

INNOSPEC INC.  
Form 10-Q  
November 02, 2009  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2009**

**Commission file number 1-13879**

**INNOSPEC INC.**

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

Edgar Filing: INNOSPEC INC. - Form 10-Q

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

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

**Innospec Manufacturing Park**

**Oil Sites Road**

**Ellesmere Port**

**Cheshire**

**United Kingdom**  
 (Address of principal executive offices)

**CH65 4EY**  
 (Zip Code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

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

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

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

**Outstanding as of October 28, 2009**  
 23,664,053

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

Part I	<u>Financial Information</u>	3
Item 1	<u>Financial Statements</u>	3
	<u>Consolidated Statements of Income</u>	3
	<u>Consolidated Balance Sheets</u>	4
	<u>Consolidated Balance Sheets (continued)</u>	5
	<u>Consolidated Statements of Cash Flows</u>	6
	<u>Consolidated Statement of Stockholders' Equity</u>	7
	<u>Consolidated Statements of Comprehensive Income</u>	7
	<u>Notes to Unaudited Interim Consolidated Financial Statements</u>	8
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations for the Three and Nine Months Ended September 30, 2009</u>	27
	<u>Critical Accounting Estimates</u>	27
	<u>Results of Operations</u>	28
	<u>Liquidity and Financial Condition</u>	35
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	36
Item 4	<u>Controls and Procedures</u>	36
Part II	<u>Other Information</u>	37
Item 1	<u>Legal Proceedings</u>	37
Item 1A	<u>Risk Factors</u>	40
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	40
Item 3	<u>Defaults Upon Senior Securities</u>	40
Item 4	<u>Submission of Matters to a Vote of Security Holders</u>	40
Item 5	<u>Other Information</u>	40
Item 6	<u>Exhibits</u>	40
	<u>Signatures</u>	41
	<u>Exhibit 31.1</u>	42
	<u>Exhibit 31.2</u>	43
	<u>Exhibit 32.1</u>	44
	<u>Exhibit 32.2</u>	45

**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, anticipates, may, believes or similar words or expressions), for example, which relate to operating performance, events or developments that we expect or anticipate will or may occur in the future (including, without limitation, all of the Company's guidance in respect of sales, gross margins, net income, growth potential and other measures of financial performance). Although forward-looking statements are believed by management to be reasonable when made, caution should be exercised not to place undue reliance on such statements because they are subject to certain risks, uncertainties and assumptions, including in respect of the general business environment, regulatory actions or changes. If the risks or uncertainties materialize or assumptions prove incorrect or change, our actual performance or results may differ materially from those expressed or implied by such forward-looking statements and assumptions. Additional information regarding risks, uncertainties and assumptions relating to the Company and affecting our business operations and prospects are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2008, and other reports filed with the U.S. Securities and Exchange Commission. You are urged to carefully review and consider the cautionary statements and other disclosures made in those filings, specifically those under the heading Risk Factors. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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

(in millions except share and per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Net sales (Note 2)	\$ 149.2	\$ 158.5	\$ 434.3	\$ 472.5
Cost of goods sold	(102.0)	(115.1)	(296.1)	(336.3)
Gross profit (Note 2)	47.2	43.4	138.2	136.2
Operating expenses				
Selling, general and administrative	(42.9)	(31.7)	(97.3)	(92.6)
Research and development	(4.2)	(3.5)	(11.4)	(11.1)
Restructuring charge		(0.3)	(1.7)	(1.9)
Amortization of intangible assets (Note 4)	(1.2)	(2.1)	(3.5)	(6.2)
Impairment of Octane Additives business goodwill (Note 5)	(0.6)	(1.1)	(1.7)	(3.2)
Profit on disposal				0.4
	(48.9)	(38.7)	(115.6)	(114.6)
Operating (loss)/income (Note 2)	(1.7)	4.7	22.6	21.6
Other net income/(expense)	7.1	(5.0)	0.3	(5.8)
Interest expense	(1.5)	(1.6)	(4.9)	(4.9)
Interest income	0.1	0.2	0.2	0.9
Income/(loss) before income taxes	4.0	(1.7)	18.2	11.8
Income taxes (Note 6)	(6.7)	1.1	(11.5)	(4.3)
Net (loss)/income	\$ (2.7)	\$ (0.6)	\$ 6.7	\$ 7.5
(Loss)/earnings per share (Note 7):				
Basic	\$ (0.11)	\$ (0.03)	\$ 0.28	\$ 0.32
Diluted	\$ (0.11)	\$ (0.03)	\$ 0.27	\$ 0.31
Weighted average shares outstanding (in thousands) (Note 7):				
Basic	23,663	23,596	23,635	23,594
Diluted	23,663	23,596	24,709	24,211
Dividend declared per common share (Note 8):	\$	\$ 0.05	\$ 0.05	\$ 0.10

