STEPAN COMPANY

Moderator: James Hurlbutt
October 20, 2006
8:00 A.M. CT

Operator: Welcome to the Stepan Company Third Quarter Earnings Results Conference Call.

During the presentation, all participants will be in a listen-only mode. Afterwards, we will conduct a question and answer session. At that time, if you have a question, please press the 1 followed by the 4 on your telephone. If at any time during the conference you need to reach an operator, please press star-0.

As a reminder, this conference is being recorded, Friday, October 20, 2006.

I would now like to turn the conference over to Mr. Jim Hurlbutt, Vice President, Finance. Please go ahead, sir.

James Hurlbutt: Good morning, and thank you for joining us.

Before I begin, please note that information in this conference call contains forward-looking statements, which are not historical facts.

These statements involve risks and uncertainties that could cause actual results to differ materially, including but not limited to, prospects for our foreign operations, global and regional economic conditions, and factors detailed in the Company’s Securities and Exchange Commission filings.

I will now take a few minutes to review our third quarter operating results.

Net sales for the third quarter of 2006 increased 14% to $302.8 million from $265.7 million for the same period in 2005. The increase was due to a 7% increase in selling prices, coupled with a 6% improvement in sales volume and favorable foreign exchange impact.

The net income for the third quarter was $6.1 million, or 61 cents per diluted share, compared with net income of $4.2 million, or 43 cents per diluted share, a year ago.

Gross profit increased by $3.2 million, or 10%, to $35.9 million due to increased sales volume and improved sales mix. Excluding fire insurance proceeds received in 2005, gross profit grew $4.8 million, or 15% for the quarter.

Operating income increased 40%, to $11.3 million, for the third quarter of 2006 from $8.1 million for the same period in 2005. Operating expenses remained flat year-over-year due to a $2.4 million decline in deferred compensation plan expense.

Now, I would like to highlight the performance in each of our three segments.

We begin with surfactants, which accounted for approximately 74% of the Company's sales for the third quarter. Surfactant earnings rose for the quarter on a favorable mix of higher margin products and improved biodiesel sales, which offset lower sales volumes of commodity laundry products.

All of the earnings improvement occurred in North America. Europe recorded a loss on slightly lower volumes and margins. Latin America continues to experience volume growth primarily from sales of fabric softener, but earnings were lower due to higher costs.

While surfactant sales volume grew by 2% for the quarter, it declined by 1% for the first nine months.

Turning to our polymer segment, which represented 24% of our revenue in the third quarter, polymer earnings increased in the third quarter due to higher polyurethane polyol sales volume.

The non-recurring polyurethane system order fulfilled in the year ago quarter was largely responsible for the decline in year-to-date polymer earnings.

The new Chinese polyol joint venture recorded a slight loss for the third quarter due to rising raw material cost but should turn profitable in the fourth quarter based on recent price increases.

And, finally, specialty products, which accounted for 2% of the Company's sales in the third quarter. Earnings decreased slightly for the third quarter and the year due to lower pharmaceutical sales volume.

Turning back to operating expenses, operating expenses remained unchanged for the quarter but increased $5.2 million, or 7% for the year. Operating expenses, excluding deferred compensation expense, rose 10%

for the quarter on higher employee benefit costs, salaries and legal expenditures.

Deferred compensation expense decreased $2.4 million for the third quarter and increased $900,000 for the year. As we have said in the past, the accounting requirement for the Company's funded deferred compensation plan results in expense when the price of Stepan Company stock or mutual funds held in the plan rise and income may decline.

General administrative expense increased 8% and 11% for the quarter and year-to-date due primarily to higher legal and consulting costs related to recent pension plan changes and environmental and regulatory compliance.

Marketing and research costs increased due to higher salary and benefit costs, coupled with increased travel expenses. Marketing expenses were up roughly 12% for the quarter and 6% for the full year.

Turning to other income, interest expense increased by 17% during the third quarter and 13% year-to-date due to higher average debt levels and interest rates. Higher raw material costs, due mainly to the high cost of crude oil, continued to elevate our working capital requirements.

The Philippine joint venture has recorded losses for the quarter and year-to-date periods. The new fabric softener plant at our Philippine operation was completed during the second quarter and customer product approvals are ongoing. Sales volume gains are not expected to restore the Philippine joint venture to profitability until next year.

Our year-to-date tax rate increased from 29.4% percent at June 30th, 2006 to a year-to-date tax rate of 31.8% due to a higher mix of U.S. versus foreign income.

Turning now to the balance sheet, total debt as of September 30, 2006 was $141.1 million, up from $125.7 million at the end of 2005. Our total debt to total capitalization at quarter end was 43.8%, up from 42.4% at the same time last year.

Capital expenditures were $9.3 million for the third quarter and $30.2 million for the first nine months. Full year capital expenditures are projected to be in the range of $45 million to $50 million.

Looking ahead, despite the fourth quarter traditionally being weaker due to seasonality, we are positive on our outlook. We expect volume to exceed last year's fourth quarter for both surfactants and polymers.

Our efforts to recover higher raw material costs continue to be successful in North America.

