INNOSPEC INC.
Form 10-Q
November 03, 2016
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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 September 30, 2016

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	**98-0181725**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
8310 South Valley Highway **Suite 350** **Englewood** **Colorado**	**80112**
(Address of principal executive offices)	**(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 x 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 x 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 x	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 x

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

Class	**Outstanding as of October 28, 2016**
Common Stock, par value $0.01	23,982,705

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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, estimates, anticipates, may, believes, feels or similar words or expressions, for example,) which relat 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, 2015, Innospec s Quarterly Report on Form 10-Q for the quarter ended June 30, 2016 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.

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PART I FINANCIAL INFORMATION

Item 1 Financial Statements

INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions, except share and per share data)	**2016**	**2015**	**2016**	**2015**
Net sales	$ 205.5	$ 254.2	$ 645.6	$ 766.3
Cost of goods sold	(126.3)	(163.8)	(404.7)	(506.6)
Gross profit	79.2	90.4	240.9	259.7
Operating expenses:				
Selling, general and administrative	(56.1)	(52.7)	(153.1)	(151.6)
Research and development	(6.5)	(6.6)	(19.6)	(19.3)
Adjustment to fair value of contingent consideration	2.3	8.5	6.3	31.6
Profit/(loss) on disposal of subsidiary	0.0	1.6	(1.4)	1.6
Total operating expenses	(60.3)	(49.2)	(167.8)	(137.7)
Operating income	18.9	41.2	73.1	122.0
Other net (expense)/income	(5.0)	1.2	3.2	(2.0)
Interest expense, net	(0.7)	(1.0)	(2.2)	(2.9)
Income before income taxes	13.2	41.4	74.1	117.1
Income taxes	(1.8)	(5.8)	(14.9)	(29.1)
Net income	$ 11.4	$ 35.6	$ 59.2	$ 88.0
Earnings per share:				
Basic	$ 0.48	$ 1.48	$ 2.47	$ 3.64
Diluted	$ 0.47	$ 1.45	$ 2.42	$ 3.57
Weighted average shares outstanding (in thousands):				
Basic	23,977	24,121	23,989	24,162
Diluted	24,476	24,611	24,462	24,660

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

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INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in millions)	**Three Months Ended September 30 2016**	**Three Months Ended September 30 2015**	**Nine Months Ended September 30 2016**	**Nine Months Ended September 30 2015**
Net income	$ 11.4	$ 35.6	$ 59.2	$ 88.0
Other comprehensive income/(loss):				
Changes in cumulative translation adjustment	(0.1)	5.1	(0.3)	0.4
Amortization of prior service credit, net of tax of $0.0 million, $0.1 million, $0.1 million and $0.2 million, respectively	(0.2)	(0.2)	(0.7)	(0.7)
Amortization of actuarial net losses, net of tax of $(0.1) million, $(0.2) million, $(0.4) million and $(0.8) million, respectively	0.5	1.1	1.6	3.1
Total other comprehensive income	0.2	6.0	0.6	2.8
Total comprehensive income	$ 11.6	$ 41.6	$ 59.8	$ 90.8

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

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INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in millions, except share and per share data)	September 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 167.1	$ 136.9
Short-term investments	0.0	4.8
Trade and other accounts receivable (less allowances of $4.4 million and $3.6 million, respectively)	125.5	137.4
Inventories (less allowances of $8.4 million and $8.8 million, respectively):		
Finished goods	109.5	104.4
Work in progress	0.8	2.7
Raw materials	51.5	52.8
Total inventories	161.8	159.9
Current portion of deferred tax assets	8.6	8.8
Prepaid expenses	9.2	6.1
Prepaid income taxes	7.0	3.0
Other current assets	0.0	1.8
Total current assets	479.2	458.7
Property, plant and equipment:		
Gross cost	174.5	161.0
Less accumulated depreciation	(94.3)	(85.0)
Net property, plant and equipment	80.2	76.0
Goodwill	267.4	267.4
Other intangible assets	150.5	168.7
Deferred finance costs	1.2	1.4
Deferred tax assets, net of current portion	1.4	1.4
Pension asset	62.6	55.5
Other non-current assets	0.8	0.9
Total assets	$ 1,043.3	$ 1,030.0

