

QUAKER CHEMICAL CORP  
Form 10-Q  
October 30, 2012

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

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FORM 10-Q

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

For the quarterly period ended September 30, 2012

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 001-12019

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QUAKER CHEMICAL CORPORATION  
(Exact name of Registrant as specified in its charter)

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Pennsylvania  
(State or other jurisdiction of  
incorporation or organization)

23-0993790  
(I.R.S. Employer  
Identification No.)

One Quaker Park, 901 E. Hector Street,

19428 – 2380

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Conshohocken, Pennsylvania  
(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: 610-832-4000

Not Applicable

Former name, former address and former fiscal year, if changed since last report.

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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 smaller reporting company)

Smaller reporting Company

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

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

Number of Shares of Common Stock  
Outstanding on September 30, 2012

13,081,917

QUAKER CHEMICAL CORPORATION AND CONSOLIDATED SUBSIDIARIES

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FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited).

## Quaker Chemical Corporation

## Condensed Consolidated Balance Sheet

	Unaudited (Dollars in thousands, except par value and share amounts)	
	September 30, 2012	December 31, 2011*
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 30,172	\$ 16,909
Accounts receivable, net	155,878	150,676
Inventories		
Raw materials and supplies	42,733	41,771
Work-in-process and finished goods	33,701	32,987
Prepaid expenses and other current assets	18,576	17,206
Total current assets	281,060	259,549
Property, plant and equipment, at cost	219,513	214,695
Less accumulated depreciation	(135,204)	(131,779)
Net property, plant and equipment	84,309	82,916
Goodwill	59,461	58,152
Other intangible assets, net	33,563	31,783
Investments in associated companies	8,302	7,942
Deferred income taxes	27,855	29,823
Other assets	36,191	35,356
Total assets	\$ 530,741	\$ 505,521
<b>LIABILITIES AND EQUITY</b>		
Current liabilities		
Short-term borrowings and current portion of long-term debt	\$ 576	\$ 636
Accounts and other payables	74,277	68,125
Accrued compensation	14,390	16,987
Other current liabilities	22,812	20,901
Total current liabilities	112,055	106,649
Long-term debt	37,980	46,701
Deferred income taxes	9,319	7,094
Other non-current liabilities	86,162	89,351

Total liabilities	245,516	249,795
<b>Equity</b>		
Common stock \$1 par value; authorized 30,000,000 shares; issued and outstanding 2012 – 13,081,917 shares; 2011 – 12,911,508 shares	13,082	12,912
Capital in excess of par value	93,845	89,725
Retained earnings	199,388	175,932
Accumulated other comprehensive loss	(30,206)	(29,820)
Total Quaker shareholders' equity	276,109	248,749
Noncontrolling interest	9,116	6,977
Total equity	285,225	255,726
Total liabilities and equity	\$ 530,741	\$ 505,521

\* Condensed from audited  
financial statements

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

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## Quaker Chemical Corporation

## Condensed Consolidated Statement of Income

	Unaudited			
	(Dollars in thousands, except per share amounts)			
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
Net sales	\$ 180,923	\$ 182,313	\$ 535,358	\$ 509,970
Cost of goods sold	121,797	122,827	355,801	343,984
Gross profit	59,126	59,486	179,557	165,986
Selling, general and administrative expenses	43,263	41,982	130,009	119,441
Operating income	15,863	17,504	49,548	46,545
Other income, net	322	2,740	529	4,070
Interest expense	(1,034 )	(1,166 )	(3,359 )	(3,584 )
Interest income	149	262	409	805
Income before taxes and equity in net income of associated companies	15,300	19,340	47,127	47,836
Taxes on income before equity in net income of associated companies	4,373	5,640	12,692	12,961
Income before equity in net income of associated companies	10,927	13,700	34,435	34,875
Equity in net income of associated companies	257	105	612	715
Net income	11,184	13,805	35,047	35,590
Less: Net income attributable to noncontrolling interest	698	447	2,075	1,791
Net income attributable to Quaker Chemical Corporation	\$ 10,486	\$ 13,358	\$ 32,972	\$ 33,799
Per share data:				
Net income attributable to Quaker Chemical Corporation				
Common				
Shareholders – basic	\$ 0.80	\$ 1.04	\$ 2.54	\$ 2.77
Net income attributable to Quaker Chemical Corporation				
Common				
Shareholders – diluted	\$ 0.80	\$ 1.03	\$ 2.52	\$ 2.73
Dividends declared	\$ 0.245	\$ 0.24	\$ 0.73	\$ 0.715