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



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

(in millions, except per share data)	September 30 2009 (Unaudited)	December 31 2008
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 50.2	\$ 13.9
Accounts receivable (less allowance of \$2.7 and \$2.8, respectively)	84.3	89.9
Inventories		
Finished goods	83.8	95.0
Work in progress	0.8	2.0
Raw materials	35.4	41.3
Total inventories	120.0	138.3
Prepaid expenses	5.2	4.4
Prepaid income taxes	7.1	10.1
Total current assets	266.8	256.6
Property, plant and equipment	123.0	113.2
Less accumulated depreciation	(71.9)	(59.7)
Net property, plant and equipment	51.1	53.5
Goodwill Octane Additives (Note 5)	7.3	9.0
Goodwill Other (Note 5)	139.3	139.2
Intangible assets (Note 4)	24.8	28.3
Deferred finance costs	2.3	0.5
Deferred income taxes	9.2	7.2
Other non-current assets	1.7	
Total assets	\$ 502.5	\$ 494.3

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

**Table of Contents**

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

(in millions, except per share data)	September 30 2009 (Unaudited)	December 31 2008
<b>Liabilities and Stockholders' Equity</b>		
<b>Liabilities</b>		
Current liabilities		
Accounts payable	\$ 46.2	\$ 55.4
Accrued liabilities	74.1	46.3
Short-term borrowing (Note 9)	10.0	73.0
Current portion of plant closure provisions (Note 10)	5.4	4.1
Current portion of unrecognized tax benefits (Note 6)	16.0	9.2
Current portion of deferred income	0.1	0.1
<b>Total current liabilities</b>	<b>151.8</b>	<b>188.1</b>
Long-term debt, net of current portion (Note 9)	51.0	
Plant closure provisions, net of current portion (Note 10)	21.6	22.8
Unrecognized tax benefits, net of current portion (Note 6)	20.1	25.6
Pension liability (Note 3)	14.0	13.8
Other non-current liabilities	3.6	13.9
Deferred income, net of current portion	0.9	0.8
Commitments and contingencies (Note 13)		
<b>Stockholders' Equity</b>		
Common stock, \$0.01 par value, authorized 40,000,000 shares, issued 29,554,500 shares	0.3	0.3
Additional paid-in capital	284.7	282.5
Treasury stock (5,890,447 and 5,956,384 shares at cost, respectively)	(64.2)	(64.9)
Retained earnings	137.1	131.6
Accumulated other comprehensive loss	(118.4)	(120.2)
<b>Total stockholders' equity</b>	<b>239.5</b>	<b>229.3</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 502.5</b>	<b>\$ 494.3</b>

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



**Table of Contents**

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

(Unaudited)