We will reorganize our European business in the fourth quarter as we focus on improved profitability. Negotiations are currently underway with the European labor organizations to facilitate consolidation of some job functions that are currently spread over three European manufacturing sites.

Proposed headcount reductions are less than 10% of the current European workforce of approximately 260 people.

We anticipate severance cost in the range of $1 million to $1.5 million pretax to be possible during the fourth quarter with comparable annual savings thereafter.

We also continue to look at the possible expansion of our biodiesel output but no final decision has been made, as we are exploring alternative manufacturing technologies and the related profitability of those options. 2006 biodiesel sales will exceed 14 million gallons or approximately $40 million.

This concludes my prepared remarks. At this time, I would like to turn the call over for questions.

Operator, please read the instructions for the question portion of today's call.

Operator: Thank you.

Ladies and gentlemen if you would like to register for a question, please press the 1 followed by the 4 on your telephone. You will hear a three-tone prompt to acknowledge your request.

If your question has been answered and you would like to withdraw your registration, please press the 1 followed by the 3.

If you're using a speakerphone, please lift your handset before entering your request.

One moment please for the first question.

Ladies and gentlemen as a reminder, to register for a question, press the 1 followed by the 4.

One moment please.

Our first question is coming from the line of Beverly Machtinger from Grace & White.

Please proceed with your question.

Beverly Machtinger: Good morning, Jim.

I was wondering if you could expand a little bit about the European situation. Maybe you can just give us a little background of how many facilities you have there and the products that are coming out of there, which ones might be cut or consolidated, or however you want to talk about it.

James Hurlbutt: Yes, absolutely. Good morning, Beverly.

We have three sites in Europe. We have a German plant near Cologne, which originally was primarily a sulfonation surfactant-manufacturing site, primarily commodity surfactants. And that's been a tough market in terms of competition in Europe with excess capacity. We added polyol to that site to diversify the product portfolio and spread the cost of the site over a broader product base.

The polyol business in Europe is profitable. The surfactant business is where we continue to face tough margins. It's a vertically integrated market with raw material producers also coming downstream into our traditional end-use market, or, intermediate market.

We have another site in the UK which is primarily surfactants, both detergent type products, as well as fabric softeners. That site made money for several years after we acquired it.

The competitive landscape drove margins down and it turned unprofitable to the point now where there are some signs of consolidation occurring in the industry in Europe. Huntsman shut down a similar manufacturing facility in the UK serving the merchant market.

So we're still not seeing as much positive impact on margins from that rationalization of plant assets. I think we're starting to see a little tightening in capacity for the first time, but it's still premature to see if it's going to help margins significantly on the surfactant side.

And the French plant is our longest plant. We've been there 25 to 30 years. That's more of a niche market. They have been in fabric softeners and fuel additives for most of that time, and they don't compete directly in as much of the commodity surfactants. So that site has historically been profitable and should be able to continue to be profitable going forward. It's our headquarter location in Europe.

Really, the reorganization involves trying to take some of the duplication of costs out of those three sites: customer service, research, technical service.

We still operate the sites, for the most part, as stand-alone operations. We're going to provide a little more support from the United States and then reduce some of the duplication of efforts in Europe.

Beverly Machtinger: So mostly, administrative type of positions?

James Hurlbutt: I would say customer service, and tech service, and research, and there'll be some streamlining of the sales and marketing organization and possibly, some streamlining in the accounting functions.

We've implemented SAP software globally so it should be an easier operation to consolidate some of the accounting functions as well. So it's primarily trying to drive cost out of the organization structure.

Beverly Machtinger: Okay. I have a question on biodiesel. I recall - last year I think it was - during the winter when the biodiesel sales were down, I guess, there's an issue about its use during the heavy winter months. And I think you had said that you're either looking at reformulations or some way to compensate for that issue of the thickening, I guess, of the fuel itself. I was wondering if there's been any progress on that or what you're anticipating for the cold winter months as far as sales in that line.

James Hurlbutt: Yes. Our technology people feel they've got that problem solved. Again, it's partly dependent on how bad a winter you get. Our current process can get to a product that will have adequate performance characteristics in winter, coupled with -- we are educating our customers on the existing fuel additives that they can use. Even with straight diesel, a lot of people, particularly the further north you go, use fuel additives to keep it from gelling during the wintertime.

So we are recommending fuel additive packages for certain temperatures and we think we've got a cleaner product that will have less problems for our customers. And we're being a little more rigid on feedstock. The purity of the feedstock we use certainly has an impact on how well the product performs. So, we're fairly confident we've got a product that will sell all winter. Obviously, if temperatures get brutal, then we need our customers to be willing to use additive packages.

Beverly Machtinger: Okay, great. Thanks.

Operator: Thank you.

Ladies and gentlemen as a reminder, to register for a question, press the 1 followed by the 4.

Mr. Hurlbutt, there are no further questions at this time. I will now turn the call back to you. Please continue with your presentation or closing remarks.

James Hurlbutt: Okay. I have no further remarks. So, I just want to thank you for participating in today's call and look forward to talking to you again. Thank you.

Operator: Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your line.

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