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

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## Quaker Chemical Corporation

## Condensed Consolidated Statement of Comprehensive Income (Loss)

	Unaudited			
	(Dollars in thousands, except per share amounts)			
	Three Months Ended		Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011
Net income	\$ 11,184	\$ 13,805	\$ 35,047	\$ 35,590
Other comprehensive income (loss), net of tax				
Currency translation adjustments	1,600	(13,936)	(1,976 )	(6,459 )
Defined benefit retirement plans	436	(637 )	1,405	12
Current period change in fair value of derivatives	73	112	272	286
Unrealized gain (loss) on available-for-sale securities	4	(23 )	7	(17 )
Other comprehensive income (loss)	2,113	(14,484)	(292 )	(6,178 )
Comprehensive income (loss)	13,297	(679 )	34,755	29,412
Less: comprehensive (income) loss attributable to noncontrolling interest	(926 )	447	(2,169 )	(974 )
Comprehensive income (loss) attributable to Quaker Chemical Corporation	\$ 12,371	\$ (232 )	\$ 32,586	\$ 28,438

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

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## Quaker Chemical Corporation

## Condensed Consolidated Statement of Cash Flows

	Unaudited (Dollars in thousands) For the Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities		
Net income	\$ 35,047	\$ 35,590
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,001	8,527
Amortization	2,283	1,596
Equity in undistributed earnings of associated companies, net of dividends	(428 )	(136 )
Deferred compensation and other, net	1,848	6,987
Stock-based compensation	2,954	2,675
Non-cash gain from purchase of equity affiliate	—	(2,718 )
Gain on disposal of property, plant and equipment	(75 )	(61 )
Insurance settlement realized	(1,074 )	(1,242 )
Pension and other postretirement benefits	(1,823 )	(4,099 )
(Decrease) increase in cash from changes in current assets and current liabilities, net of acquisitions:		
Accounts receivable	(1,381 )	(29,390)
Inventories	(875 )	(16,334)
Prepaid expenses and other current assets	(1,976 )	(3,061 )
Accounts payable and accrued liabilities	(1,731 )	6,196
Net cash provided by operating activities	41,770	4,530
Cash flows from investing activities		
Investments in property, plant and equipment	(8,757 )	(8,914 )
Payments related to acquisitions, net of cash acquired	(2,635 )	(10,981)
Proceeds from disposition of assets	193	221
Insurance settlement received and interest earned	53	61
Change in restricted cash, net	1,021	1,181
Net cash used in investing activities	(10,125)	(18,432)
Cash flows from financing activities		
Net decrease in short-term borrowings	—	(185 )
Repayment of long-term debt	(9,672 )	(30,613)
Dividends paid	(9,410 )	(8,492 )
Stock options exercised, other	(828 )	629
Excess tax benefit related to stock option exercises	2,164	153
Proceeds from sale of common stock, net of related expenses	—	48,143
Distributions to noncontrolling shareholders	(30 )	—
Net cash (used in) provided by financing activities	(17,776)	9,635

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Effect of exchange rate changes on cash	(606 )	(920 )
Net increase (decrease) in cash and cash equivalents	13,263	(5,187 )
Cash and cash equivalents at beginning of period	16,909	25,766
Cash and cash equivalents at end of period	\$ 30,172	\$ 20,579

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

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Quaker Chemical Corporation  
Notes to Condensed Consolidated Financial Statements  
(Dollars in thousands, except per share amounts)  
(Unaudited)

Note 1 – Condensed Financial Information

The condensed consolidated financial statements included herein are unaudited and have been prepared in accordance with generally accepted accounting principles in the United States for interim financial reporting and the United States Securities and Exchange Commission regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the financial statements reflect all adjustments (consisting only of normal recurring adjustments, except as discussed below) which are necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods. The results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company's Annual Report filed on Form 10-K for the year ended December 31, 2011.