The accompanying notes 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, 2016 (Unaudited)	December 31, 2015
Liabilities and Equity		
Current liabilities:		
Accounts payable	$ 56.4	$ 52.2
Accrued liabilities	79.7	84.1
Current portion of finance leases	1.6	0.7
Current portion of plant closure provisions	5.0	6.4
Current portion of accrued income taxes	11.8	7.9
Current portion of acquisition-related contingent consideration	4.3	54.6
Current portion of deferred income	0.2	0.2
Total current liabilities	159.0	206.1
Long-term debt, net of current portion	143.0	133.0
Finance leases, net of current portion	2.9	2.4
Plant closure provisions, net of current portion	34.2	31.3
Unrecognized tax benefits, net of current portion	2.3	3.9
Deferred tax liabilities, net of current portion	38.2	37.7
Pension liability	10.0	9.2
Deferred income, net of current portion	0.6	0.6
Other non-current liabilities	0.9	0.5
Total liabilities	391.1	424.7
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	313.4	311.0
Treasury stock (5,572,705 and 5,453,078 shares at cost, respectively)	(99.0)	(91.8)
Retained earnings	547.5	496.4
Accumulated other comprehensive loss	(110.3)	(110.9)
Total Innospec stockholders equity	651.9	605.0
Non-controlling interest	0.3	0.3
Total equity	652.2	605.3
Total liabilities and equity	$ 1,043.3	$ 1,030.0

The accompanying notes 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 September 30 2016**	**2015**
Cash Flows from Operating Activities		
Net income	$ 59.2	$ 88.0
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28.5	25.7
Adjustment to fair value of contingent consideration	(6.3)	(31.6)
Deferred taxes	0.5	13.9
Excess tax benefit from stock-based payment arrangements	(0.2)	(0.7)
Loss/(profit) on disposal of subsidiary	1.4	(1.6)
Cash contributions to defined benefit pension plans	(0.8)	(7.9)
Non-cash movements on defined benefit pension plans	(4.7)	0.4
Stock option compensation	2.8	2.7
Changes in assets and liabilities, net of effects of acquired and divested companies:		
Trade and other accounts receivable	12.3	21.2
Inventories	(1.0)	0.8
Prepaid expenses	(3.0)	4.0
Accounts payable and accrued liabilities	(1.0)	(21.6)
Accrued income taxes	(0.9)	0.8
Plant closure provisions	1.5	1.4
Unrecognized tax benefits	(1.6)	(2.6)
Other non-current assets and liabilities	0.1	(2.3)
Net cash provided by operating activities	86.8	90.6
Cash Flows from Investing Activities		
Capital expenditures	(12.2)	(12.0)
Proceeds from disposal of subsidiary	0.0	41.5
Business combinations, net of cash acquired	1.8	0.0
Internally developed software	0.0	(7.0)
Purchase of short-term investments	0.0	(5.3)
Sale of short-term investments	4.7	4.8
Net cash (used in)/provided by investing activities	(5.7)	22.0
Cash Flows from Financing Activities		
Non-controlling interest	0.0	0.4
Proceeds from revolving credit facility	28.0	0.0
Repayments of revolving credit facility	(18.0)	(12.0)
Repayments of finance leases and term loans	(0.8)	(0.4)

Receipt of short-term borrowing	0.0	7.6
Payment for acquisition-related contingent consideration	(44.0)	0.0
Excess tax benefit from stock-based payment arrangements	0.2	0.7
Dividend paid	(8.1)	(7.3)
Issue of treasury stock	0.3	1.0
Repurchase of common stock	(8.2)	(15.4)
Net cash used in financing activities	(50.6)	(25.4)
Effect of foreign currency exchange rate changes on cash	(0.3)	(1.1)
Net change in cash and cash equivalents	30.2	86.1
Cash and cash equivalents at beginning of period	136.9	41.6
Cash and cash equivalents at end of period	$ 167.1	$ 127.7

Amortization of deferred finance costs of $0.2 million (2015 $0.6 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.