(in millions)	Nine Months Ended September 30	
	2009	2008
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 6.7	\$ 7.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13.7	18.1
Impairment of Octane Additives business goodwill (Note 5)	1.7	3.2
Deferred income taxes	(2.0)	(2.3)
(Profit) on disposal of property, plant and equipment		(0.4)
Non-cash intangible asset other adjustments		6.3
Changes in working capital:		
Accounts receivable and prepaid expenses	5.5	2.8
Inventories	19.5	(21.5)
Accounts payable and accrued liabilities	19.1	0.7
Excess tax benefit from stock based payment arrangements	(0.1)	(3.3)
Income taxes and other current liabilities	3.1	(15.9)
Movement on plant closure provisions		(0.3)
Movement on pension asset/(liability)	0.2	(3.8)
Stock option compensation charge	0.6	3.1
Movement on other non-current assets and liabilities	(11.3)	(3.5)
<b>Net cash provided by/(used in) operating activities</b>	<b>56.7</b>	<b>(9.3)</b>
<b>Cash Flows from Investing Activities</b>		
Capital expenditures	(4.6)	(6.8)
Proceeds on disposal of property, plant and equipment		1.3
<b>Net cash (used in) investing activities</b>	<b>(4.6)</b>	<b>(5.5)</b>
<b>Cash Flows from Financing Activities</b>		
Net (repayment)/receipt of revolving credit facility	(7.0)	31.0
Repayment of term loan	(55.0)	(20.0)
Receipt of term loan	50.0	
Refinancing costs	(3.6)	(0.4)
Excess tax benefit from stock based payment arrangements	0.1	3.3
Dividend paid	(1.2)	(1.2)
Issue of treasury stock	0.2	1.9
Repurchase of common stock		(10.5)
<b>Net cash (used in)/provided by financing activities</b>	<b>(16.5)</b>	<b>4.1</b>
Effect of exchange rate changes on cash	0.7	1.6
<b>Net change in cash and cash equivalents</b>	<b>36.3</b>	<b>(9.1)</b>
Cash and cash equivalents at beginning of period	13.9	24.3
<b>Cash and cash equivalents at end of period</b>	<b>\$ 50.2</b>	<b>\$ 15.2</b>

Amortization of deferred finance costs of \$1.5m (2008 \$0.3m) are included in depreciation and amortization in the cash flow statement but in interest in the income statement.

Edgar Filing: INNOSPEC INC. - Form 10-Q

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

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

(Unaudited)

(in millions)	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
Balance at December 31, 2008	\$ 0.3	\$ 282.5	\$ (64.9)	\$ 131.6	\$ (120.2)	\$ 229.3
Net income				6.7		6.7
Dividend (\$0.05 per share)				(1.2)		(1.2)
Derivatives (1)					2.5	2.5
Net CTA change (2)					(0.7)	(0.7)
Treasury stock re-issued		(0.2)	0.7			0.5
Stock option compensation charge		2.4				2.4
Balance at September 30, 2009	\$ 0.3	\$ 284.7	\$ (64.2)	\$ 137.1	\$ (118.4)	\$ 239.5

(1) Changes in unrealized gains on derivative instruments, net of tax.

(2) Changes in cumulative translation adjustment.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(in millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Net (loss)/income for the period	\$ (2.7)	\$ (0.6)	\$ 6.7	\$ 7.5
Changes in cumulative translation adjustment	(7.0)	(8.0)	(0.7)	(6.6)
Unrealized gains on derivative instruments, net of tax	0.4	5.2	2.5	4.9
Total comprehensive (loss)/income	\$ (9.3)	\$ (3.4)	\$ 8.5	\$ 5.8

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

**Table of Contents**

**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

***NOTE 1 BASIS OF PRESENTATION***

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

It is our opinion, however, that all 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 20, 2009.

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

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

***NOTE 2 SEGMENTAL REPORTING***

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

On June 23, 2008 the Company announced a further streamlining of its business into a unified, sales-led global business focused on rapidly meeting customers' needs anywhere in the world. The Company is moving to an integrated regional model running its growth businesses as one streamlined business operating across three geographical regions: Americas, EMEA (i.e. Europe, Middle East and Africa), and ASPAC (i.e. Asia-Pacific). The Company will report its financial performance based on the segments contained within this integrated regional model when the Chief Operating Decision Maker reviews the Company's operating results primarily on this basis.