During the first quarter of 2012, the Company adopted the Financial Accounting Standards Board's ("FASB's") guidance regarding presentation of comprehensive income. The guidance requires that comprehensive income be presented with the Condensed Consolidated Statement of Income or as a separate statement immediately following the Condensed Consolidated Statement of Income, and can no longer be presented as part of the Consolidated Statement of Changes in Equity. The Company adopted the guidance using the two statement approach, and the adoption of this guidance did not have a material impact on the Company's results or financial condition.

During the second quarter of 2012, the Company recorded charges of \$1,156 to its allowance for doubtful accounts and selling, general and administrative expenses due to the bankruptcies of two U.S. customers.

As part of the Company's chemical management services, certain third-party product sales to customers are managed by the Company. Where the Company acts as the principal, revenue is recognized on a gross reporting basis at the selling price negotiated with customers. Where the Company acts as an agent, such revenue is recorded using net reporting as service revenues, at the amount of the administrative fee earned by the Company for ordering the goods. Third-party products transferred under arrangements resulting in net reporting totaled \$30,878 and \$37,787 for the nine months ended September 30, 2012 and September 30, 2011, respectively.

Note 2 – Recently Issued Accounting Standards

The FASB updated its guidance in July 2012 regarding indefinite-lived intangible asset impairment testing. The updated guidance permits a Company to first assess qualitative factors to determine whether it is more likely than not that the fair value of the indefinite-lived intangible asset is less than its carrying value. If the Company determines that the fair value is more likely than not above its carrying value, no further impairment testing is required. However, if the Company concludes otherwise, then the first step of the traditional two-step impairment test is required to be performed. The guidance is effective for annual and interim fiscal periods beginning after September 15, 2012, with early adoption permitted if an entity's financial statements have not been issued as of the date of the entity's interim or annual impairment test. The Company elected to test its indefinite-lived intangible assets for impairment under the traditional two-step method during the current year but is currently evaluating the effect of this guidance for future applicability.

The FASB updated its guidance in December 2011 regarding disclosures pertaining to the netting and offsetting of derivatives and financial instruments on an entity's Consolidated Balance Sheet. Disclosures required under the updated guidance include presenting gross amounts of assets and liabilities related to financial instruments that may have been historically offset on the Consolidated Balance Sheet. The guidance is effective for annual and interim fiscal periods beginning on or after January 1, 2013. The Company is currently evaluating the effect of this guidance.

Note 3 – Income Taxes and Uncertain Income Tax Positions

The Company's year-to-date 2012 effective tax rate of 26.9% was lower than the year-to-date 2011 effective tax rate of 27.1%. Both year-to-date effective tax rates reflect decreases in reserves for uncertain tax positions due to the expiration of applicable statutes of limitations for certain tax years of approximately \$0.15 and \$0.14 per diluted share for the nine months ended September 30, 2012 and September 30, 2011, respectively.

The FASB's guidance regarding accounting for uncertainty in income taxes prescribes the recognition threshold and measurement attributes for financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. The guidance further requires the determination of whether the benefits of tax positions will be more likely than not sustained upon audit

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Quaker Chemical Corporation  
Notes to Condensed Consolidated Financial Statements - Continued  
(Dollars in thousands, except per share amounts)  
(Unaudited)

based upon the technical merits of the tax position. For tax positions that are determined to be more likely than not sustained upon audit, a company recognizes the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not determined to be more likely than not sustained upon audit, a company does not recognize any portion of the benefit in the financial statements. Additionally, the guidance provides for derecognition, classification, penalties and interest, accounting in interim periods, disclosure and transition.

As of September 30, 2012, the Company's cumulative liability for gross unrecognized tax benefits was \$12,043. At December 31, 2011, the Company's cumulative liability for gross unrecognized tax benefits was \$12,719.

The Company continues to recognize interest and penalties associated with uncertain tax positions as a component of taxes on income before equity in net income of associated companies in its Condensed Consolidated Statement of Income. The Company recognized \$57 and \$6 for interest and \$70 and \$264 for penalties on its Condensed Consolidated Statement of Income for the three and nine months ended September 30, 2012, respectively, and recognized \$63 and \$122 for interest and \$110 and \$535 for penalties on its Condensed Consolidated Statement of Income for the three and nine months ended September 30, 2011, respectively. As of September 30, 2012, the Company had accrued \$2,266 for cumulative interest and \$1,555 for cumulative penalties, and \$2,268 for cumulative interest and \$1,298 for cumulative penalties at December 31, 2011.

During the three and nine months ended September 30, 2012, the Company recognized decreases of approximately \$426 and \$1,498, respectively, in its cumulative liability for gross unrecognized tax benefits due to the expiration of the applicable statutes of limitations for certain tax years. During the three and nine months ended September 30, 2011, the Company recognized decreases of approximately \$424 and \$1,382, respectively, in its cumulative liability for gross unrecognized tax benefits due to the expiration of the applicable statutes of limitations for certain tax years.

The Company estimates that during the year ending December 31, 2012 it will reduce its cumulative liability for gross unrecognized tax benefits by approximately \$1,700 to \$1,800 due to the expiration of the statute of limitations with regard to certain tax positions. This estimated reduction in the cumulative liability for unrecognized tax benefits does not consider any increase in liability for unrecognized tax benefits with regard to existing tax positions or any increase in cumulative liability for unrecognized tax benefits with regard to new tax positions for the year ending December 31, 2012.

The Company and its subsidiaries are subject to U.S. Federal income tax, as well as the income tax of various state and foreign tax jurisdictions. Tax years that remain subject to examination by major tax jurisdictions include the Netherlands and the United Kingdom from 2006, Brazil from 2007, Spain from 2008, the United States and China from 2009, Italy from 2010, and various domestic state tax jurisdictions from 1993.

In the second quarter of 2012, the Internal Revenue Service ("IRS") initiated a limited scope audit of the Company's 2009 Federal income tax return. By letter dated October 15, 2012, the IRS notified the Company that it had completed the review of the Company's 2009 Federal income tax return without any changes to the reported information, completing the audit. Also, during the second quarter of 2012, the Italian tax authorities initiated a transfer pricing audit of the Company's Italian subsidiary. On July 7, 2012, the Company received a preliminary tax report related to this transfer pricing audit, which proposed several adjustments to the taxable income of the subsidiary. In conjunction with outside counsel, the Company reviewed the report and believes it should prevail on its

merits. As a result, the Company does not believe it has any exposures warranting an uncertain tax position reserve. There has been no change in this matter during the third quarter of 2012.

Note 4 – Fair Value Measurements

The FASB's guidance regarding fair value measurements establishes a common definition for fair value to be applied to guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. The guidance does not require any new fair value measurements, but rather applies to all other accounting guidance that requires or permits fair value measurements.

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Quaker Chemical Corporation  
Notes to Condensed Consolidated Financial Statements - Continued  
(Dollars in thousands, except per share amounts)  
(Unaudited)

The guidance utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

The Company values its company-owned life insurance policies, various deferred compensation assets and liabilities, acquisition-related consideration and an obligation related to a non-competition agreement at fair value, and valued its interest rate swaps at fair value prior to their maturity in the third quarter of 2012. The Company's assets and liabilities subject to fair value measurement are as follows:

	Fair Value as of September 30, 2012	Fair Value Measurements at September 30, 2012 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Assets				
Company-owned life insurance	\$1,650	\$—	\$1,650	\$—
Company-owned life insurance - Deferred compensation assets	444	—	444	—
Other deferred compensation assets				
Large capitalization registered investment companies	63	63	—	—
Mid capitalization registered investment companies	5	5	—	—
Small capitalization registered investment companies	9	9	—	—
International developed and emerging markets registered investment companies	34	34	—	—
Fixed income registered investment companies	9	9	—	—
Total	\$2,214	\$120	\$2,094	\$—

	Fair Value as of September 30, 2012	Fair Value Measurements at September 30, 2012 Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Liabilities				

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Deferred compensation liabilities

Large capitalization registered investment companies	\$334	\$334	\$—	\$—
Mid capitalization registered investment companies	85	85	—	—
Small capitalization registered investment companies	71	71	—	—
International developed and emerging markets registered investment companies	174	174	—	—
Fixed income registered investment companies	49	49	—	—