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INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF EQUITY

(Unaudited)

(in millions)	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Non-controlling Interest	Total Equity
Balance at December 31, 2015	$ 0.3	$ 311.0	$ (91.8)	$ 496.4	$ (110.9)	$ 0.3	$ 605.3
Net income				59.2			59.2
Dividend paid				(8.1)			(8.1)
Changes in cumulative translation adjustment					(0.3)		(0.3)
Treasury stock reissued		(0.6)	1.0				0.4
Treasury stock repurchased			(8.2)				(8.2)
Excess tax benefit from stock-based payment arrangements		0.2					0.2
Stock option compensation		2.8					2.8
Amortization of prior service credit, net of tax					(0.7)		(0.7)
Amortization of actuarial net losses, net of tax					1.6		1.6
Balance at September 30, 2016	$ 0.3	$ 313.4	$ (99.0)	$ 547.5	$ (110.3)	$ 0.3	$ 652.2

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

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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, 2016.

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

During the second quarter of 2016, we announced a change in the organization structure of the Group. As a result of these changes, information that the Company s chief operating decision maker regularly reviews for purposes of allocating resources and assessing performance changed. Therefore, in the third quarter of 2016, the Company has reported its financial performance based on the new segments: Fuel Specialties, Performance Chemicals, Oilfield Services and Octane Additives (See Note 2 of the Notes to the Consolidated Financial Statements for further information).

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

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NOTE 2 SEGMENT REPORTING

In the second quarter of 2016, we finalized changes to our reporting segments to reflect the development of our management structure and strategy. As a result of these changes, information that the Company s chief operating decision maker regularly reviews for purposes of allocating resources and assessing financial performance has changed. Therefore, in the third quarter of 2016, the Company has reported its financial performance based on the four reportable segments described below.

Fuel Specialties, including the Polymers business previously reported in Performance Chemicals and excluding Oilfield Services business

Performance Chemicals, excluding the Polymers business

Oilfield Services, which was previously reported within Fuel Specialties

Octane Additives (no change)

We have recast certain prior period amounts to conform to the way we internally manage and monitor segment performance.

The Fuel Specialties, Performance Chemicals and Oilfield Services segments operate in markets where we actively seek growth opportunities although their ultimate customers are different. The Octane Additives segment is expected to decline in the near future as our one remaining refinery 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:

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions)	**2016**	**2015**	**2016**	**2015**
Net sales:				
Fuel Specialties	$ 114.4	$ 121.3	$ 367.1	$ 386.6
Performance Chemicals	36.8	33.7	106.8	124.4
Oilfield Services	49.7	78.9	132.4	216.3
Octane Additives	4.6	20.3	39.3	39.0
	$ 205.5	$ 254.2	$ 645.6	$ 766.3
Gross profit:				
Fuel Specialties	$ 43.8	$ 39.5	$ 129.5	$ 125.4
Performance Chemicals	12.3	9.9	34.4	33.3

Oilfield Services	20.6	32.0	52.1	82.4
Octane Additives	2.5	9.0	24.9	18.6
	$ 79.2	$ 90.4	$ 240.9	$ 259.7
Operating income:				
Fuel Specialties	$ 24.1	$ 21.6	$ 72.2	$ 70.7
Performance Chemicals	4.2	3.6	13.3	13.1
Oilfield Services	0.0	7.2	(7.1)	13.8
Octane Additives	1.9	8.0	22.5	15.9
Pension credit	1.6	0.0	5.1	0.1
Corporate costs	(15.2)	(9.3)	(37.8)	(24.8)
Adjustment to fair value of contingent consideration	2.3	8.5	6.3	31.6
Profit/(loss) on disposal of subsidiary	0.0	1.6	(1.4)	1.6
Total operating income	$ 18.9	$ 41.2	$ 73.1	$ 122.0

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The pension credit 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.