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

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

(in millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Net sales</b>				
Fuel Specialties	\$ 100.1	\$ 114.2	\$ 305.7	\$ 323.1
Active Chemicals	36.6	37.0	97.7	110.4
Octane Additives	12.5	7.3	30.9	39.0
	\$ 149.2	\$ 158.5	\$ 434.3	\$ 472.5
<b>Gross profit</b>				
Fuel Specialties	\$ 32.9	\$ 35.6	\$ 105.1	\$ 107.3
Active Chemicals	8.7	4.1	20.8	10.9
Octane Additives	5.6	3.7	12.3	18.0
	\$ 47.2	\$ 43.4	\$ 138.2	\$ 136.2
<b>Operating (loss)/income</b>				
Fuel Specialties	\$ 16.0	\$ 19.2	\$ 57.3	\$ 58.0
Active Chemicals	3.7	(0.3)	7.7	(2.6)
Octane Additives	(14.7)	(7.3)	(24.1)	(6.8)
Pension charge	(1.7)	(0.6)	(4.7)	(1.8)
Corporate costs	(4.4)	(4.9)	(10.2)	(20.5)
	(1.1)	6.1	26.0	26.3
Restructuring charge		(0.3)	(1.7)	(1.9)
Impairment of Octane Additives business goodwill	(0.6)	(1.1)	(1.7)	(3.2)
Profit on disposal				0.4
Total operating (loss)/income	(1.7)	4.7	22.6	21.6
Other net income/(expense)	7.1	(5.0)	0.3	(5.8)
Interest expense	(1.5)	(1.6)	(4.9)	(4.9)
Interest income	0.1	0.2	0.2	0.9
Income/(loss) before income taxes	\$ 4.0	\$ (1.7)	\$ 18.2	\$ 11.8

Corporate costs for the nine months ended September 30, 2008 include the expensing of \$3.9 million of advisory and financing costs related to two large potential acquisitions that the Company decided not to pursue.

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

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

(in millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
<b>Depreciation</b>				
Fuel Specialties	\$ 0.6	\$ 1.0	\$ 1.7	\$ 2.3
Active Chemicals	1.4	1.1	3.8	3.7
Octane Additives	0.4	1.3	1.5	3.0
Corporate	0.4	1.0	1.7	2.6
	\$ 2.8	\$ 4.4	\$ 8.7	\$ 11.6
<b>Amortization</b>				
Fuel Specialties	\$ 0.6	\$ 0.5	\$ 1.7	\$ 1.7
Active Chemicals	0.3	0.4	1.0	1.1
Octane Additives	0.3	1.2	0.8	3.4
	\$ 1.2	\$ 2.1	\$ 3.5	\$ 6.2

**NOTE 3 PENSION PLANS**

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

(in millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Service cost	\$ (1.0)	\$ (1.4)	\$ (2.8)	\$ (4.2)
Interest cost on projected benefit obligation	(10.8)	(12.2)	(28.6)	(36.6)
Expected return on plan assets	10.1	13.0	26.7	39.0
	\$ (1.7)	\$ (0.6)	\$ (4.7)	\$ (1.8)

At September 30, 2009, the Company has a pension liability of \$14.0 million recorded in its balance sheet.

**NOTE 4 INTANGIBLE ASSETS**

(in millions)	Nine Months Ended September 30	
	2009	2008
Gross cost at January 1	\$ 109.0	\$ 115.3
Other adjustments		(6.3)

Edgar Filing: INNOSPEC INC. - Form 10-Q

Gross cost at September 30	109.0	109.0
Accumulated amortization at January 1	(80.7)	(73.4)
Amortization charge	(3.5)	(6.2)
Accumulated amortization at September 30	(84.2)	(79.6)
Net book amount at September 30	\$ 24.8	\$ 29.4

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

An intangible asset was recognized in the second quarter of 2007 in respect of Ethyl foregoing their entitlement to a share of the future income under sales and marketing agreements to sell tetra ethyl lead. In the third quarter of 2008 contract provisions no longer deemed necessary of \$6.3 million were offset against the intangible asset. Commencing April 1, 2007, the amount attributable to the Octane Additives business segment was being amortized straight-line to December 31, 2010 and the amount attributable to the Fuel Specialties business segment is being amortized straight-line to December 31, 2017. Effective October 1, 2008 the Company extended its estimate for the future life of the Octane Additives business from December 31, 2010 to December 31, 2012 and therefore prospectively adjusted the amortization period for the amount attributed to the Octane Additives business segment. An amortization charge of \$1.5 million was recognized in the first nine months of 2009 (2008 \$4.2 million).

