STEPAN COMPANY

Moderator: James Hurlbutt
February 15, 2006
1:00 pm CT

Operator: Ladies and gentlemen, thank you for standing by.

Welcome to the Stepan Company's Fourth Quarter 2005 Earnings 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 any time during the conference you need to reach an operator, you may press the star followed by the 0.

As a reminder, this conference is being recorded Wednesday, February 15, 2006.

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

James Hurlbutt: Good afternoon 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 and certain 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 fourth quarter operating results.

Net sales for the fourth quarter of 2005 increased 13% to $270.1 million from $239.4 million for the same period in 2004. An increase in sales volume, higher selling prices and the effect of foreign currency translation accounted for the increase in sales. We increased selling prices to reflect

rising raw material cost brought on by the rapid increase in the cost of crude oil.

The fourth quarter resulted in a net loss of $400.4 million or 7 cents per diluted share compared to income of $0.6 million or 4 cents per diluted share a year ago. Contributing to the lower net income were a decline in Philippine joint venture income of $1.4 million and a $1.0 million reduction in foreign exchange gains included in other income. These items were partially offset by a favorable $2.0 million reduction in the income tax provision due to new income tax credits for biodiesel production and improved utilization of foreign tax loss carry-forwards.

Operating income increased to $64,000 for the fourth quarter of 2005 from $43,000 for the same period in 2004.

For the full year of 2005, I am proud to say that net sales increased 15% reaching the billion-dollar mark at $1.1 billion from $935.8 million in 2004. Sales were positively impacted by higher volume, selling price increases and foreign currency translation contributions.

Full year 2005 net income grew by 27% to $13.2 million or $1.35 per diluted share from $10.3 million or $1.05 per diluted share in 2004. Gross profit also increased by 11% as a result of growth in both polymer and surfactant earnings.

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

We begin with surfactants, which accounted for approximately 76% of the company's sales for 2005. Surfactants sales increased 19% in the fourth quarter and 16% year-over-year due to higher selling prices and an increase in volume. The volume was primarily due to sales of biodiesel fuel in the U.S. and volume gains in Latin America and in the U.K.

Surfactant earnings also improved due to increased biodiesel and fabric softener sales. And the European earnings improved due to the closure of a competitor's plant and a $1.4 million net gain from insurance recoveries related to equipment destroyed by a fire in 2004 at the company's plant in the U.K.

Turning to our polymer segment, which represented 21% of our revenue in 2005, we saw polymer sales decline by 3% in the fourth quarter due to lower polyurethane polyol demand and production problems in our Illinois phthalic anhydride plant.

Year-over-year, we saw a sales improvement of 15% due to higher selling prices. Polymer earnings declined in the fourth quarter due to the phthalic anhydride production problems and lower polyurethane polyol volume.

The full year earnings improved, however, due to price increases implemented to recover higher raw material costs.

Finally, specialty products, which accounted for 3% of the company's sales in 2005, decreased by 8% compared with the 2004 fourth quarter and decreased by 3% year-over-year due to lower food ingredient volume and competitive pressure impacting profit margins.

Turning to expenses, the increase in marketing and research expense is largely due to higher salary, healthcare and pension expenses. While general administrative expenses declined during the fourth quarter, increased expenses in deferred compensation and research resulted in a 6% increase in overall operating expenses in 2005.

Looking at other income, interest expense increased due to higher average debt levels and higher short-term interest rates.

Regarding our Philippine joint venture, income declined by $1.4 million during the fourth quarter due to lower sales volume and a market shift to lower margin products. A new fabric softener reactor, currently under construction in the Philippines, will not benefit earnings until the second half of 2006.

Turning to the balance sheet, total debt as of December 31st was $125.7 million, up from $112.0 million at the end of 2004. Our total debt to total capitalization at quarter and year end was 43%, up from 40% at the same time last year.

Capital expenditures were $12.4 million for the fourth quarter and $41.5 million in 2005. During 2006, capital spending will continue at roughly the pace of the fourth quarter of 2005.

Looking ahead, we expect continued improvement in surfactant earnings. Polymer volume is expected to gradually improve throughout the year, high crude oil and natural gas prices have led to increased cost for all of our business segments. However, price increases have helped to recover these costs.

Biodiesel capacity expansion undertaken last year should be completed by the end of the first quarter of 2006 and construction of our Philippine joint venture's fabric softener plant should be completed during the second

quarter. We also have cost containment initiatives underway to help drive a higher return from our business. We look to further full year earnings growth in 2006.

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 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 are using a speaker phone, please lift your handset before entering your request.

As a reminder, to register for a question, press 1-4 on your telephone.

One moment, please, for our first question.

And it comes from the line of Beverly Machtinger from Grace & White. Please proceed.

Beverly Machtinger Hi, Jim. I was wondering…

James Hurlbutt: Hi, Beverly.

Beverly Machtinger: How are you? I was wondering if there were - if you were doing any hedging for the natural gas pricing.

James Hurlbutt: We've done forward buying; we had a pretty good program going. We internally got a little bit aggressive on holding off and it probably hurt us. And we've gone back to our former model and we bought out a little more, higher percentage going forward. So I think prospectively, we're going to be a little safer and more cautious and have the amount of forward gas we have under contract so we don't get caught with some of the volatility we saw in the fourth quarter last year.

Beverly Machtinger: Okay. And then the other question was about the raw material pricing. I mean, everyday the prices are up and down and all around. I was wondering what you're seeing from your suppliers as far as a trend. Has

it stabilized; is it continuing to go up? Is there any relief? What, you know, can you give us some feedback on that?

James Hurlbutt: It's a little bit of a mixed bag. Obviously, crude is very volatile which is going to continue to affect our polymer segment the most because of the orthoxylene and diethylene glycol used in our polyol products. So that one is a little tougher to look out and have any confidence in.

But we are seeing more capacity coming on-line in some of our surfactant feedstocks and some flexibility. In other words, in the detergent market, they do have the option of moving between linear alkylbenzene and some of the alcohols to get to a surfactant. That is putting a little more pressure on them to compete with the feedstocks. And, as more capacity comes on-line for some of the alcohol-based feedstocks, we're anticipating some relief, although we're seeing limited downward pressure right now. But at least we're not seeing, compared to last year, we're not seeing upward pressure, which is the most important factor for us right now.

Beverly Machtinger: And also the phthalic anhydride plant that has the fire - are you going to be able to recover anything in insurance and also is that plant now up and running, back at normal?

James Hurlbutt: The plant is up and running at normal throughput capacity. The total insurable claim is below our deductible. However, we have gone back to the electrical provider with a claim and are in active negotiations for recovery of a portion of those costs. So we hope, and we did not record any receivable or contingent recovery in the 2005 results. So we're fairly confident there will be some recovery. Is it going to be large as we would hope? It's premature to say.

Beverly Machtinger: Okay. That's it for me.

James Hurlbutt: Okay. Thanks, Beverly.

Beverly Machtinger: Thank you.

Operator: Ladies and gentlemen, as a reminder, to register for a question, press 1-4 on your telephone.

Mr. Hurlbutt, there are no further questions at this time. I'll turn the call back to you.

James Hurlbutt: Okay. Well I just want to thank everybody for participating in today's call. Thank you very much.

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 lines.

Thank you.

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