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

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions)	**2016**	**2015**	**2016**	**2015**
Depreciation:				
Fuel Specialties	$ 0.9	$ 0.7	$ 2.8	$ 2.3
Performance Chemicals	0.5	0.5	1.6	1.7
Oilfield Services	1.7	1.4	4.6	4.1
Octane Additives	0.1	0.1	0.4	0.3
Corporate	0.3	0.3	0.7	1.1
	$ 3.5	$ 3.0	$ 10.1	$ 9.5
Amortization:				
Fuel Specialties	$ 0.2	$ 0.2	$ 0.7	$ 0.8
Performance Chemicals	1.1	1.1	3.1	3.1
Oilfield Services	2.9	3.0	8.9	8.9
Corporate	1.9	0.9	5.5	2.8
	$ 6.1	$ 5.2	$ 18.2	$ 15.6

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 September 30		Nine Months Ended September 30	
	2016	**2015**	**2016**	**2015**
Numerator (in millions):				
Net income available to common stockholders	$ 11.4	$ 35.6	$ 59.2	$ 88.0
Denominator (in thousands):				
Weighted average common shares outstanding	23,977	24,121	23,989	24,162
Dilutive effect of stock options and awards	499	490	473	498

Denominator for diluted earnings per share	24,476	24,611	24,462	24,660
Net income per share, basic:	$ 0.48	$ 1.48	$ 2.47	$ 3.64
Net income per share, diluted:	$ 0.47	$ 1.45	$ 2.42	$ 3.57

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In the three and nine months ended September 30, 2016, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were 0 and 0, respectively (three and nine months ended September 30, 2015 21,959 and 21,959, respectively).

NOTE 4 GOODWILL

The following table summarizes goodwill at the balance sheet dates:

(in millions)	September 30, 2016	December 31, 2015
Gross cost [1]	$ 503.9	$ 503.9
Accumulated impairment losses	(236.5)	(236.5)
Net book amount	$ 267.4	$ 267.4

[1] Gross cost for 2016 and 2015 is net of $298.5 million of historical accumulated amortization.

NOTE 5 OTHER INTANGIBLE ASSETS

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

	Nine Months Ended September 30	
(in millions)	2016	2015
Gross cost at January 1	$ 248.6	$ 247.6
Capitalization of internally developed software	0.0	7.0
Exchange effect	0.0	0.1
Disposal of subsidiary	0.0	(7.7)
Gross cost at September 30	248.6	247.0
Accumulated amortization at January 1	(79.9)	(66.5)
Amortization expense	(18.2)	(15.6)
Exchange effect	0.0	0.0
Disposal of subsidiary	0.0	7.7
Accumulated amortization at September 30	(98.1)	(74.4)
Net book amount at September 30	$ 150.5	$ 172.6

Amortization expense

(in millions)	Nine Months Ended September 30 2016	2015
Product rights	$ (2.8)	$ (2.8)
Brand names	(0.9)	(0.9)
Technology	(2.5)	(2.6)
Customer relationships	(5.1)	(5.1)
Non-compete agreements	(0.7)	(0.7)
Marketing related	(0.7)	(0.7)
Internally developed software	(5.5)	(2.8)
Total	$ (18.2)	$ (15.6)

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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.

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions)	**2016**	**2015**	**2016**	**2015**
Plan net pension credit/(charge):				
Service cost	$ (0.2)	$ (0.5)	$ (0.7)	$ (1.2)
Interest cost on projected benefit obligation	(5.0)	(7.0)	(16.0)	(20.8)
Expected return on plan assets	7.2	8.5	23.0	25.1
Amortization of prior service credit	0.2	0.3	0.8	0.9
Amortization of actuarial net losses	(0.6)	(1.3)	(2.0)	(3.9)
	$ 1.6	$ 0.0	$ 5.1	$ 0.1

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 for the three and nine months ended September 30, 2016, was $0.2 million and $0.6 million, respectively (three and nine months ended September 30, 2015 - $0.1 million and $0.5 million, respectively).