**Others**

The remaining intangible assets of \$86.9 million relate to those recognized in the acquisition accounting in respect of Finetex (now merged into Innospec Active Chemicals LLC), Innospec Widnes Limited (previously known as Aroma Fine Chemicals Limited), Innospec Fuel Specialties LLC (previously known as Octel Starreon LLC) and Veritel Chemicals BV. These assets are being amortized straight-line over periods of up to 13 years with the exception of the Veritel asset which was fully amortized as at December 31, 2007. An amortization charge of \$2.0 million was recognized in the first nine months of 2009 (2008 \$2.0 million).

**NOTE 5 GOODWILL**

(in millions)	Nine Months Ended September 30	
	2009	2008
At January 1		
Gross cost	\$ 673.9	\$ 673.8
Accumulated Octane Additives business goodwill impairment losses	(227.6)	(223.9)
	446.3	449.9
Impairment of Octane Additives business goodwill	(1.7)	(3.2)
Exchange effect	0.5	0.4
At September 30	\$ 445.1	\$ 447.1
Gross cost	\$ 674.4	\$ 674.2
Accumulated Octane Additives business goodwill impairment losses	(229.3)	(227.1)
	445.1	447.1
Accumulated amortization at January 1	(298.1)	(298.1)
Exchange effect	(0.4)	(0.3)
Accumulated amortization at September 30	(298.5)	(298.4)
Net book amount at September 30	\$ 146.6	\$ 148.7
Octane Additives business goodwill	\$ 7.3	\$ 9.5



Edgar Filing: INNOSPEC INC. - Form 10-Q

Other	139.3	139.2
	\$ 146.6	\$ 148.7

**Table of Contents****INNOSPEC INC. AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Impairment of Octane Additives business goodwill**

Our Octane Additives business is the world's only producer of tetra ethyl lead ( TEL ). The Octane Additives business comprises sales of TEL for use in automotive gasoline and trading in respect of our environmental remediation business. Worldwide use of TEL has declined since 1973 following the enactment of the U.S. Clean Air Act of 1970 and similar legislation in other countries. The trend of countries exiting the leaded gasoline market has resulted in a general rate of decline in volume terms in the last few years of between 10% and 25% per annum.

In light of the continuing decline in the Octane Additives market globally, as the Company makes sales of Octane Additives in each quarter, the remaining sales and corresponding cash flows that can be derived from the Octane Additives business are reduced, and accordingly the fair value of the Octane Additives reporting unit is reduced. As a result the Company determined that the fair value of the Octane Additives business be estimated quarterly from January 1, 2004 and any impairment charge arising be recognized in the relevant quarter. The fair value of Octane Additives goodwill is estimated on a quarterly basis with reference to forecast sales, production levels, and hence projected cash flows. Given the quantum and predictability of the remaining future cash flows from the Octane Additives business the Company expects goodwill impairment charges to be recognized in the income statement on an approximate straight-line basis to December 31, 2012. Effective October 1, 2008, the Company extended its estimate for the future life of the Octane Additives business from December 31, 2010 to December 31, 2012.

**NOTE 6 TAXATION**

The following table describes changes to unrecognized tax benefits and associated accrued interest and penalties in the period:

(in millions)	Interest and penalties	Unrecognized tax benefits	Total
Opening balance at January 1, 2009	\$ 3.5	\$ 31.3	\$ 34.8
Additions related to tax positions taken in the current period		1.1	1.1
Additions for tax positions of prior periods	0.2		0.2
Closing balance at September 30, 2009	3.7	32.4	36.1
Current	(1.7)	(14.3)	(16.0)
Non-current	\$ 2.0	\$ 18.1	\$ 20.1

All of the \$36.1 million of unrecognized tax benefits would impact our effective tax rate if recognized.

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

The Company has commenced detailed discussions with the United Kingdom tax authorities with a view to resolving a number of United Kingdom tax issues, including transfer pricing policies, which account for a large element of the uncertain tax positions as at September 30, 2009. Although the outcome and timing of any possible settlement is uncertain these discussions may be concluded during the next 12 months. The eventual outcome of these discussions is inherently uncertain and the outcome may have a favorable or adverse material impact on our consolidated financial statements.

