarily related to the normal expensing of prepaid costs.

## **Table of Contents**

We had a \$33.5 million decrease in accounts payable and accrued liabilities in 2015, as our payables unwind following the higher sales in the fourth quarter of 2014, together with payments for personnel-related compensation in the first quarter of 2015. Creditor days in our Fuel Specialties segment decreased from 40 days to 28 days (30 days March 31, 2014) and in our Performance Chemicals segment decreased from 31 days to 27 days (26 days March 31, 2014).

## **Operating Cash Flows**

We generated cash from operating activities of \$18.2 million in 2015 compared to \$20.9 million in 2014. Year over year cash from operating activities has been adversely impacted by additional working capital requirements, primarily related to the timing of shipments in our Octane Additives segment and significant changes in our income tax cash flows.

## **Cash**

At March 31, 2015 and December 31, 2014 we had cash and cash equivalents of \$46.5 million and \$41.6 million, respectively, of which \$35.2 million and \$30.1 million, respectively, were held by non-U.S. subsidiaries principally in the United Kingdom. The Company is in a position to control whether or not to repatriate foreign earnings. We currently do not expect to make a repatriation in the foreseeable future and hence have not provided for future income taxes on the cash held by overseas subsidiaries. If circumstances were to change that would cause these earnings to be repatriated, an additional U.S. tax liability could be incurred, and we continue to monitor this position.

## **Short-term investments**

At March 31, 2015 and December 31, 2014, the Company had short-term investments of \$5.2 million and \$4.7 million, respectively.

## **Debt**

At March 31, 2015, the Company had \$139.0 million of debt outstanding under the revolving credit facility, \$0.2 million of debt financing within our Independence business and \$2.9 million of obligations under finance leases relating to certain fixed assets within our Independence business.

The Company has a revolving credit facility that provides for borrowing of up to \$200.0 million which expires on December 14, 2016 and may be drawn down in full in the U.S..

## **Item 3 Quantitative and Qualitative Disclosures about Market Risk**

The Company uses floating rate debt to finance its global operations. 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 major 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.

From time to time, 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

## **Table of Contents**

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 the 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.

The Company offers fixed prices for some long-term sales contracts. As manufacturing and raw material costs are subject to variability the Company, from time to time, 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 2014 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**

Based on an evaluation carried out as of the end of the period covered by this report, under the supervision and with the participation of our management, our Chief Executive Officer and our Chief Financial Officer concluded that 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) were effective as of March 31, 2015.

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

The Company is continuously seeking to improve the efficiency and effectiveness of its operations and of its internal control over financial reporting. This is intended to result in refinements to processes throughout the Company.

### **Remediation of Existing Material Weaknesses:**

The following material weakness that existed as of December 31, 2014 and reported in the Company's 2014 Form 10-K filed on February 17, 2015, was remediated as of March 31, 2015:

#### *Treatment of Intercompany Loans Denominated in Currencies Other Than the Entity's Functional Currency:*

The Company previously reported that it lacked effective internal control over financial reporting procedures to ensure the proper application of ASC 830, Foreign Currency Matters, (ASC 830), related to the treatment of foreign currency gains or losses on intercompany loan balances denominated in currencies other than the entity's functional currency. The Company previously reported it did not maintain effective internal control over the calculation of intercompany foreign exchange gains or losses and lacked an effective control to assess and document at inception whether or not intercompany loan balances are long-term in nature. The ineffectiveness of the internal control environment with respect to the treatment of foreign currency gains or losses on intercompany loan balances has not resulted in an adjustment to any financial statements.

## **Table of Contents**

The Company has designed and implemented new internal control over financial reporting procedures to address this material weakness in the quarter. The Company has completed the remediation plan including the following:

Implemented and evidenced a monthly review of all loan balances to ensure the designation and documentation of certain intercompany loans is correct to ensure the proper application of ASC 830; and

Implemented additional control procedures to ensure the calculation of foreign exchange gains and losses on intercompany loans included in other comprehensive income is correct.

The Company has tested the operating effectiveness of the internal control over financial reporting steps described above, which are performed on a monthly basis, and concluded that, as of March 31, 2015, this previously reported material weakness has been remediated.

Except as otherwise discussed herein, there were no changes to our internal control over financial reporting, which were identified in connection with the evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, that occurred during the first quarter of 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1 Legal Proceedings**

#### **Legal matters**

While 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 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. It is possible, however, that an adverse resolution of an unexpectedly large number of such individual claims or proceedings could in the aggregate have a material adverse effect on results of operations for a particular year or quarter.

### **Item 1A Risk Factors**

Information regarding risk factors appears in Item 1A of the Company's 2014 Annual Report on Form 10-K and, in management's view, 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**

There were no unregistered sales of equity securities, nor any purchases of equity securities by the issuer in the quarter ended March 31, 2015.

**Item 3 Defaults Upon Senior Securities**

None.

**Item 4 Mine Safety Disclosures**

Not applicable.

**Item 5 Other Information**

None.

**Table of Contents**

**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.
- 101 XBRL Instance Document and Related Items.

**Table of Contents**

**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.

INNOSPEC INC.  
**Registrant**

Date: May 6, 2015

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

Date: May 6, 2015

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