NOTE 7 INCOME TAXES

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

(in millions)	**Unrecognized Tax Benefits**	**Interest and Penalties**	**Total**
Opening balance at January 1, 2016	$ 3.6	$ 0.3	$ 3.9
Decrease for prior period tax positions	(0.6)	(0.1)	(0.7)
Reductions due to lapsed statute of limitations	(0.8)	(0.1)	(0.9)
Closing balance at September 30, 2016	2.2	0.1	2.3
Current	0.0	0.0	0.0
Non-current	$ 2.2	$ 0.1	$ 2.3

All of the unrecognized tax benefits, interest and penalties, 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.

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The Company or one of its subsidiaries files income tax returns with the U.S. federal government, and various state and foreign jurisdictions. As previously disclosed, one of the Company s U.S. subsidiaries is currently subject to a state tax examination in respect of 2012 through to 2014 inclusive. The Company currently anticipates 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 September 30, 2016.

As previously disclosed, the Company s German subsidiaries are subject to a tax audit in respect of 2010 through to 2014 inclusive. The Company currently anticipates 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 September 30, 2016.

The Company and its U.S. subsidiaries remain open to examination by the IRS for years 2013 onwards. The Company s subsidiaries in foreign tax jurisdictions are open to examination including France (2013 onwards), Germany (2010 onwards), Switzerland (2014 onwards) and the United Kingdom (2014 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, 2015 was approximately $775 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:

(in millions)	September 30, 2016	December 31, 2015
Revolving credit facility	$ 143.0	$ 133.0

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:

	Nine Months Ended September 30	
(in millions)	2016	2015
Total at January 1	$ 37.7	$ 34.1
Charge for the period	3.5	3.1
Utilized in the period	(2.1)	(1.7)

Disposal in the period	0.0	(0.3)
Exchange effect	0.1	(0.2)
Total at September 30	39.2	35.0
Due within one year	(5.0)	(3.8)
Due after one year	$ 34.2	$ 31.2

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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:

	September 30, 2016		December 31, 2015	
(in millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Assets				
Non-derivatives:				
Cash and cash equivalents	$ 167.1	$ 167.1	$ 136.9	$ 136.9
Short-term investments	0.0	0.0	4.8	4.8
Liabilities				
Non-derivatives:				
Long-term debt (including current portion)	$ 143.0	$ 143.0	$ 133.0	$ 133.0
Finance leases (including current portion)	4.5	4.5	3.1	3.1
Derivatives (Level 1 measurement):				
Other non-current liabilities:				
Foreign currency forward exchange contracts	0.6	0.6	0.3	0.3
Non-financial liabilities (Level 3 measurement):				
Acquisition-related contingent consideration	4.3	4.3	54.6	54.6
Stock equivalent units	9.1	9.1	7.8	7.8

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. Finance leases relate to certain fixed assets in our Oilfield Services businesses. The carrying amount of long-term debt and finance leases approximates the fair value.

Derivatives: The fair value of derivatives relating to foreign currency forward exchange contracts 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 estimated fair value at each balance sheet date. Where contingent consideration is dependent upon pre-determined financial targets, an estimate of the fair value of the likely consideration payable is made at each balance sheet date. The carrying value of the contingent consideration at the balance

sheet dates is based on the estimated EBITDA (earnings before interest, taxes, depreciation and amortization) and free cash flow generated by Independence Oilfield Chemicals LLC (Independence) through the period to October 31, 2016. The contingent consideration payable in relation to the acquisition of Independence is based on management s latest forecasts of the business and on the current trading performance. The results of the Independence business are particularly sensitive to the level of exploration, development and production activity of our customers in the oil and gas sector, which is directly affected by trends in oil prices.

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 depending on the terms of each grant.

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 September 30, 2016 the contracts have maturity dates of up to twelve 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 nine months of 2016 was a gain of $3.2 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 September 30, 2016, 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.

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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.

Stock option plans

The following table summarizes the transactions of the Company s stock option plans for the nine months ended September 30, 2016:

	Number of Options	Weighted Average Exercise Price	Weighted Average Grant-Date Fair Value
Outstanding at December 31, 2015	667,439	$ 19.87	$ 20.19
Granted - at discount	67,546	$ 0.00	$ 38.13
- at market value	24,794	$ 44.34	$ 9.17
Exercised	(58,125)	$ 5.42	$ 28.50
Forfeited	(24,273)	$ 21.15	$ 21.12
Outstanding at September 30, 2016	677,381	$ 19.97	$ 20.83

At September 30, 2016, there were 112,604 stock options that were exercisable, of which 30,712 had performance conditions attached.

The stock option compensation cost for the first nine months of 2016 was $2.8 million (2015 $2.7 million). The total intrinsic value of options exercised in the first nine months of 2016 was $1.8 million (2015 $2.1 million).

The total compensation cost related to non-vested stock options not yet recognized at September 30, 2016 was $4.3 million and this cost is expected to be recognized over the weighted-average period of 2.08 years.

Stock equivalent units

The following table summarizes the transactions of the Company s SEUs for the nine months ended September 30, 2016:

	Number of SEUs	Weighted Average Exercise Price	Weighted Average Grant-Date Fair Value
Outstanding at December 31, 2015	279,750	$ 3.79	$ 31.72

Granted - at discount	70,153	$	0.00	$	36.56
- at market value	7,316	$	44.18	$	9.11
Exercised	(49,623)	$	1.74	$	27.79
Forfeited	(8,980)	$	4.41	$	30.73
Outstanding at September 30, 2016	298,616	$	4.21	$	32.99

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At September 30, 2016 there were 59,765 SEUs that are exercisable, of which 51,163 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.

The SEU compensation cost for the first nine months of 2016 was $3.7 million (2015 - $2.4 million). The total intrinsic value of SEUs exercised in the first nine months of 2016 was $1.5 million (2015 $2.2 million).

The weighted-average remaining vesting period of non-vested SEUs is 1.61 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)	2016	2015
Balance at January 1	$ 1.0	$ 0.1
Compensation charge for the period	0.6	0.4
Balance at September 30	$ 1.6	$ 0.5

The following assumptions were used in the Monte Carlo model at September 30:

	2016	2015
Dividend yield	1.05%	1.25%
Volatility of Innospec s share price	25.55%	24.47%
Risk free interest rate	0.88%	0.92%

NOTE 14 RECLASSIFICATIONS OUT OF ACCUMULATED OTHER COMPREHENSIVE LOSS

Reclassifications out of accumulated other comprehensive loss for the first nine months of 2016 were:

(in millions) Details about AOCL Components	Amount Reclassified from AOCL	Affected Line Item in the Statement where Net Income is Presented
Defined benefit pension plan items:		
Amortization of prior service credit	$ (0.8)	See (1) below
Amortization of actuarial net losses	2.0	See (1) below

		1.2	Total before tax
		(0.3)	Income tax expense
Total reclassifications	$	0.9	Net of tax

(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.

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Changes in accumulated other comprehensive loss for the first nine months of 2016, net of tax, were:

(in millions)	Defined Benefit Pension Plan Items	Cumulative Translation Adjustments	Total
Balance at December 31, 2015	$ (50.9)	$ (60.0)	$ (110.9)
Other comprehensive income before reclassifications	0.0	(0.3)	(0.3)
Amounts reclassified from AOCL	0.9	0.0	0.9
Total other comprehensive income	0.9	(0.3)	0.6
Balance at September 30, 2016	$ (50.0)	$ (60.3)	$ (110.3)

NOTE 15 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers ASC Topic 606, which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers. The original effective date for ASU 2014-09 was for annual and interim periods within those years beginning after December 15, 2016. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers Deferral of the Effective Date, which defers the effective date of ASU 2014-09 for one year and permits early adoption as early as the original effective date of ASU 2014-09. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company has been evaluating the potential timing and impact of adopting the new revenue standard on its consolidated financial statements and has not yet determined the effect of the standard on its ongoing financial reporting.

In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, Revision to Lease Accounting, which amends ASC Topic 842, Leases. The ASU requires lessees to recognize a right-of-use asset and a lease liability for virtually all of their leases (other than leases that meet the definition of a short-term lease). The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The new standard must be adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. The Company has not yet determined the effect of the standard on its ongoing financial reporting.

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In June 2016, the FASB issued a new standard Accounting Standard Update 2016-13 to replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to develop credit loss estimates. For trade and other receivables, loans, and other financial instruments, we will be required to use a forward-looking expected loss model rather than the incurred loss model for recognizing credit losses. The new standard is effective for fiscal periods beginning after December 15, 2019. Early adoption is permitted. The Company has not yet 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 nine months of 2016 the Company incurred fees from SGR of $0.4 million (2015 $0.3 million). As at September 30, 2016, the amount due to SGR from the Company was $0.1 million (December 31, 2015 - $0.1 million).

NOTE 17 SUBSEQUENT EVENT

On July 29, 2016 Innospec International Ltd., a wholly owned subsidiary of Innospec Inc. entered into an Exclusivity and Put Option Agreement with Huntsman Investments B.V. (the Seller). The Put Option Agreement set forth the terms of a commitment to acquire the European Personal Care and Home Care business of the Seller.

On October 25, 2016, pursuant to the terms of the Put Option Agreement, the Company entered into a Share and Asset Purchase Agreement (the SAPA). The aggregate purchase price to be paid under the SAPA is approximately $200 million subject to adjustments for certain working capital items, inventory and certain adjustments related to employee matters.

The Proposed Transaction is expected to close in the Fourth quarter of 2016 subject to customary closing conditions.

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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, 2016

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 business combinations, contingencies, environmental liabilities, pensions, deferred tax and uncertain income tax positions, goodwill, property, plant and equipment and other intangible assets (net of amortization). These policies have been discussed in the Company s 2015 Annual Report on Form 10-K.

RESULTS OF OPERATIONS

In the second quarter of 2016, we finalized changes to our reporting segments to reflect the development of our management structure and strategy. As a result of these changes, information that the Company s chief operating decision maker regularly reviews for purposes of allocating resources and assessing financial performance has changed. Therefore, in the third quarter of 2016, the Company reported its financial performance based on the four reportable segments described below.

Fuel Specialties, including the Polymers business previously reported in Performance Chemicals and excluding Oilfield Services business

Performance Chemicals, excluding the Polymers business

Oilfield Services, which was previously reported within Fuel Specialties

Octane Additives (no change)

We have recast certain prior period amounts to conform to the way we internally manage and monitor segment performance.

The following table provides operating income by reporting segment:

	Three Months Ended September 30		Nine Months Ended September 30	
(in millions)	**2016**	**2015**	**2016**	**2015**
Net sales:				
Fuel Specialties	$ 114.4	$ 121.3	$ 367.1	$ 386.6
Performance Chemicals	36.8	33.7	106.8	124.4
Oilfield Services	49.7	78.9	132.4	216.3

Octane Additives	4.6	20.3	39.3	39.0
	$ 205.5	$ 254.2	$ 645.6	$ 766.3
Gross profit:				
Fuel Specialties	$ 43.8	$ 39.5	$ 129.5	$ 125.4
Performance Chemicals	12.3	9.9	34.4	33.3
Oilfield Services	20.6	32.0	52.1	82.4
Octane Additives	2.5	9.0	24.9	18.6
	$ 79.2	$ 90.4	$ 240.9	$ 259.7
Operating income:				
Fuel Specialties	$ 24.1	$ 21.6	$ 72.2	$ 70.7
Performance Chemicals	4.2	3.6	13.3	13.1
Oilfield Services	0.0	7.2		