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

The Company, or one of its subsidiaries, files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As at September 30, 2009, the Company's subsidiaries in France and Germany are subject to tax authority investigations into their respective transfer pricing policies. The Company does not anticipate that adjustments arising out of these investigations would result in a material change to its financial position as at September 30, 2009.

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

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

Basic (loss)/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:

	<b>Three Months Ended September 30</b>		<b>Nine Months Ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Numerator (millions of dollars):</b>				
Net (loss)/income available to common stockholders	\$ (2.7)	\$ (0.6)	\$ 6.7	\$ 7.5
<b>Denominator (in thousands):</b>				
Weighted average common shares outstanding	23,663	23,596	23,635	23,594
Dilutive effect of stock options and awards			1,074	617
Denominator for diluted earnings per share	23,663	23,596	24,709	24,211
<b>Net (loss)/income per share, basic:</b>	<b>\$ (0.11)</b>	<b>\$ (0.03)</b>	<b>\$ 0.28</b>	<b>\$ 0.32</b>
<b>Net (loss)/income per share, diluted:</b>	<b>\$ (0.11)</b>	<b>\$ (0.03)</b>	<b>\$ 0.27</b>	<b>\$ 0.31</b>

In the three and nine months ended September 30, 2009, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were 63,576 and 134,984, respectively (2008 92,588 and 60,519, respectively).

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

At September 30, 2009, the Company had authorized common stock of 40,000,000 shares (December 31, 2008 40,000,000). Issued shares at September 30, 2009, were 29,554,500 (December 31, 2008 29,554,500) and treasury stock amounted to 5,890,447 shares (December 31, 2008 5,956,384).

On February 23, 2009 the Company announced that its Board of Directors had declared a semi-annual dividend of 5 cents per share payable on April 6, 2009 to stockholders of record as of March 16, 2009.

On June 12, 2009 the Company approved a stockholder rights plan (the Plan). In connection with the Plan a dividend was declared of one preferred stock (designated as Series B Junior Participating Preferred Stock) right for each outstanding share of Innospec Inc. common stock (each a Right). The dividend was distributed on June 26, 2009 to stockholders of record on that date. Subject to certain exceptions, the Rights are exercisable



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

only if a person or group acquires 15% or more of Innospec Inc.'s common stock, including through derivatives, or announces a tender or exchange offer which would result in ownership of 15% or more of the common stock (an "Acquiring Person"). Tontine Capital Partners, L.P. and its affiliates, which already own approximately 20% of the Company's common stock, will not be treated as an Acquiring Person for the purposes of the Plan unless they purchase additional shares and as a result own 21% or more of the Company's common stock, or unless another person or entity becomes affiliated or associated with them and together they own 21% or more of the Company's common stock. Each Right entitles its holder to buy one one-thousandth of a share of Series B Junior Participating Preferred Stock at an exercise price of \$55, subject to adjustment. Initially, the Rights are not exercisable and will trade with the Company's common stock. Following the acquisition of 15% or more of Innospec Inc. common stock by a person or group, the holders of the Rights (other than the Acquiring Person or group) will be entitled to purchase shares of common stock at one-half the market price of such shares, and, in the event of a subsequent merger or other acquisition of the Company, to buy shares of common stock of the acquiring entity at one-half of the market price of those shares.

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

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

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

	2009	2008
Dividend yield	2.5%	0.5%
Expected life	5 years	4 years
Volatility	76.5%	50.1%
Risk free interest rate	1.24%	2.73%

The following table summarizes the transactions of the Company's stock option plans for the three and nine months ended September 30, 2009:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding at July 1, 2009	981,231	\$ 3.03	
Grants at discount	200,100	\$	\$ 12.73
Exercised	(1,220)	\$	
Cancelled for payment	(400)	\$	
Forfeitures	(7,876)	\$ 9.04	
Expired	(7,450)	\$ 6.64	
Outstanding at September 30, 2009	1,164,385	\$ 2.45	

