

INNOSPEC INC.  
Form 10-Q  
May 07, 2009  
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**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 March 31, 2009**

**Commission file number 1-13879**

**INNOSPEC INC.**

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

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**DELAWARE**  
(State or other jurisdiction of

**98-0181725**  
(IRS Employer

incorporation or organization)

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 April 30, 2009**  
23,633,917

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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. 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. 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<br>March 31 |          |
|--|--------------------------------|----------|
|  | 2009                           | 2008     |
| Net sales (Note 2)   | \$ 148.1                       | \$ 168.7 |
| Cost of goods sold   | (97.9)                         | (117.0)  |
| Gross profit (Note 2)  | 50.2                           | 51.7     |
| Operating expenses   |                                |          |
| Selling, general and administrative                          | (25.7)                         | (31.8)   |
| Research and development                                     | (3.2)                          | (3.7)    |
| Restructuring charge   | (1.3)                          | (0.5)    |
| Amortization of intangible assets (Note 4)                   | (1.2)                          | (2.1)    |
| Impairment of Octane Additives business goodwill (Note 5)    | (0.6)                          | (1.1)    |
|  | (32.0)                         | (39.2)   |
| Operating income (Note 2)                                    | 18.2                           | 12.5     |
| Other net (expense)/income                                   | (7.1)                          | 0.5      |
| Interest expense   | (1.7)                          | (1.7)    |
| Interest income  | 0.1                            | 0.4      |
| Income before income taxes                                   | 9.5                            | 11.7     |
| Income taxes (Note 6)  | (3.1)                          | (4.4)    |
| Net income   | \$ 6.4                         | \$ 7.3   |
| Earnings per share (Note 7):                                 |                                |          |
| Basic  | \$ 0.27                        | \$ 0.31  |
| Diluted  | \$ 0.26                        | \$ 0.30  |
| Weighted average shares outstanding (in thousands) (Note 7): |                                |          |
| Basic  | 23,603                         | 23,680   |
| Diluted  | 24,564                         | 24,357   |
| Dividend declared per common share (Note 8):                 | \$ 0.05                        | \$ 0.05  |

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)                                  | March 31<br>2009<br>(Unaudited) | December 31<br>2008 |
|---|---------------------------------|---------------------|
| <b>Assets</b>   |                                 |                     |
| Current assets  |                                 |                     |
| Cash and cash equivalents   | \$ 35.5                         | \$ 13.9             |
| Accounts receivable (less allowance of \$2.3 and \$2.8, respectively) | 79.8                            | 89.9                |
| Inventories   |                                 |                     |
| Finished goods  | 96.0                            | 95.0                |
| Work in progress  | 0.2                             | 2.0                 |
| Raw materials   | 33.6                            | 41.3                |
| Total inventories   | 129.8                           | 138.3               |
| Prepaid expenses  | 3.6                             | 4.4                 |
| Prepaid income taxes  | 5.5                             | 10.1                |
| Total current assets  | 254.2                           | 256.6               |
| Property, plant and equipment   | 113.6                           | 113.2               |
| Less accumulated depreciation   | (61.8)                          | (59.7)              |
| Net property, plant and equipment                                     | 51.8                            | 53.5                |
| Goodwill Octane Additives (Note 5)                                    | 8.4                             | 9.0                 |
| Goodwill Other (Note 5)   | 139.2                           | 139.2               |
| Intangible assets (Note 4)  | 27.1                            | 28.3                |
| Deferred finance costs  | 3.4                             | 0.5                 |
| Deferred income taxes   | 10.1                            | 7.2                 |
| Total assets  | \$ 494.2                        | \$ 494.3            |

The accompanying footnotes 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 per share data)   | March 31<br>2009<br>(Unaudited) | December 31<br>2008 |
|--|---------------------------------|---------------------|
| <b><u>Liabilities and Stockholders' Equity</u></b>                                     |                                 |                     |
| Current liabilities  |                                 |                     |
| Accounts payable   | \$ 52.1                         | \$ 55.4             |
| Dividend payable   | 1.2                             |                     |
| Accrued liabilities  | 45.2                            | 46.3                |
| Short-term borrowing (Note 9)  | 10.0                            | 73.0                |
| Current portion of plant closure provisions (Note 10)                                  | 5.3                             | 4.1                 |
| Current portion of unrecognized tax benefits (Note 6)                                  | 16.1                            | 9.2                 |
| Current portion of deferred income   | 0.1                             | 0.1                 |
| Total current liabilities  | 130.0                           | 188.1               |
| Long-term debt, net of current portion (Note 9)  | 63.0                            |                     |
| Plant closure provisions, net of current portion (Note 10)                             | 22.7                            | 22.8                |
| Unrecognized tax benefits, net of current portion (Note 6)                             | 19.5                            | 25.6                |
| Pension liability (Note 3)   | 13.9                            | 13.8                |
| Other non-current liabilities  | 9.3                             | 13.9                |
| Deferred income, net of current portion  | 0.8                             | 0.8                 |
| Commitments and contingencies (Note 13)  |                                 |                     |
| <b><u>Stockholders' Equity</u></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   | 283.2                           | 282.5               |
| Treasury stock (5,941,028 and 5,956,384 shares at cost, respectively)                  | (64.7)                          | (64.9)              |
| Retained earnings  | 136.8                           | 131.6               |
| Accumulated other comprehensive loss   | (120.6)                         | (120.2)             |
| Total stockholders' equity   | 235.0                           | 229.3               |
| Total liabilities and stockholders' equity   | \$ 494.2                        | \$ 494.3            |

The accompanying footnotes 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)   | Three Months<br>Ended March 31 |                |
|---|--------------------------------|----------------|
|   | 2009                           | 2008           |
| <b><u>Cash Flows from Operating Activities</u></b>                                |                                |                |
| Net income  | \$ 6.4                         | \$ 7.3         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                |                |
| Depreciation and amortization   | 4.8                            | 5.7            |
| Impairment of Octane Additives business goodwill (Note 5)                         | 0.6                            | 1.1            |
| Deferred income taxes   | (2.9)                          | (0.1)          |
| Changes in working capital:   |                                |                |
| Accounts receivable and prepaid expenses  | 9.8                            | 2.6            |
| Inventories   | 8.2                            | 5.9            |
| Accounts payable and accrued liabilities  | (2.5)                          | 6.1            |
| Excess tax benefit from stock based payment arrangements                          |                                | (1.0)          |
| Income taxes and other current liabilities  | 4.5                            | (3.9)          |
| Movement on plant closure provisions  | 1.2                            | (0.5)          |
| Movement on pension asset/(liability)   | 0.1                            | (1.3)          |
| Stock option compensation (credit)/charge   | (1.3)                          | 1.0            |
| Movement on other non-current liabilities   | (1.6)                          | (3.1)          |
| Net cash provided by operating activities   | 27.3                           | 19.8           |
| <b><u>Cash Flows from Investing Activities</u></b>                                |                                |                |
| Capital expenditures  | (2.1)                          | (1.7)          |
| Net cash (used in) investing activities   | (2.1)                          | (1.7)          |
| <b><u>Cash Flows from Financing Activities</u></b>                                |                                |                |
| Net receipt/(repayment) of revolving credit facility                              | 5.0                            | (2.0)          |
| Repayment of term loan  | (55.0)                         | (20.0)         |
| Receipt of term loan  | 50.0                           |                |
| Refinancing costs   | (3.6)                          |                |
| Excess tax benefit from stock based payment arrangements                          |                                | 1.0            |
| Issue of treasury stock   |                                | 0.3            |
| Repurchase of common stock  |                                | (7.7)          |
| Net cash (used in) financing activities   | (3.6)                          | (28.4)         |
| Effect of exchange rate changes on cash   |                                | 0.1            |
| Net change in cash and cash equivalents   | 21.6                           | (10.2)         |
| Cash and cash equivalents at beginning of period                                  | 13.9                           | 24.3           |
| <b><u>Cash and cash equivalents at end of period</u></b>                          | <b>\$ 35.5</b>                 | <b>\$ 14.1</b> |

Amortization of deferred finance costs of \$0.5m (2008 \$0.2m) are included in depreciation and amortization in the cash flow statement but in interest in the income statement.

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<br>Stock | Additional<br>Paid-In<br>Capital | Treasury<br>Stock | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders<br>Equity |
|----------------------------------|-----------------|----------------------------------|-------------------|----------------------|---|---------------------------------|
| Balance at December 31, 2008     | \$ 0.3          | \$ 282.5                         | \$ (64.9)         | \$ 131.6             | \$ (120.2)                                    | \$ 229.3                        |
| Net income                       |                 |                                  |                   | 6.4                  |   | 6.4                             |
| Dividend (\$0.05 per share)      |                 |                                  |                   | (1.2)                |   | (1.2)                           |
| Derivatives (1)                  |                 |                                  |                   |                      | 1.1   | 1.1                             |
| Net CTA change (2)               |                 |                                  |                   |                      | (1.5)   | (1.5)                           |
| Treasury stock re-issued         |                 |                                  | 0.2               |                      |   | 0.2                             |
| Stock option compensation charge |                 | 0.7                              |                   |                      |   | 0.7                             |
| Balance at March 31, 2009        | \$ 0.3          | \$ 283.2                         | \$ (64.7)         | \$ 136.8             | \$ (120.6)                                    | \$ 235.0                        |

(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)   | 2009   | 2008   |
|---|--------|--------|
| Net income for the period                                       | \$ 6.4 | \$ 7.3 |
| Changes in cumulative translation adjustment                    | (1.5)  | 1.4    |
| Unrealized gains/(losses) on derivative instruments, net of tax | 1.1    | (0.8)  |
| Total comprehensive income                                      | \$ 6.0 | \$ 7.9 |

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

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**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 material adjustments 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<br>March 31 |          |
|--|--------------------------------|----------|
|  | 2009                           | 2008     |
| <b>Net sales</b>                                 |                                |          |
| Fuel Specialties                                 | \$ 113.5                       | \$ 114.6 |
| Active Chemicals                                 | 29.3                           | 35.5     |
| Octane Additives                                 | 5.3                            | 18.6     |
|  | \$ 148.1                       | \$ 168.7 |
| <b>Gross profit</b>                              |                                |          |
| Fuel Specialties                                 | \$ 42.4                        | \$ 39.4  |
| Active Chemicals                                 | 5.1                            | 4.8      |
| Octane Additives                                 | 2.7                            | 7.5      |
|  | \$ 50.2                        | \$ 51.7  |
| <b>Operating income</b>                          |                                |          |
| Fuel Specialties                                 | \$ 27.2                        | \$ 23.6  |
| Active Chemicals                                 | 1.2                            | 0.1      |
| Octane Additives                                 | (5.8)                          | (3.0)    |
| FAS 158/87 pension (charge)                      | (1.5)                          | (0.6)    |
| Corporate costs                                  | (1.0)                          | (6.0)    |
|  | 20.1                           | 14.1     |
| Restructuring charge                             | (1.3)                          | (0.5)    |
| Impairment of Octane Additives business goodwill | (0.6)                          | (1.1)    |
| Total operating income                           | 18.2                           | 12.5     |
| Other net (expense)/income                       | (7.1)                          | 0.5      |
| Interest expense                                 | (1.7)                          | (1.7)    |
| Interest income                                  | 0.1                            | 0.4      |
| Income before income taxes                       | \$ 9.5                         | \$ 11.7  |

**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<br>March 31 |        |
|---------------------|--------------------------------|--------|
|                     | 2009                           | 2008   |
| <i>Depreciation</i> |                                |        |
| Fuel Specialties    | \$ 0.6                         | \$ 0.5 |
| Active Chemicals    | 1.2                            | 1.2    |
| Octane Additives    | 0.5                            | 0.9    |
| Corporate           | 0.8                            | 0.8    |
|                     | \$ 3.1                         | \$ 3.4 |
| <i>Amortization</i> |                                |        |
| Fuel Specialties    | \$ 0.6                         | \$ 0.6 |
| Active Chemicals    | 0.3                            | 0.4    |
| Octane Additives    | 0.3                            | 1.1    |
|                     | \$ 1.2                         | \$ 2.1 |

**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<br>March 31 |          |
|---|--------------------------------|----------|
|   | 2009                           | 2008     |
| Service cost                                  | \$ (0.9)                       | \$ (1.4) |
| Interest cost on projected benefit obligation | (8.9)                          | (12.2)   |
| Expected return on plan assets                | 8.3                            | 13.0     |
|   | \$ (1.5)                       | \$ (0.6) |

At March 31, 2009, the Company has a pension liability of \$13.9 million recorded in its balance sheet in accordance with FAS 158.

**NOTE 4 INTANGIBLE ASSETS**

| (in millions)                        | Three Months Ended<br>March 31 |          |
|--------------------------------------|--------------------------------|----------|
|                                      | 2009                           | 2008     |
| Gross cost at January 1 and March 31 | \$ 109.0                       | \$ 115.3 |

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|                                       |         |         |
|---------------------------------------|---------|---------|
| Accumulated amortization at January 1 | (80.7)  | (73.4)  |
| Amortization charge                   | (1.2)   | (2.1)   |
| Accumulated amortization at March 31  | (81.9)  | (75.5)  |
| Net book amount at March 31           | \$ 27.1 | \$ 39.8 |

**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. 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 \$0.5 million was recognized in the first quarter of 2009 (2008 \$1.4 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. An amortization charge of \$0.7 million was recognized in the first quarter of 2009 (2008 \$0.7 million).

**NOTE 5 GOODWILL**

| (in millions)                                    | Three Months Ended<br>March 31 |          |
|--|--------------------------------|----------|
|  | 2009                           | 2008     |
| Gross cost at January 1                          | \$ 446.3                       | \$ 449.9 |
| Impairment of Octane Additives business goodwill | (0.6)                          | (1.1)    |
| Exchange effect                                  | 0.3                            | 0.3      |
| Gross cost at March 31                           | 446.0                          | 449.1    |
| Accumulated amortization at January 1            | (298.1)                        | (298.1)  |
| Exchange effect                                  | (0.3)                          |          |
| Accumulated amortization at March 31             | (298.4)                        | (298.1)  |
| Net book amount at March 31                      | \$ 147.6                       | \$ 151.0 |
| Octane Additives                                 | \$ 8.4                         | \$ 11.6  |
| Other  | 139.2                          | 139.4    |
|  | \$ 147.6                       | \$ 151.0 |

**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.





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

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 quarterly impairment reviews be performed from January 1, 2004 and any impairment charge arising be recognized in the relevant quarter. 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**

On January 1, 2007, the Company adopted FASB Interpretation No 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return.

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

| (in millions)  | Interest and<br>penalties | Unrecognized<br>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 |                           | 0.6                          | 0.6     |
| Additions for tax positions of prior periods                   | 0.1                       | 0.1                          | 0.2     |
| Settlements  |                           |                              |         |
| Closing balance at March 31, 2009                              | 3.6                       | 32.0                         | 35.6    |
| Current  | (1.7)                     | (14.4)                       | (16.1)  |
| Non-current  | \$ 1.9                    | \$ 17.6                      | \$ 19.5 |

All of the \$35.6 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 or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As at March 31, 2009, the Company's subsidiaries in France, Germany and the United Kingdom 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 March 31, 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 major tax jurisdictions are open to examination including France (2005 onwards), Germany (2002 onwards), Switzerland (2007 onwards) and the United Kingdom (2002 onwards). We are currently under examination in various foreign jurisdictions.

**Table of Contents****INNOSPEC INC. AND SUBSIDIARIES****NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 7 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:

|   | <b>Three Months Ended<br/>March 31</b> |                |
|---|--|----------------|
|   | <b>2009</b>                            | <b>2008</b>    |
| <b>Numerator (millions of dollars):</b>     |  |                |
| Net income available to common stockholders | \$ 6.4                                 | \$ 7.3         |
| <b>Denominator (in thousands):</b>          |  |                |
| Weighted average common shares outstanding  | 23,603                                 | 23,680         |
| Dilutive effect of stock options and awards | 961                                    | 677            |
| Denominator for diluted earnings per share  | 24,564                                 | 24,357         |
| <b>Net income per share, basic:</b>         | <b>\$ 0.27</b>                         | <b>\$ 0.31</b> |
| <b>Net income per share, diluted:</b>       | <b>\$ 0.26</b>                         | <b>\$ 0.30</b> |

In the quarter ended March 31, 2009 and 2008, respectively, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were 213,486 and 60,602, respectively.

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

At March 31, 2009, the Company had authorized common stock of 40,000,000 shares (December 31, 2008 40,000,000). Issued shares at March 31, 2009, were 29,554,500 (December 31, 2008 29,554,500) and treasury stock amounted to 5,941,028 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.

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 27 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:

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

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

The following table summarizes the transactions of the Company's stock option plans for the quarter ended March 31, 2009:

|                                | Number<br>of Shares | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Fair<br>Value |
|--------------------------------|---------------------|--|--------------------------------------|
| Outstanding at January 1, 2009 | 983,581             | \$ 3.47                                  |                                      |
| Grants at discount             | 130,340             | \$                                       | \$ 2.66                              |
| Grants at market value         |                     | \$                                       |                                      |
| Grants at premium              | 82,217              | \$ 4.62                                  | \$ 1.65                              |
| Exercised                      | (15,356)            | \$                                       |                                      |
| Forfeitures                    | (241,284)           | \$ 0.24                                  |                                      |
| Outstanding at March 31, 2009  | 939,498             | \$ 3.98                                  |                                      |

The following table summarizes information about options outstanding at March 31, 2009

| Range of<br>Exercise<br>Price | Number<br>outstanding<br>at<br>March 31,<br>2009 | Weighted<br>Average<br>Remaining<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price | Number<br>Exercisable<br>and fully<br>vested at<br>March 31,<br>2009 | Weighted<br>Average<br>Remaining<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price |
|-------------------------------|--|--|--|--|--|--|
| \$ 0 - \$5                    | 705,582  | 7.04   | \$ 0.69                                  | 129,856  | 5.24   | \$ 0.83                                  |
| \$ 5 - \$10                   | 140,162  | 3.84   | \$ 8.42                                  | 140,162  | 3.84   | \$ 8.42                                  |
| \$10 - \$15                   | 2,300  | 5.12   | \$ 11.50                                 | 2,300  | 5.12   | \$ 11.50                                 |
| \$20 - \$25                   | 63,588   | 8.90   | \$ 20.29                                 |  |  | \$                                       |
| \$25 - \$30                   | 27,866   | 7.90   | \$ 27.09                                 |  |  | \$                                       |
|                               | 939,498  |  |  | 272,318  |  |  |

The aggregate intrinsic value of fully vested stock options is \$1.0 million. Of the 272,318 stock options that are exercisable, 96,090 have performance conditions attached. The total compensation cost for the first quarter of 2009 was a gain of \$1.4 million, of which \$2.4 million related to the gain on stock options forfeited upon resignation of the Company's former CEO (2008 \$1.0 million charge). The total compensation cost related to nonvested stock options not yet recognized at March 31, 2009 is \$3.3 million and this cost is expected to be recognized over the weighted-average period of 2.10 years.

In the first quarter of 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. Under FAS 123(R), additional compensation cost of \$0.2 million is required to be recognized for these modified stock options over the next 2 years. No stock options awards were modified in 2008.

The total intrinsic value of options exercised in the first quarter of 2009 was \$0.2 million (2008 \$0.9 million). The amount of cash received from the exercise of stock option awards in the first quarter of 2009 was \$nil (2008 \$0.3 million). The Company's policy is to issue shares from Treasury stock to holders of stock options who exercise those options. During the first quarter 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 quarter of 2009 were 175,188 (2008 256,448).

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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 three years from January 2008 to December 2010. 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 \$4 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 three 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 credit to the compensation charge of \$0.1 million, and no corresponding liability, was recognized in the first quarter of 2009 (2008 \$0.2 million compensation charge and \$0.2 million liability).

The following assumptions were used in the Monte Carlo model:

|                         | 2009  | 2008  |
|-------------------------|-------|-------|
| Dividend yield          | 2.65% | 0.47% |
| Volatility              | 77%   | 51%   |
| Risk free interest rate | 1.15% | 2.27% |

**NOTE 9 DEBT**

Long-term debt consists of the following:

| (in millions)        | March 31<br>2009 | December 31<br>2008 |
|----------------------|------------------|---------------------|
| Senior term loan     | \$ 50.0          | \$ 55.0             |
| Revolving credit     | 23.0             | 18.0                |
|                      | 73.0             | 73.0                |
| Less current portion | (10.0)           | (73.0)              |
|                      | \$ 63.0          | \$                  |

On February 6, 2009 we entered into a new three-year finance facility which provides for borrowings by us of up to \$150 million including a term loan of \$50 million and revolving credit facility of \$100 million. The revolving credit facility can be drawn down until the finance facility expires on February 6, 2012. The term loan is repayable as follows: \$10 million is due on February 5, 2010; \$15 million on February 7, 2011; and \$25 million on February 6, 2012. This new finance facility replaced the previous finance facility which was in place at March 31 and December 31, 2008.

The Company's new finance facility contains restrictive clauses which may constrain our activities and limit our operational and financial flexibility. The new facility obliges the lenders to comply with a request for utilization of finance unless there is an event of default outstanding. Events of default are defined in the finance facility and include a material adverse change to our business, properties, assets, financial condition or results of operations. The new facility contains a number of restrictions that limit our ability, amongst other things, and subject to certain limited exceptions, to incur additional indebtedness, pledge our assets as security, guarantee obligations of third parties, make investments, undergo a merger or consolidation, dispose of assets, or materially change our line of business.





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

In addition, the new facility also contains terms which, if breached, would result in the loan becoming repayable on demand. It requires, among other matters, compliance with two financial covenant ratios. These ratios are (1) the ratio of net debt to EBITDA and (2) the ratio of net interest to EBITDA. EBITDA is a non U.S. GAAP measure of liquidity defined in the finance facility.

Management believes that the Company has not breached these covenants throughout the period to March 31, 2009. The finance facility is secured by a number of fixed and floating charges over certain assets of the Company and its subsidiaries.

The following table presents the projected annual maturities for the next four years after March 31, 2009:

| (in millions) | Term loan | Revolving<br>credit<br>facility | Total   |
|---------------|-----------|---------------------------------|---------|
| 2009          | \$        | \$                              | \$      |
| 2010          | 10.0      |                                 | 10.0    |
| 2011          | 15.0      |                                 | 15.0    |
| 2012          | 25.0      | 23.0                            | 48.0    |
|               | \$ 50.0   | \$ 23.0                         | \$ 73.0 |

**NOTE 10 PLANT CLOSURE PROVISIONS**

The liability for estimated closure costs of Innospec's Octane Additives manufacturing facilities includes costs for personnel reductions (severance), decontamination and environmental remediation activities (remediation) when demand for TEL diminishes. Severance provisions have also been made in relation to Corporate personnel and the Fuel Specialties and Active Chemicals businesses.

Movements in the provisions are summarized as follows:

| (in millions)         | Q1 YTD 2009 |                        |             |          | Q1 YTD<br>2008 |
|-----------------------|-------------|------------------------|-------------|----------|----------------|
|                       | Severance   | Other<br>Restructuring | Remediation | Total    | Total          |
| Total at January 1    | \$ 1.6      | \$ 0.2                 | \$ 25.1     | \$ 26.9  | \$ 26.8        |
| Charge for the period | 1.3         |                        | 0.5         | 1.8      | 1.1            |
| Expenditure           | (0.3)       |                        | (0.3)       | (0.6)    | (1.6)          |
| Exchange effect       |             |                        | (0.1)       | (0.1)    | 0.2            |
| Total at March 31     | 2.6         | 0.2                    | 25.2        | 28.0     | 26.5           |
| Due within one year   | (2.6)       |                        | \$ (2.7)    | \$ (5.3) | (3.3)          |
| Balance at March 31   | \$          | \$ 0.2                 | \$ 22.5     | \$ 22.7  | \$ 23.2        |

Amounts due within one year refer to provisions where expenditure is expected to arise within one year of the balance sheet date. Severance charges are recognized in the income statement as restructuring costs along with other restructuring costs. Remediation costs are recognized in cost of goods sold.

Severance

A charge of \$1.3 million was recognized in respect of the separation agreement with the former CEO who resigned on March 20, 2009 (\$1.2 million) and a reduction in EMEA headcount (\$0.1 million).

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

The remediation provision represents the fair value of the Company's liability recognized under FAS 143, *Accounting for Asset Retirement Obligations*. The accretion expense recognized under FAS 143 in the first quarter of 2009 was \$0.5 million.

The Company records environmental liabilities when they are probable and costs can be estimated reasonably. The Company has to anticipate the program of work required and the associated future costs, and has to comply with environmental legislation in the relevant countries. The Company views the costs of vacating our main United Kingdom site as a contingent liability because there is no present intention to exit the site. The Company has further determined that, due to the uncertain product life of TEL, particularly in the market for aviation gas, there exists such uncertainty as to the timing of such cash flows that it is not possible to estimate these flows sufficiently reliably to recognize a provision.

**NOTE 11 FAIR VALUE MEASUREMENTS**

As defined in FAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). As permitted under FAS 157, the Company utilizes a mid-market pricing convention for valuing the majority of its assets and liabilities measured and reported at fair value. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements and endeavors to utilize the best available information. Accordingly, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs. FAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement). As required by FAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

The following table presents the carrying amount and fair values of the Company's assets and liabilities measured on a recurring basis at March 31, 2009 and December 31, 2008:

| (in millions)  | March 31, 2009  |            | December 31, 2008 |            |
|--|-----------------|------------|-------------------|------------|
|  | Carrying amount | Fair value | Carrying amount   | Fair value |
| <b><u>Assets</u></b>                                   |                 |            |                   |            |
| <b>Non-financial assets (all level 3 measurement):</b> |                 |            |                   |            |
| Goodwill Octane Additives                              | 8.4             | 8.4        | 9.0               | 9.0        |
| <b><u>Liabilities</u></b>                              |                 |            |                   |            |
| <b>Derivatives (all level 1 measurement):</b>          |                 |            |                   |            |
| Interest rate swaps                                    | 0.4             | 0.4        | 0.7               | 0.7        |
| Foreign exchange contracts                             | 8.7             | 8.7        | 12.3              | 12.3       |
| Commodity swaps  | 0.1             | 0.1        | 1.3               | 1.3        |

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

For assets and liabilities measured at fair value on a recurring basis using level 3 inputs, the following reconciles the opening and closing positions:

| (in millions)  | Goodwill         | Octane |
|--|------------------|--------|
| <u>Assets</u>  | <u>Additives</u> |        |
| Balance at January 1, 2009                                       | \$               | 9.0    |
| Total gains or losses (realized/unrealized) Included in earnings |                  | (0.6)  |
| Included in other comprehensive income                           |                  |        |
| Balance at March 31, 2009  | \$               | 8.4    |

The cumulative gains and losses on the interest rate swaps and commodity swaps are summarized as follows:

| (in millions)        | 2009     | 2008     |
|----------------------|----------|----------|
| Balance at January 1 | \$ (2.0) | \$ (1.0) |
| Change in fair value | 1.5      | (0.2)    |
| Balance at March 31  | \$ (0.5) | \$ (1.2) |

The interest rate swaps have been designated as a cash flow hedge against \$50.0 million of underlying floating rate debt obligations that stood at \$73.0 million at March 31, 2009. All of the swaps mature on June 12, 2009.

The commodity swaps are used to manage the Company's cash flow exposure to raw material price volatility. They have been designated as cash flow hedges and all the commodity swaps qualify for hedge accounting as at March 31, 2009 and December 31, 2008.

The interest rate and commodity hedges were determined to be effective and consequently the unrealized loss of \$0.5 million at March 31, 2009 (2008 \$1.2 million) has been recorded in other comprehensive income. Ineffectiveness was determined to be immaterial in 2009 and 2008 and accordingly no gain or loss was recognized in earnings in either period. The Company expects the unrealized loss of \$0.5 million at March 31, 2009 to be reclassified into earnings in the next 12 months.

Foreign 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 and fair values of these contracts is largely due to changes in exchange rates against the U.S. dollar. The U.S. dollar strengthened significantly against other major currencies in the latter part of 2008.

**NOTE 12 DERIVATIVE INSTRUMENTS**

The Company has limited involvement with derivative instruments and does not trade them. The Company does use derivatives to manage certain interest rate, foreign exchange exposures and raw material pricing exposures.

The Company uses interest rate swaps, floors, collar and cap agreements to reduce the impact of changes in interest rates on its floating rate debt. The swap agreements are contracts to exchange floating rate for fixed interest payments periodically over the life of the agreements without the exchange of the underlying notional amounts. The notional amounts are used to calculate interest to be paid or received and do not represent the amount of exposure to credit loss.



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

The Company has determined to hedge a proportion of the outstanding floating rate debt obligation. As at March 31, 2009 and December 31, 2008 the Company had the following interest rate instruments in effect (notional amounts in millions):

| (in millions) | Notional Amount | Strike Rate | Expiry date   |
|---------------|-----------------|-------------|---------------|
| Interest swap | \$ 20.0         | 4.7675%     | June 12, 2009 |
|               | \$ 15.0         | 4.7800%     | June 12, 2009 |
|               | \$ 15.0         | 4.7550%     | June 12, 2009 |

The Company has hedged the price of certain raw materials with commodity swaps. As at March 31, 2009 and December 31, 2008 the Company had the following summarized commodity swaps:

| (in millions)                  | March 31, 2009<br>Carrying Amount | Fair Value | December 31, 2008<br>Carrying Amount | Fair Value |
|--------------------------------|-----------------------------------|------------|--------------------------------------|------------|
| Notional quantity 3,101 tonnes |                                   |            | \$ (1.3)                             | \$ (1.3)   |
| Notional quantity 2,666 tonnes | \$ (0.1)                          | \$ (0.1)   |                                      |            |

These derivative instruments have been classified as cash flow hedging relationships according to the provisions of FAS 133. In accordance with FAS 133, their effectiveness has been tested and determined to be effective at March 31, 2009. The impact on the income statement for the first quarter is summarized below:

| (in millions)           | Gain/(loss) recognized in OCI on derivative | Location of gain/(loss) reclassified from accumulated OCI into income | Amount of gain/(loss) reclassified from accumulated OCI into income |
|-------------------------|---|---|---|
| Interest rate contracts | \$  | Interest income/(expense)   | \$ (0.3)  |
| Commodity contracts     | (0.7)                                       | Cost of goods sold  | (0.5)   |
|                         | \$ (0.7)                                    |   | \$ (0.8)  |

We enter into various foreign currency forward exchange contracts to minimize currency exposure from expected future cash flows. The contracts have maturity dates of up to 12 months at the date of inception. These foreign currency contracts have not been designated as hedging instruments according to FAS 133, and their impact on the income statement for the first quarter of 2009 is summarized below:

| (in millions)              | Location of gain/(loss) recognized in income | Amount of gain/(loss) recognized in income |
|----------------------------|--|--|
| Foreign exchange contracts | Other income/(expense)                       | \$ (0.8)                                   |

The Company sells a range of Fuel Specialties, Active Chemicals and Octane Additives to major oil refineries and chemical companies throughout the world. Credit limits, ongoing credit evaluation and account monitoring procedures are used to minimize bad debt risk. Collateral is not generally required.

***NOTE 13 COMMITMENTS AND CONTINGENCIES***

**Oil for Food Program and related investigations**

On February 7, 2006, the Securities and Exchange Commission ( SEC ) notified the Company that it had commenced an investigation to determine whether any violations of law had occurred in connection with certain

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**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

transactions conducted by or involving the Company, including those conducted by its wholly owned indirect Swiss subsidiary, Alcor Chemie Vertriebs GmbH ( Alcor ), under the United Nations Oil for Food Program ( OFFP ) between June 1, 1999 and December 31, 2003. As part of its investigation, the SEC issued a subpoena requiring the production of certain documents, including documents relating to these transactions, by the Company and Alcor. Upon receipt of the SEC's notification and initial subpoena, the Company undertook a review of its participation in the OFFP.

On October 10, 2007 and November 1, 2007, the SEC served two additional subpoenas on the Company. These additional subpoenas required the production of documents relating primarily to the OFFP, but also relating to transactions conducted by the Company or its subsidiaries with state owned or state controlled entities between June 1, 1999 and the date of such subpoenas, concerning the use of foreign agents and the possibility of extra-contractual payments to secure business with foreign governmental entities in the context of the U.S. Foreign Corrupt Practices Act ( FCPA ) and other laws. In a co-ordinated investigation, the Company was also notified by the U.S. Department of Justice ( DOJ ) regarding the possibility of violations by the Company or its subsidiaries arising under other laws stemming from matters covered by the SEC investigation as well as certain preliminary inquiries regarding compliance with anti-trust laws applicable to the U.S. and international tetra-ethyl lead markets. The subjects into which the SEC and DOJ have inquired include areas that concern certain former and current executives of the Company, including our former CEO, who resigned on March 20, 2009. The Company, and its officers and directors are cooperating with the SEC and DOJ investigations.

On February 19, 2008, the Board of Directors of the Company formed a committee comprised of the chairmen of the Board, the Audit Committee and the Nominating and Governance Committee, all of whom were independent directors. (The chairman of the Nominating and Governance Committee retired as a director of the Company effective May 6, 2008, but his services have been retained in an independent capacity as a member of the committee). External counsel to the Company, reporting to the committee has, on behalf of the committee, conducted and will continue to conduct an investigation into the circumstances giving rise to the SEC and DOJ investigations. External counsel reports directly to the committee and assists in connection with communications and interactions with the SEC and DOJ.

On March 5, 2008, a letter was received by the Company from the DOJ in which a request for a wider and more detailed range of documents was made. The Company and its officers and directors intend to continue to co-operate with the SEC and DOJ.

Separately, on May 21, 2008, the United Kingdom's Serious Fraud Office ( SFO ) notified Innospec Limited, a wholly owned subsidiary of the Company, that it had commenced an investigation into certain contracts involving British companies under the OFFP. As part of this investigation, the SFO has asked the Company to produce documents in respect of the Company's participation in the OFFP between January 1, 1996 and December 31, 2003. Following receipt of the SFO's notice the Company has instructed external legal counsel to advise and assist in relation to the investigation and the Company and its directors and officers intend to co-operate with the SFO. On October 16, 2008, the Company was further notified that the scope of the SFO's investigation would extend to matters relating to potential bribery involving overseas commercial agents that are already in the large part the subject of the ongoing DOJ and SEC investigations. This investigation by the SFO similarly includes areas that concern certain former and current executives of the Company.

The outcome of these investigations remains uncertain to the Company. On the facts available to us it is not yet possible to form any reasonable estimate of the potential disgorgement, penalties and fine payments, either by reference to a range of possible outcomes or by reference to the lower end of such a range of outcomes. The amount of any disgorgements, penalties or fines that the Company could face would depend on a number of eventual factors which are not currently known to the Company, including findings by relevant authorities



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**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

regarding the amount, nature and scope of any improper payments, the amount of any pecuniary gain involved, the Company's ability to pay, and the level of co-operation provided to government authorities during the investigations.

Because of the uncertainties associated with the ultimate outcome of these investigations and the costs to the Company of responding and participating in them, no assurance can be given that the ultimate costs incurred and sanctions that may be imposed will not have a material adverse effect on the Company's results of operations, financial position and/or cash flows from operating activities.

At December 31, 2007 we had accrued \$3.7 million in respect of estimated probable future legal and other professional expenses and provided no additional accruals in respect of the investigations. As part of our continuing commitment to co-operate and comply with the SEC and DOJ investigations, including the request for documents set out in the DOJ letter dated March 5, 2008, we accrued a further \$6.8 million during the quarter ended March 31, 2008 in respect of estimated probable future legal and other professional expenses. During the quarter ended June 30, 2008, the Company provided no additional accruals in respect of these matters.

During the quarter ended September 30, 2008 the Company accrued an additional \$8.7 million in respect of estimated probable legal and other professional fees and expenses. During the quarter ended December 31, 2008 the Company provided no additional accruals in respect of these matters. The various investigations remain ongoing and therefore the Company has accordingly accrued an additional amount of \$7.0 million during the quarter ended March 31, 2009 for estimated probable future legal and other professional fees and expenses. The Company's provision for probable future legal and other professional fees and expenses amounted to \$5.4 million at March 31, 2009.

These accruals are made on the basis of the Company's then current best estimate, working in consultation with the committee of the Board of Directors, external legal counsel to the Company and its other professional advisors. Should any underlying assumptions prove incorrect or should any of the DOJ, SEC and/or the SFO alter the scope of the investigations, then the actual costs incurred by the Company could differ materially from current estimates.

The Company continues to keep the amount of such accrual provisions under review as it has been doing, including through working with the committee of the Board and external legal counsel and other professional advisors.

**Bycosin Disposal**

*Voluntary disclosure of possible violations of the Cuban Assets Control Regulations to the Office of Foreign Assets Control.* Given the international scope of its operations, the Company is subject to laws of many different jurisdictions, including laws relating to the imposition of restrictions on trade and investment with various entities, persons and countries, some of which laws are conflicting. In 2004 the Company reviewed, as it does periodically, aspects of its operations in respect of such restrictions, and determined to dispose of certain non-core, non-U.S. subsidiaries of Bycosin AB. Bycosin's non-U.S. subsidiaries had been engaged in transactions and activities involving Cuban persons and entities before the acquisition of the Bycosin Group by the Company in June 2001, and such subsidiaries were continuing to engage in such transactions and activities at the time of the disposal of the non-core Fuel Specialties business and related assets in November 2004. On November 15, 2004, Bycosin AB, a wholly-owned subsidiary of the Company organized under the laws of Sweden (now known as Innospec Sweden AB, the "Seller"), entered into a Business and Asset Purchase Agreement (the "Agreement") with Pesdo Swedcap Holdings AB (the "Purchaser"), Håkan Byström and others as the Purchaser's guarantors, and Octel Petroleum Specialties Limited (now known as Innospec Fuel Specialties

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**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Limited) as the Seller's guarantor, and completed the all-cash transaction contemplated thereby (together with related transactions, the Transaction). The Agreement provided for, amongst other things: (i) the disposal of certain non-core Fuel Specialties business and related manufacturing and other assets of the Seller; and (ii) the supply and distribution of certain power products to certain geographic regions. The net consideration paid by the Purchaser was approximately \$2.9 million.

Following completion of the Transaction, the Company made a voluntary disclosure to the U.S. Office of Foreign Assets Control (OFAC) regarding transactions and activities engaged in by certain non-U.S. subsidiaries of the Company. Disclosures, amongst other items, included that the aggregate monetary value of the transactions involving Cuban persons and entities conducted by the Company's non-U.S. subsidiaries since January 1999 was approximately \$26.6 million.

At this time, however, management believes that it would be speculative and potentially misleading for the Company to predict the specific nature or amount of penalties that OFAC might eventually assess against it. While penalties could be assessed on different bases, if OFAC assessed penalties against the Company on a performance of contracts basis, the applicable regulations provide for penalties, in the case of civil violations of the Cuban Assets Control Regulations (31 CFR, Part 515) (CACR), of the lesser of \$65,000 per violation or the value of the contract. Since January 1999, non-U.S. subsidiaries of the Company have entered into 43 contracts with Cuban entities, each of which could be considered a separate violation of the CACR by OFAC. OFAC may take the position that the CACR should be interpreted or applied in a different manner, potentially even to permit the assessment of penalties equal to or greater than the value of the business conducted with Cuban persons or entities.

The Company has considered the range of possible outcomes and potential penalties payable. In accordance with the Company's accounting policies, provision has been made for management's current best estimate of the potential liability, including anticipated legal costs. However, should the underlying assumptions prove incorrect, the actual outcome could differ materially from management's current expectations. Management is not able to estimate the amount of any additional loss, if any.

If the Company or its subsidiaries (current or former) were found not to have complied with the CACR, the Company believes that it could be subject to fines or other civil or criminal penalties which could be material.

**Other legal matters**

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 product liability claims. There are no other 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, other than ordinary, routine litigation incidental to their respective businesses.

**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 included guarantees of non-U.S. excise taxes and customs duties. As at March 31, 2009, such contingent liabilities amounted to \$7.3 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.

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**INNOSPEC INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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.

**Indemnities and warranties**

In connection with the disposal of Octel Waste Management Limited on June 26, 2003, the Company provided certain warranties. The Company would be required to perform should the contingent liabilities in respect of the warranties become actual and could be required to make maximum future payments of £3.59 million (\$5.1 million). There are no recourse provisions enabling recovery of any amounts from third parties nor are any assets held as collateral in respect of the warranties.

**NOTE 14 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In April 2008, the FASB issued FASB Staff Position FAS 142-3, *Determination of Useful Life of Intangible Assets* ( FSP FAS 142-3 ). FSP FAS 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. The Company adopted FSP FAS 142-3 on January 1, 2009, and adoption did not have a material impact on our consolidated financial statements.

In March 2008, the FASB issued FAS 161, *Disclosures about Derivative Instruments and Hedging Activities*. FAS 161 requires enhanced disclosures surrounding the use and financial reporting of derivative instruments and hedging activities. The Company adopted FAS 161 on January 1, 2009, and adoption did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued FAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This Company adopted FAS 160 on January 1, 2009, and adoption did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued FAS 141R, *Business Combinations a replacement of FASB Statement No. 141*, which significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141R is effective for the Company beginning January 1, 2009, and changes the accounting for business combinations on a prospective basis.

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**ITEM 2 Management's Discussion and Analysis of Financial Condition and Results of Operations for the Quarter Ended March 31, 2009**

This discussion should be read in conjunction with our unaudited interim consolidated financial statements and the notes thereto.

***CRITICAL ACCOUNTING ESTIMATES***

Our objective is to clearly present our financial information in a manner that enhances the understanding of our sources of earnings and cash flows together with our financial position. We aim to achieve this by disclosing information required by the SEC together with further information that provides insight into our businesses.

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses Innospec's consolidated financial statements which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis management evaluates its estimates and judgments. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The policies and estimates that the Company considers the most critical in terms of complexity and subjectivity of assessment are those related to contingencies, environmental liabilities, goodwill, intangible assets (net of amortization), pensions, and deferred tax asset valuation allowance and uncertain income tax positions. These policies have been discussed in the Company's 2008 Annual Report on Form 10-K.

**Table of Contents*****RESULTS OF OPERATIONS***

| (in millions)                                    | Three Months<br>Ended March 31 |          |
|--|--------------------------------|----------|
|  | 2009                           | 2008     |
| <b>Net sales</b>                                 |                                |          |
| Fuel Specialties                                 | \$ 113.5                       | \$ 114.6 |
| Active Chemicals                                 | 29.3                           | 35.5     |
| Octane Additives                                 | 5.3                            | 18.6     |
|  | \$ 148.1                       | \$ 168.7 |
| <b>Gross profit</b>                              |                                |          |
| Fuel Specialties                                 | \$ 42.4                        | \$ 39.4  |
| Active Chemicals                                 | 5.1                            | 4.8      |
| Octane Additives                                 | 2.7                            | 7.5      |
|  | \$ 50.2                        | \$ 51.7  |
| <b>Operating income</b>                          |                                |          |
| Fuel Specialties                                 | \$ 27.2                        | \$ 23.6  |
| Active Chemicals                                 | 1.2                            | 0.1      |
| Octane Additives                                 | (5.8)                          | (3.0)    |
| FAS 158/87 pension (charge)                      | (1.5)                          | (0.6)    |
| Corporate costs                                  | (1.0)                          | (6.0)    |
|  | 20.1                           | 14.1     |
| Restructuring charge                             | (1.3)                          | (0.5)    |
| Impairment of Octane Additives business goodwill | (0.6)                          | (1.1)    |
| Total operating income                           | 18.2                           | 12.5     |
| Other net (expense)/income                       | (7.1)                          | 0.5      |
| Interest expense                                 | (1.7)                          | (1.7)    |
| Interest income                                  | 0.1                            | 0.4      |
| Income before income taxes                       | \$ 9.5                         | \$ 11.7  |

**Table of Contents****Three months to March 31, 2009:**

| (in millions except ratios) | 2009      | 2008      | Change    |       |
|-----------------------------|-----------|-----------|-----------|-------|
| <b>Net sales:</b>           |           |           |           |       |
| Fuel Specialties            | \$ 113.5  | \$ 114.6  | \$ (1.1)  | -1%   |
| Active Chemicals            | 29.3      | 35.5      | (6.2)     | -17%  |
| Octane Additives            | 5.3       | 18.6      | (13.3)    | -72%  |
|                             | \$ 148.1  | \$ 168.7  | \$ (20.6) | -12%  |
| <b>Gross profit:</b>        |           |           |           |       |
| Fuel Specialties            | \$ 42.4   | \$ 39.4   | \$ 3.0    | +8%   |
| Active Chemicals            | 5.1       | 4.8       | 0.3       | +6%   |
| Octane Additives            | 2.7       | 7.5       | (4.8)     | -64%  |
|                             | \$ 50.2   | \$ 51.7   | \$ (1.5)  | -3%   |
| <b>Gross margin (%)</b>     |           |           |           |       |
| Fuel Specialties            | 37.4      | 34.4      | +3.0      |       |
| Active Chemicals            | 17.4      | 13.5      | +3.9      |       |
| Octane Additives            | 50.9      | 40.3      | +10.6     |       |
| Aggregate                   | 33.9      | 30.6      | +3.3      |       |
| <b>Operating expenses:</b>  |           |           |           |       |
| Fuel Specialties            | \$ (14.6) | \$ (15.3) | \$ 0.7    | -5%   |
| Active Chemicals            | (3.6)     | (4.3)     | 0.7       | -16%  |
| Octane Additives            | (8.2)     | (9.3)     | 1.1       | -12%  |
| FAS 158/87 pension charge   | (1.5)     | (0.6)     | (0.9)     | +150% |
| Corporate costs             | (1.0)     | (6.0)     | 5.0       | -83%  |
|                             | \$ (28.9) | \$ (35.5) | \$ 6.6    | -19%  |

**Fuel Specialties**

*Net sales:* the year on year decrease of 1% was spread across the markets in which we operate as follows the Americas (up 9%), EMEA (no change), ASPAC (down 17%) and Avtel (down 41%). This reduction in revenue was due to the adverse impact of exchange rates (down 6 percentage points) and volume (down 5 percentage points) offset by a richer price and product mix (up 10 percentage points).

Americas benefited from a richer price and product mix (up 10 percentage points) offset by slightly lower volumes (down 1 percentage point). Revenue growth was focused in detergent products sold to refineries.

EMEA net sales were adversely impacted by exchange rates (down 16 percentage points) due to the large proportion of European Union euro-denominated sales in that market. However, underlying growth was focused on price and product mix (up 14 percentage points) and volumes (up 2 percentage points).

ASPAC revenues fell primarily due to a poorer price and product mix (down 12 percentage points) in tandem with slightly lower volumes (down 3 percentage points) and the adverse impact of exchange rates (down 2 percentage points).

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Avtel saw volumes decline by 56 percentage points, primarily due to the timing of shipments, offset by a richer price and product mix (up 15 percentage points).

*Gross margin:* the year on year increase of 3.0 percentage points reflects continued declines in our raw material costs and our ability, especially early in the quarter, to hold pricing relatively firm. In addition, gross margins benefited from strong sales of higher-margin winter products in the both the Americas and EMEA.

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*Operating expenses:* operating expenses fell by 5% due to the favourable impact of exchange rates on our European cost base denominated in European Union euro and British pound sterling.

### **Active Chemicals**

*Net sales:* the year on year decline of 17% was spread across the markets in which we operate as follows the Americas (down 12%), EMEA (down 27%) and ASPAC (up 14%). This decline in revenues was due to lower volumes (down 16 percentage points), the unfavourable impact of exchange rates (down 12 percentage points) offset by improved pricing and product mix (up 11 percentage points).

The Americas experienced a fall due to volumes (down 21 percentage points) and the unfavourable impact of exchange rates (down 8 percentage points) partially offset by an improvement to pricing and product mix (up 17 percentage points). The volume reduction was caused by lower sales in custom manufacturing as we decided to exit some of our low-volume, low-margin business in that market.

EMEA experienced a fall due to volumes (down 18 percentage points) and the unfavourable impact of exchange rates (down 14 percentage points) partially offset by an improvement to pricing and product mix (up 5 percentage points). The low margin non-core polymers business suffered a significant drop in revenues due to its reliance on sales to the automotive and construction industry.

Our ASPAC business growth in the current quarter was driven by fragrances with volumes up 13 percentage points and a richer price and product mix (up 17 percentage points) offset by the unfavourable impact of exchange rates (down 16 percentage points).

*Gross margin:* the year on year increase of 3.9 percentage points reflects the impact of improved pricing, a shift away from lower-margin polymer sales and the favourable impact of raw material cost reductions.

*Operating expenses:* the year on year reduction of 16% is due to the favourable impact of exchange rates on our European cost base denominated in European Union euro and British pound sterling.

### **Octane Additives**

*Net sales:* net sales declined 72% due to lower volumes (down 67 percentage points), which suffered from a very strong fourth quarter in 2008, and a moderately poorer sales mix (down 5 percentage points). In both 2009 and 2008 sales were focused in the Middle East and Africa.

*Gross margin:* the year on year increase in gross margin of 10.6 percentage points reflected the increased proportion of our higher-margin environmental remediation business at these low trading levels.

*Operating expenses:* excluding the impact of legal and other professional expenses of \$7.0 million and \$6.8 million in 2009 and 2008, respectively, relating to the Oil for Food Program and related investigations, the year on year decrease in operating expenses was \$1.3 million or 52% primarily in respect of reduced selling costs.

### **Other Income Statement Captions**

*FAS 158/87 pension charge:* this non-cash pension charge increased by \$0.9 million to \$1.5 million despite a decrease in the underlying current service cost. This increased charge primarily reflects a lower expected future return on plan assets.

*Corporate costs:* corporate costs fell by \$5.0 million as the Company recognized a \$2.4 million gain on stock options forfeited upon resignation of the Company's former CEO. A further \$1.7 million reduction reflects the favourable impact of exchange rates on the predominantly British pound sterling cost base in tandem with tight cost controls.



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*Restructuring charge:* restructuring costs are comprised of the following:

| (in millions)  | 2009   | 2008   |
|--|--------|--------|
| Separation agreement with the former CEO                           | \$ 1.2 | \$     |
| Reduction in EMEA headcount  | 0.1    |        |
| United Kingdom site clearance                                      |        | 0.3    |
| Relocation of our European Headquarters to the Ellesmere Port site |        | 0.2    |
|  | \$ 1.3 | \$ 0.5 |

*Amortization of intangible assets:* the amortization charge has declined by \$0.9 million from \$2.1 million to \$1.2 million due to a reduction in the amortization charge related to the agreements with Ethyl Corporation. The reduction is the result of an extension to the estimated future life of our Octane Additives business and the \$6.3 million reduction in intangible assets in 2008 for contract related provisions no longer deemed necessary.

*Impairment of Octane Additives business goodwill:* the 2009 charge was lower than that recognized in 2008 primarily due to the higher operating income and associated cash flows in 2008. Effective October 1, 2008 we have updated the estimates used in the detailed forecast model to calculate impairment charges to reflect the Company's extended estimate for the future life of our Octane Additives business from December 31, 2010 to December 31, 2012.

*Interest expense (net):* the net interest expense increased by \$0.3 million to \$1.6 million in 2009 primarily reflecting the accelerated write-off of \$0.2 million of unamortized deferred finance costs from the previous finance facility.

*Other net (expense)/income:* other net expense of \$7.1 million in 2009 relates to losses on translation of net assets in our European business of \$6.3 million and losses on foreign currency forward exchange contracts of \$0.8 million. In 2008 other net income of \$0.5 million related to gains on translation of net assets in our European business of \$0.7 million offset by losses on foreign currency forward exchange contracts of \$0.2 million.

*Income taxes:* tax relief is not available on the charge for impairment of Octane Additives business goodwill and accordingly we believe that the change in the effective rate of tax to 32.6% in 2009 from 37.6% in 2008 is best explained by adjusting for this non-deductible charge. This adjusted effective tax rate has decreased by 3.7 percentage points principally due to the revised assumption from the comparative period that significant legal and other professional expenses may be tax deductible.

| (in millions)   | 2009    | 2008    |
|---|---------|---------|
| Income before income taxes                                | \$ 9.5  | \$ 11.7 |
| Add back Impairment of Octane Additives business goodwill | 0.6     | 1.1     |
|   | \$ 10.1 | \$ 12.8 |
| Income taxes  | \$ 3.1  | \$ 4.4  |
| Adjusted effective tax rate                               | 30.7%   | 34.4%   |

**Table of Contents****LIQUIDITY AND FINANCIAL CONDITION****Working Capital**

| (in millions)   | March 31,<br>2009 | December 31,<br>2008 |
|---|-------------------|----------------------|
| Total current assets                                  | \$ 254.2          | \$ 256.6             |
| Total current liabilities                             | (130.0)           | (188.1)              |
| Working capital                                       | 124.2             | 68.5                 |
| Less prepaid income taxes                             | (5.5)             | (10.1)               |
| Less cash and cash equivalents                        | (35.5)            | (13.9)               |
| Add back dividend payable                             | 1.2               |                      |
| Add back short-term borrowing                         | 10.0              | 73.0                 |
| Add back current portion of plant closure provisions  | 5.3               | 4.1                  |
| Add back current portion of unrecognized tax benefits | 16.1              | 9.2                  |
| Add back current portion of deferred income           | 0.1               | 0.1                  |
| Adjusted working capital                              | \$ 115.9          | \$ 130.9             |

In the first quarter of 2009 adjusted working capital decreased by \$15.0 million (defined by the Company as accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities rather than total current assets less total current liabilities). The \$10.9 million decrease in accounts receivable and prepaid expenses was focused heavily within our Octane Additives business as it collected significant year end receivables. Inventories declined by \$8.5 million as we actively managed production levels across all three business units to meet market demand. The \$4.4 million increase in accounts payable and accrued liabilities primarily reflects the increased provision for probable future legal and other professional expenses relating to the Oil for Food Program and related investigations.

**Cash**

At March 31, 2009 and December 31, 2008 we had cash and cash equivalents of \$35.5 million and \$13.9 million, respectively.

**Debt**

On February 6, 2009 we entered into a new three-year finance facility which provides for borrowings by us of up to \$150 million including a term loan of \$50 million and revolving credit facility of \$100 million. The revolving credit facility can be drawn down until the finance facility expires on February 6, 2012. This new finance facility replaced the previous finance facility which was in place at March 31 and December 31, 2008.

The Company's new finance facility contains restrictive clauses which may constrain our activities and limit our operational and financial flexibility. The new facility obliges the lenders to comply with a request for utilization of finance unless there is an event of default outstanding. Events of default are defined in the finance facility and include a material adverse change to our business, properties, assets, financial condition or results of operations. The new facility contains a number of restrictions that limit our ability, amongst other things, and subject to certain limited exceptions, to incur additional indebtedness, pledge our assets as security, guarantee obligations of third parties, make investments, undergo a merger or consolidation, dispose of assets, or materially change our line of business.

In addition, the new facility also contains terms which, if breached, would result in the loan becoming repayable on demand. It requires, among other matters, compliance with two financial covenant ratios. These ratios are (1) the ratio of net debt to EBITDA and (2) the ratio of net interest to EBITDA. EBITDA is a non U.S. GAAP measure of liquidity defined in the finance facility.

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As of March 31, 2009, the Company had \$73.0 million of debt outstanding under its finance facility and was in compliance with all financial covenants therein. The debt profile as at March 31, 2009, including the finance facility, is set out below:

|  |         |
|--|---------|
| <b>(in millions)</b>                   |         |
| 2009                                   | \$      |
| 2010                                   | 10.0    |
| 2011                                   | 15.0    |
| 2012                                   | 48.0    |
|  | 73.0    |
| Current portion of long-term debt      | (10.0)  |
| Long-term debt, net of current portion | \$ 63.0 |

**ITEM 3 Quantitative and Qualitative Disclosures About Market Risk**

The Company operates manufacturing and blending facilities, offices and laboratories around the world, though the largest manufacturing facility is located in the United Kingdom. The Company sells a range of specialty chemicals to customers around the world. The Company uses floating rate debt to finance these global operations. Consequently, the Company is subject to business risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations, and market risk related to changes in interest rates and foreign exchange rates. The political and economic risks are mitigated by the stability of the countries in which the Company's largest operations are located. Credit limits, ongoing credit evaluation and account monitoring procedures are used to minimize bad debt risk. Collateral is not generally required.

The Company uses derivatives, including interest rate swaps, commodity swaps and foreign currency forward exchange contracts, in the normal course of business to manage market risks. The derivatives used in hedging activities are considered risk management tools and are not used for trading purposes. In addition, the Company enters into derivative instruments with a diversified group of major financial institutions in order to monitor the exposure to non-performance of such instruments. The Company's objective in managing exposure to changes in interest rates is to limit the impact of such changes on earnings and cash flows and to lower overall borrowing costs. The Company's objective in managing the exposure to changes in foreign exchange rates is to reduce volatility on earnings and cash flows associated with such changes.

The Company offers fixed prices for some long-term sales contracts. As manufacturing costs and raw materials are subject to variability the Company uses commodity swaps to hedge the price of some raw materials thus reducing volatility on earnings and cash flows. The derivatives are considered risk management tools and are not used for trading purposes. The Company's objective is to manage its exposure to fluctuating prices of raw materials.

The Company's exposure to market risk has been discussed in the Company's 2008 Annual Report on Form 10-K and there have been no significant changes since that time.

**ITEM 4 Controls and Procedures**  
**Evaluation of Disclosure Controls and Procedures**

As of the end of the period covered by this report the Company carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934, as amended (the Exchange Act)).

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Based upon this evaluation of disclosure controls and procedures, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of March 31, 2009, in timely making known material information relating to the Company and the Company's consolidated subsidiaries required to be disclosed in the Company's reports filed or submitted under the Exchange Act.

### **Changes in Internal Controls over Financial Reporting**

The Company is continuously seeking to improve the efficiency and effectiveness of its operations and of its internal controls. This results in refinements to processes throughout the Company. However, there has been no change in the Company's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1 Legal Proceedings**

#### **Oil for Food Program and related investigations**

On February 7, 2006, the Securities and Exchange Commission ( SEC ) notified the Company that it had commenced an investigation to determine whether any violations of law had occurred in connection with certain transactions conducted by or involving the Company, including those conducted by its wholly owned indirect Swiss subsidiary, Alcor Chemie Vertriebs GmbH ( Alcor ), under the United Nations Oil for Food Program ( OFFP ) between June 1, 1999 and December 31, 2003. As part of its investigation, the SEC issued a subpoena requiring the production of certain documents, including documents relating to these transactions, by the Company and Alcor. Upon receipt of the SEC's notification and initial subpoena, the Company undertook a review of its participation in the OFFP.

On October 10, 2007 and November 1, 2007, the SEC served two additional subpoenas on the Company. These additional subpoenas required the production of documents relating primarily to the OFFP, but also relating to transactions conducted by the Company or its subsidiaries with state owned or state controlled entities between June 1, 1999 and the date of such subpoenas, concerning the use of foreign agents and the possibility of extra-contractual payments to secure business with foreign governmental entities in the context of the U.S. Foreign Corrupt Practices Act ( FCPA ) and other laws. In a co-ordinated investigation, the Company was also notified by the U.S. Department of Justice ( DOJ ) regarding the possibility of violations by the Company or its subsidiaries arising under other laws stemming from matters covered by the SEC investigation as well as certain preliminary inquiries regarding compliance with anti-trust laws applicable to the U.S. and international tetra-ethyl lead markets. The subjects into which the SEC and DOJ have inquired include areas that concern certain former and current executives of the Company, including our former CEO, who resigned on March 20, 2009. The Company, and its officers and directors are cooperating with the SEC and DOJ investigations.

On February 19, 2008, the Board of Directors of the Company formed a committee comprised of the chairmen of the Board, the Audit Committee and the Nominating and Governance Committee, all of whom were independent directors. (The chairman of the Nominating and Governance Committee retired as a director of the Company effective May 6, 2008, but his services have been retained in an independent capacity as a member of the committee). External counsel to the Company, reporting to the committee has, on behalf of the committee, conducted and will continue to conduct an investigation into the circumstances giving rise to the SEC and DOJ investigations. External counsel reports directly to the committee and assists in connection with communications and interactions with the SEC and DOJ.

On March 5, 2008, a letter was received by the Company from the DOJ in which a request for a wider and more detailed range of documents was made. The Company and its officers and directors intend to continue to co-operate with the SEC and DOJ.

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Separately, on May 21, 2008, the United Kingdom's Serious Fraud Office (SFO) notified Innospec Limited, a wholly owned subsidiary of the Company, that it had commenced an investigation into certain contracts involving British companies under the OFFP. As part of this investigation, the SFO has asked the Company to produce documents in respect of the Company's participation in the OFFP between January 1, 1996 and December 31, 2003. Following receipt of the SFO's notice the Company has instructed external legal counsel to advise and assist in relation to the investigation and the Company and its directors and officers intend to co-operate with the SFO. On October 16, 2008, the Company was further notified that the scope of the SFO's investigation would extend to matters relating to potential bribery involving overseas commercial agents that are already in the large part the subject of the ongoing DOJ and SEC investigations. This investigation by the SFO similarly includes areas that concern certain former and current executives of the Company.

The outcome of these investigations remains uncertain to the Company. On the facts available to us it is not yet possible to form any reasonable estimate of the potential disgorgement, penalties and fine payments, either by reference to a range of possible outcomes or by reference to the lower end of such a range of outcomes. The amount of any disgorgements, penalties or fines that the Company could face would depend on a number of eventual factors which are not currently known to the Company, including findings by relevant authorities regarding the amount, nature and scope of any improper payments, the amount of any pecuniary gain involved, the Company's ability to pay, and the level of co-operation provided to government authorities during the investigations.

Because of the uncertainties associated with the ultimate outcome of these investigations and the costs to the Company of responding and participating in them, no assurance can be given that the ultimate costs incurred and sanctions that may be imposed will not have a material adverse effect on the Company's results of operations, financial position and/or cash flows from operating activities.

At December 31, 2007 we had accrued \$3.7 million in respect of estimated probable future legal and other professional expenses and provided no additional accruals in respect of the investigations. As part of our continuing commitment to co-operate and comply with the SEC and DOJ investigations, including the request for documents set out in the DOJ letter dated March 5, 2008, we accrued a further \$6.8 million during the quarter ended March 31, 2008 in respect of estimated probable future legal and other professional expenses. During the quarter ended June 30, 2008, the Company provided no additional accruals in respect of these matters.

During the quarter ended September 30, 2008 the Company accrued an additional \$8.7 million in respect of estimated probable legal and other professional fees and expenses. During the quarter ended December 31, 2008 the Company provided no additional accruals in respect of these matters. The various investigations remain ongoing and therefore the Company has accordingly accrued an additional amount of \$7.0 million during the quarter ended March 31, 2009 for estimated probable future legal and other professional fees and expenses. The Company's provision for probable future legal and other professional fees and expenses amounted to \$5.4 million at March 31, 2009.

These accruals are made on the basis of the Company's then current best estimate, working in consultation with the committee of the Board of Directors, external legal counsel to the Company and its other professional advisors. Should any underlying assumptions prove incorrect or should any of the DOJ, SEC and/or the SFO alter the scope of the investigations, then the actual costs incurred by the Company could differ materially from current estimates.

The Company continues to keep the amount of such accrual provisions under review as it has been doing, including through working with the committee of the Board and external legal counsel and other professional advisors.

### **Bycosin Disposal**

*Voluntary disclosure of possible violations of the Cuban Assets Control Regulations to the Office of Foreign Assets Control.* Given the international scope of its operations, the Company is subject to laws of many different

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jurisdictions, including laws relating to the imposition of restrictions on trade and investment with various entities, persons and countries, some of which laws are conflicting. In 2004 the Company reviewed, as it does periodically, aspects of its operations in respect of such restrictions, and determined to dispose of certain non-core, non-U.S. subsidiaries of Bycosin AB. Bycosin's non-U.S. subsidiaries had been engaged in transactions and activities involving Cuban persons and entities before the acquisition of the Bycosin Group by the Company in June 2001, and such subsidiaries were continuing to engage in such transactions and activities at the time of the disposal of the non-core Fuel Specialties business and related assets in November 2004. On November 15, 2004, Bycosin AB, a wholly-owned subsidiary of the Company organized under the laws of Sweden (now known as Innospec Sweden AB, the Seller), entered into a Business and Asset Purchase Agreement (the Agreement) with Pesdo Swedcap Holdings AB (the Purchaser), Håkan Byström and others as the Purchaser's guarantors, and Octel Petroleum Specialties Limited (now known as Innospec Fuel Specialties Limited) as the Seller's guarantor, and completed the all-cash transaction contemplated thereby (together with related transactions, the Transaction). The Agreement provided for, amongst other things: (i) the disposal of certain non-core Fuel Specialties business and related manufacturing and other assets of the Seller; and (ii) the supply and distribution of certain power products to certain geographic regions. The net consideration paid by the Purchaser was approximately \$2.9 million.

Following completion of the Transaction, the Company made a voluntary disclosure to the U.S. Office of Foreign Assets Control (OFAC) regarding transactions and activities engaged in by certain non-U.S. subsidiaries of the Company. Disclosures, amongst other items, included that the aggregate monetary value of the transactions involving Cuban persons and entities conducted by the Company's non-U.S. subsidiaries since January 1999 was approximately \$26.6 million.

At this time, however, management believes that it would be speculative and potentially misleading for the Company to predict the specific nature or amount of penalties that OFAC might eventually assess against it. While penalties could be assessed on different bases, if OFAC assessed penalties against the Company on a performance of contracts basis, the applicable regulations provide for penalties, in the case of civil violations of the Cuban Assets Control Regulations (31 CFR. Part 515) (CACR), of the lesser of \$65,000 per violation or the value of the contract. Since January 1999, non-U.S. subsidiaries of the Company have entered into 43 contracts with Cuban entities, each of which could be considered a separate violation of the CACR by OFAC. OFAC may take the position that the CACR should be interpreted or applied in a different manner, potentially even to permit the assessment of penalties equal to or greater than the value of the business conducted with Cuban persons or entities.

The Company has considered the range of possible outcomes and potential penalties payable. In accordance with the Company's accounting policies, provision has been made for management's current best estimate of the potential liability, including anticipated legal costs. However, should the underlying assumptions prove incorrect, the actual outcome could differ materially from management's current expectations. Management is not able to estimate the amount of any additional loss, if any.

If the Company or its subsidiaries (current or former) were found not to have complied with the CACR, the Company believes that it could be subject to fines or other civil or criminal penalties which could be material.

### **Patent actions**

The Company is actively opposing certain third party patents in various regions of the world. The actions are part of the Company's ongoing management of its intellectual property portfolio. The Company does not believe that any of these actions will have a material effect on the financial condition or results of operations of the Company.

### **Other legal matters**

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 product liability claims. There are no other 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, other than ordinary, routine litigation incidental to their respective businesses.

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**ITEM 1A Risk Factors**

Information regarding risk factors appears in Item 1A of the Company's 2008 Annual Report on Form 10-K, and there have been no material changes in the risk factors facing the Company since that time.

**ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds**

(c) No purchases of equity securities by the issuer or affiliated purchasers were made during the quarter.

Repurchases of common stock are held as treasury shares unless reissued under equity compensation plans.

The Company has not, within the last three years, made any sales of unregistered securities.

**ITEM 3 Defaults Upon Senior Securities**

None.

**ITEM 4 Submission of Matters to a Vote of Security Holders**

No matter was submitted to a vote of security holders during the quarter ended March 31, 2009.

**ITEM 5 Other Information**

None.

**ITEM 6 Exhibits**

- 31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: May 7, 2009

By

/s/ PATRICK S. WILLIAMS  
**Patrick S. Williams**  
**President and Chief Executive Officer**

Date: May 7, 2009

By

/s/ IAN P. CLEMINSON  
**Ian P. Cleminson**  
**Executive Vice President and Chief Financial Officer**

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