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

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding at January 1, 2009	983,581	\$ 3.47	
Grants at discount	415,640	\$	\$ 8.09
Grants at market value	90,000	\$ 4.07	\$ 2.43
Grants at premium	82,217	\$ 4.62	\$ 1.65
Exercised	(60,653)	\$ 3.27	
Cancelled for payment	(400)	\$	
Forfeitures	(308,750)	\$ 2.95	
Expired	(37,250)	\$ 6.64	
Outstanding at September 30, 2009	1,164,385	\$ 2.45	

The following table summarizes information about options outstanding at September 30, 2009

Range of Exercise Price	Number outstanding at September 30, 2009	Weighted Average Remaining Life in Years	Weighted Average Exercise Price	Number Exercisable and fully vested at September 30, 2009	Weighted Average Remaining Life in Years	Weighted Average Exercise Price
\$ 0 - \$ 5	1,021,825	7.69	\$ 0.68	40,514	3.12	\$ 1.44
\$ 5 - \$10	76,506	5.00	\$ 9.11	76,506	5.00	\$ 9.11
\$10 - \$15	1,300	4.62	\$ 11.50	1,300	4.62	\$ 11.50
\$20 - \$25	45,112	8.40	\$ 20.31			\$
\$25 - \$30	19,642	7.40	\$ 27.09			\$
	1,164,385			118,320		

The aggregate intrinsic value of fully vested stock options is \$0.3 million. Of the 118,320 stock options that are exercisable, 20,780 have performance conditions attached. The total compensation cost for the first nine months of 2009 was \$0.6 million, including a gain of \$2.4 million related to the gain on stock options forfeited upon resignation of the Company's former CEO (2008 \$3.1 million charge). The total compensation cost related to nonvested stock options not yet recognized at September 30, 2009 is \$4.5 million and this cost is expected to be recognized over the weighted-average period of 2.23 years.

On February 13, 2009, we extended the vesting period for 132,470 grants made under a key employee performance related stock option plan from February 13, 2009 to February 13, 2011, and modified the performance criteria to reflect the longer vesting period. Additional compensation cost of \$0.2 million is required to be recognized for these modified stock options in the period February 13, 2009 to February 13, 2011. No stock options awards were modified in 2008.

The total intrinsic value of options exercised in the first nine months of 2009 was \$0.4 million (2008 \$1.3 million). The amount of cash received from the exercise of stock option awards in the first nine months of 2009 was \$0.2 million (2008 \$1.9 million). The Company's policy is to issue shares from Treasury stock to holders of stock options who exercise those options. During the first nine months of 2009 the new total fair value of shares vested was \$1.1 million (2008 \$1.2 million).

The total options vested in the first nine months of 2009 were 176,848 (2008 264,588).



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

An additional long term incentive plan is in place to reward selected executives for delivering exceptional performance. Under this plan a discretionary bonus will be payable to eligible executives if the Innospec share performance out-performs that of competitors, as measured by the Russell 2000 Index, by a minimum of 10% over the five years from January 2008 to December 2012. The amount of bonus which can be earned will be a set cash amount for each one percentage point of out-performance. The maximum bonus under this plan will be payable for an out-performance versus the Russell 2000 Index of 30%. The maximum bonus under this plan, in respect of the current participants, is \$8 million (2008 \$12 million). No bonus is payable under this plan if the Innospec share price does not out-perform the Russell 2000 Index by more than 10% over the five year period, or the Russell 2000 Index falls in value over the same period. The fair value of these liability cash-settled stock appreciation rights is calculated on a quarterly basis using a Monte Carlo model. A compensation charge of \$0.1 million was recognized in the first nine months of 2009 resulting in a liability of \$0.2 million at September 30, 2009 (2008 \$0.4 million compensation charge and \$0.4 million liability).

The following assumptions were used in the Monte Carlo model:

	<b>2009</b>	<b>2008</b>
Dividend yield	0.7%	0.8%
Volatility	77.2%	60.5%
Risk free interest rate	1.45%	2.28%

**NOTE 9 DEBT**

Long-term debt consists of the following: