

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

FORM 10-Q

(MARK ONE)

- (X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001
- () TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO _____

1-4462

Commission File Number

STEPAN COMPANY

(Exact name of registrant as specified in its charter)

Delaware

36 1823834

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification Number)

Edens and Winnetka Road, Northfield, Illinois 60093

(Address of principal executive offices)

Registrant's telephone number

(847) 446-7500

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 X No ___
 --- ---

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

Class

Outstanding at October 31, 2001

Common Stock, \$1 par value

9,230,548 Shares

Part I FINANCIAL INFORMATION

Item 1 - Financial Statements

STEPAN COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
September 30, 2001 and December 31, 2000
Unaudited

(Dollars in thousands)	9/30/01 -----	12/31/00 -----
ASSETS		

CURRENT ASSETS:		
Cash and cash equivalents	\$ 3,218	\$ 3,536
Receivables, net	111,774	98,488
Inventories (Note 2)	61,160	60,132
Deferred income taxes	10,866	10,866
Other current assets	4,633	4,191
	-----	-----
Total current assets	191,651	177,213
	-----	-----
PROPERTY, PLANT AND EQUIPMENT:		
Cost	658,979	619,296
Less: Accumulated depreciation	446,219	420,149
	-----	-----
Property, plant and equipment, net	212,760	199,147
	-----	-----
OTHER ASSETS		
	39,989	38,689
	-----	-----
Total assets	\$ 444,400 =====	\$ 415,049 =====
LIABILITIES AND STOCKHOLDERS' EQUITY		

CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 10,547	\$ 9,586
Accounts payable	60,163	57,255
Accrued liabilities	42,725	39,121
	-----	-----
Total current liabilities	113,435	105,962
	-----	-----
DEFERRED INCOME TAXES		
	37,150	39,170
	-----	-----
LONG-TERM DEBT, less current maturities		
	111,548	96,466
	-----	-----
OTHER NON-CURRENT LIABILITIES		
	21,827	19,275
	-----	-----
STOCKHOLDERS' EQUITY:		
5-1/2% convertible preferred stock, cumulative, voting without par value; authorized 2,000,000 shares; issued 583,252 shares in 2001 and 583,469 shares in 2000	14,581	14,587
Common stock, \$1 par value; authorized 30,000,000 shares; issued 9,595,463 shares in 2001 and 9,411,106 shares in 2000	9,595	9,411
Additional paid-in capital	16,147	13,343
Accumulated other comprehensive loss	(13,682)	(12,402)
Retained earnings (approximately \$50,588 unrestricted in 2001 and \$46,125 in 2000)	142,126	133,308
	-----	-----
Less: Treasury stock, at cost	8,327	4,071
	-----	-----
Stockholders' equity	160,440	154,176
	-----	-----
Total liabilities and stockholders' equity	\$ 444,400 =====	\$ 415,049 =====

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these condensed consolidated balance sheets.

STEPAN COMPANY
CONSOLIDATED STATEMENTS OF INCOME For
the Three and Nine Months Ended September 30, 2001 and 2000
Unaudited

(In thousands, except per share amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2001	2000	2001	2000
	-----	-----	-----	-----
NET SALES	\$ 173,829	\$ 176,608	\$ 533,453	\$ 529,493
Cost of Sales	147,346	147,583	451,368	442,705
	-----	-----	-----	-----
Gross Profit	26,483	29,025	82,085	86,788
	-----	-----	-----	-----
Operating Expenses:				
Marketing	6,498	5,968	18,744	18,364
Administrative	5,843	5,933	18,594	18,011
Research, Development and Technical Services	5,517	5,238	16,941	16,696
	-----	-----	-----	-----
	17,858	17,139	54,279	53,071
	-----	-----	-----	-----
Operating Income	8,625	11,886	27,806	33,717
Other Income (Expense):				
Interest, Net	(1,819)	(2,099)	(5,580)	(6,336)
Income from Equity Joint Venture	529	202	1,149	470
	-----	-----	-----	-----
	(1,290)	(1,897)	(4,431)	(5,866)
	-----	-----	-----	-----
Income Before Income Taxes	7,335	9,989	23,375	27,851
Provision for Income Taxes	2,854	3,756	9,093	10,722
	-----	-----	-----	-----
NET INCOME	\$ 4,481	\$ 6,233	\$ 14,282	\$ 17,129
	=====	=====	=====	=====
Net Income Per Common Share (Note 4):				
Basic	\$ 0.46	\$ 0.65	\$ 1.48	\$ 1.76
	=====	=====	=====	=====
Diluted	\$ 0.44	\$ 0.61	\$ 1.41	\$ 1.67
	=====	=====	=====	=====
Shares used to compute Net Income Per Common Share (Note 4):				
Basic	9,260	9,282	9,255	9,390
	=====	=====	=====	=====
Diluted	10,132	10,152	10,149	10,282
	=====	=====	=====	=====
Dividends per Common Share	\$ 0.1750	\$ 0.1625	\$ 0.5250	\$ 0.4875
	=====	=====	=====	=====

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

STEPAN COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Nine Months Ended September 30, 2001 and 2000
Unaudited

(Dollars in thousands)	9/30/01 -----	9/30/00 -----
NET CASH FLOW FROM OPERATING ACTIVITIES		
Net income	\$ 14,282	\$ 17,129
Depreciation and amortization	29,758	30,782
Deferred revenue recognition	(355)	(1,635)
Deferred income taxes	(2,016)	(230)
Environmental and legal liabilities	744	(47)
Other non-cash items	1,193	(1,085)
Changes in Working Capital:		
Receivables, net	(1,505)	(4,853)
Inventories	1,122	(5,975)
Accounts payable and accrued liabilities	(2,172)	(1,209)
Other	(442)	(427)
	-----	-----
Net Cash Provided by Operating Activities	40,609	32,450
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Expenditures for property, plant and equipment	(24,375)	(19,213)
Investment in acquisitions	(24,623)	--
Other non-current assets	(627)	(222)
	-----	-----
Net Cash Used for Investing Activities	(49,625)	(19,435)
	-----	-----
CASH FLOWS FROM FINANCING AND OTHER RELATED ACTIVITIES		
Revolving debt and notes payable to banks, net	24,000	6,200
Other debt borrowings	1,152	--
Other debt repayments	(9,109)	(8,008)
Purchase of treasury stock, net	(4,257)	(7,317)
Dividends paid	(5,464)	(5,188)
Stock option exercises	2,986	1,041
Other non-cash items	(610)	(1,318)
	-----	-----
Net Cash Provided by/(Used for) Financing and Other Related Activities	8,698	(14,590)
	-----	-----
NET DECREASE IN CASH AND CASH EQUIVALENTS	(318)	(1,575)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	3,536	3,969
	-----	-----
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 3,218	\$ 2,394
	=====	=====
CASH PAID DURING THE PERIOD FOR:		
Interest	\$ 4,829	\$ 5,390
Income taxes	\$ 5,944	\$ 9,956

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

STEPAN COMPANY
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 September 30, 2001 and December 31, 2000
 Unaudited

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by the company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (although the balance sheet at 12/31/00 is condensed from the audited balance sheet at that date). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate and make the information presented not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the company's latest Annual Report to Stockholders and the Annual Report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 2000. In the opinion of management all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the consolidated financial position of Stepan Company as of September 30, 2001, and the consolidated results of operations for the three and nine months then ended and cash flows for the nine months then ended, have been included.

2. INVENTORIES

Inventories include the following amounts:

(Dollars in thousands)	9/30/01	12/31/00
	-----	-----
Inventories valued primarily on LIFO basis -		
Finished products	\$ 39,019	\$ 40,515
Raw materials	22,141	19,617
	-----	-----
Total inventories	\$ 61,160	\$ 60,132
	=====	=====

If the first-in, first-out (FIFO) inventory valuation method had been used for all inventories, inventory balances would have been approximately \$8.8 million and \$8.9 million higher than reported at September 30, 2001, and December 31, 2000, respectively.

3. CONTINGENCIES

There are a variety of legal proceedings pending against the company. Some of these proceedings may result in fines, penalties, judgments or costs being assessed against the company at some future time. The company's operations are subject to extensive local, state and federal regulations, including the federal Comprehensive Environmental

Response, Compensation and Liability Act of 1980 ("Superfund") and the Superfund amendments of 1986. The company, and others, has been named as potentially responsible parties at affected geographic sites. As discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in this filing, the company believes that it has made adequate provisions for the costs it may incur with respect to these sites. The company has estimated a range of possible environmental and legal losses from \$7.4 million to \$35.0 million at September 30, 2001. At September 30, 2001, the company's reserve was \$17.4 million for legal and environmental matters compared to \$16.6 million at December 31, 2000.

For certain sites, estimates of the total costs of compliance, or the company's share of such costs are subject to significant change due to inherited uncertainties of these estimates; accordingly, the company is unable to predict the effect thereof on future results of operations. In the event of one or more adverse determinations in any annual or interim period, the impact on results of operations for those periods could be material. However, based upon the company's present belief as to its relative involvement at these sites, other viable entities' responsibilities for cleanup and the extended period over which any costs would be incurred, the company believes that these matters will not have a material effect on the company's financial position. Certain of these matters are discussed in Item 3, Legal Proceedings, in the 2000 Form 10-K Annual Report, Item 1, Legal Proceedings, in this Form 10-Q, and in other filings of the company with the Securities and Exchange Commission, which are available upon request from the company.

Following are summaries of the environmental proceedings related to the company's Maywood, New Jersey, and Ewan and D'Imperio environmental sites:

Maywood, New Jersey, Site:

As reported previously, the company's site in Maywood, New Jersey and property formerly owned by the company adjacent to its current site, were listed on the National Priorities List in September 1993 pursuant to the provisions of the Comprehensive Environmental Response Compensation and Liabilities Act (CERCLA) because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between the United States Environmental Protection Agency (USEPA) and the company for property formerly owned by the company, and the issuance of an order by the USEPA to the company for property currently owned by the company, the company completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. In addition, the company submitted an FS Addendum to USEPA in October 2000. The company received comments from USEPA on the FS Addendum in June 2001, and submitted its response to these comments in September 2001. The company has been awaiting the issuance of a Record of Decision (ROD) from USEPA, which would relate to both the currently owned and formerly owned company property and would recommend the type of remediation required on each property. The final ROD will be issued sometime after the public comment periods.

In 1985, the company entered into a Cooperative Agreement with the United States of America represented by the Department of Energy (Agreement). Pursuant to this Agreement, the Department of Energy (DOE) took title to radiological contaminated materials and was to remediate, at its expense, all radiological waste on the company's property in Maywood, New Jersey. The Maywood property (and portions of the surrounding area) were remediated by the DOE under the Formerly Utilized Sites Remedial Action Program, a federal program under which the U.S. Government undertook to remediate properties which were used to process radiological material for the U.S. Government. In 1997, responsibility for this clean-up was transferred to the United States Army Corps of Engineers (USACE). On January 29, 1999, the company received a copy of a USACE Report to Congress dated January 1998 in which the USACE expressed their intention to evaluate, with the USEPA, whether the company and/or other parties might be responsible for cost recovery or contribution claims related to the Maywood site. Subsequent to the issuance of that report, the USACE advised the company that it had requested legal advice from the Department of Justice as to the impact of the Agreement.

By letter dated July 28, 2000, the Department of Justice advised the company that the USACE and USEPA had referred to the Justice Department claims against the company for response costs incurred or to be incurred by the USACE, USEPA and the DOE in connection with the Maywood site and the Justice Department stated that the United States is entitled to recovery of its response costs from the company under CERCLA. The letter referred to both radiological and non-radiological hazardous waste at the Maywood site and stated that the United States has incurred unreimbursed response costs to date of \$138 million. Costs associated with radiological waste at the Maywood site, which the company believes represent all but a small portion of the amount referred to in the Justice Department letter, could be expected to aggregate substantially in excess of that amount. In the letter, the Justice Department invited the company to discuss settlement of the matter in order to avoid the need for litigation. The company believes that its liability, if any, for such costs has been resolved by the aforesaid Agreement. Despite the fact that the company continues to believe that it has no liability to the United States for such costs, discussions with the Justice Department are currently ongoing to attempt to resolve this matter.

The company believes it has adequate reserves for claims associated with the Maywood site. However, depending on the results of the ongoing discussions regarding the Maywood site, the final cost of the remediation could differ from the current estimates.

Ewan and D'Imperio Site:

As reported previously, the company has been named as a potentially responsible party (PRP) in the case USEPA v. Jerome Lightman (92 CV 4710 D. N. J.) which involves the Ewan and D'Imperio Superfund Sites located in New Jersey. Trial on the issue of the company's liability at these sites was completed in March 2000. The company is awaiting a decision from the court. If the company is found liable at either site, a second trial as to the company's allocated share of clean-up costs at these sites will likely be held

in 2002. The company believes it has adequate defenses to the issue of liability. In the event of an unfavorable outcome related to the issue of liability, the company believes it has adequate reserves.

4. EARNINGS PER SHARE

Below is the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2001 and 2000.

(In thousands, except per share amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2001	2000	2001	2000

Computation of Basic Earnings per Share				

Net income	\$ 4,481	\$ 6,233	\$14,282	\$17,129
Deduct dividends on preferred stock	200	203	602	614
	-----	-----	-----	-----
Income applicable to common stock	\$ 4,281	\$ 6,030	\$13,680	\$16,515
	=====	=====	=====	=====
Weighted-average number of shares outstanding	9,260	9,282	9,255	9,390
Basic earnings per share	\$ 0.46	\$ 0.65	\$ 1.48	\$ 1.76
	=====	=====	=====	=====
Computation of Diluted Earnings per Share				

Net Income	\$ 4,481	\$ 6,233	\$14,282	\$17,129
Weighted-average number of shares outstanding	9,260	9,282	9,255	9,390
Add net shares issuable from assumed exercise of options (under treasury stock method)	206	197	228	210
Add weighted-average shares issuable from assumed conversion of convertible preferred stock	666	673	666	682
	-----	-----	-----	-----
Shares applicable to diluted earnings	10,132	10,152	10,149	10,282
	=====	=====	=====	=====
Diluted earnings per share	\$ 0.44	\$ 0.61	\$ 1.41	\$ 1.67
	=====	=====	=====	=====

5. COMPREHENSIVE INCOME

Below is the company's comprehensive income for the three and nine months ended September 30, 2001 and 2000:

(Dollars in thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2001	2000	2001	2000

Net income	\$ 4,481	\$ 6,233	\$14,282	\$17,129
Other comprehensive loss:				
Foreign currency translation adjustments	(274)	(933)	(1,280)	(2,403)
	-----	-----	-----	-----
Comprehensive income	\$ 4,207	\$ 5,300	\$13,002	\$14,726
	=====	=====	=====	=====

6. SEGMENT REPORTING

Stepan Company has three reportable segments: surfactants, polymers and specialty products. Financial results of Stepan Company's operating segments for the three and nine months ended September 30, 2001 and 2000, are summarized below:

(Dollars in thousands)	Surfactants -----	Polymers -----	Specialty Products -----	Segment Totals -----
For the quarter ended September 30, 2001 -----				
Net sales	\$ 134,379	\$ 31,906	\$ 7,544	\$ 173,829
Operating income	7,938	3,915	3,190	15,043
For the quarter ended September 30, 2000 -----				
Net sales	\$ 131,605	\$ 38,541	\$ 6,462	\$ 176,608
Operating income	10,906	5,313	2,045	18,264
For nine months ended September 30, 2001 -----				
Net sales	\$ 415,165	\$ 98,643	\$ 19,645	\$ 533,453
Operating income	28,289	13,607	6,373	48,269
For nine months ended September 30, 2000 -----				
Net sales	\$ 405,852	\$ 107,812	\$ 15,829	\$ 529,493
Operating income	35,086	15,591	2,735	53,412

Below are reconciliations of segment operating income to consolidated income before income taxes:

	Three Months Ended September 30 -----		Nine Months Ended September 30 -----	
	2001 ----	2000 ----	2001 ----	2000 ----
Operating income segment totals	\$ 15,043	\$ 18,264	\$ 48,269	\$ 53,412
Unallocated corporate expenses/(a)/	(6,418)	(6,378)	(20,463)	(19,695)
Interest expense	(1,819)	(2,099)	(5,580)	(6,336)
Income from equity in joint venture	529	202	1,149	470
Consolidated income before income taxes	\$ 7,335	\$ 9,989	\$ 23,375	\$ 27,851
	=====	=====	=====	=====

(a) Includes corporate administrative and corporate manufacturing expenses, which are not included in segment operating income and not used to evaluate segment performance.

7. NEW ACCOUNTING STANDARDS

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities", effective for fiscal years beginning after June 15, 1999. In June 1999, the FASB issued SFAS No. 137, which deferred the effective date to fiscal years beginning after June 15, 2000. The new standard establishes accounting and reporting requirements for derivative instruments, including certain derivative instruments

embedded in other contracts, and for hedging activities. Such instruments are to be recognized on the balance sheet as either an asset or a liability measured at fair value. Changes in fair value must be recognized currently in earnings or in other comprehensive income if specific hedge criteria are met. Special accounting for qualifying hedges allows a derivative instrument's gains and losses to offset related results on the hedged item in the statement of income, to the extent effective. If a transaction is designated to receive hedge accounting, the company must establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedge and the measurement approach for determining the ineffective aspect of the hedge. At December 31, 2000, and September 30, 2001, the company held no derivative instruments that fell under the accounting rules of SFAS No. 133. Therefore, the adoption of SFAS No. 133 on January 1, 2001, had no effect on the company's consolidated results of operations or financial position.

In January 2001, the Emerging Issues Task Force (EITF), issued EITF

Issue No.00-22 "Accounting for 'Points' and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future." EITF Issue No. 00-22 provides guidance regarding timing of recognition and income statement classification of costs incurred in connection with offers of volume-based sales incentives that are provided to customers at a future date upon reaching certain volume purchase levels. This guidance requires certain volume rebate offers delivered subsequent to the related transactions in which they are earned, be recognized when incurred and reported as a reduction of revenue in the statement of operations. The effective date of EITF Issue No. 00-22 was the first quarter ending after February 15, 2001. The adoption of the issue had no impact on the company's statements of income or financial position.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations", and SFAS No. 142, "Goodwill and Other Intangible Assets", effective for fiscal years beginning after December 15, 2001, for acquisitions entered into prior to June 30, 2001, and effective immediately for acquisitions entered into after June 30, 2001. SFAS No. 141 requires the use of the purchase method of accounting for all transactions initiated after June 30, 2001. SFAS No. 142 requires that the goodwill acquired as a result of a business combination completed after June 30, 2001, should not be amortized. The company has applied the provisions of SFAS No. 141 and SFAS No. 142 to the September 2001 acquisition of Manro Performance Chemicals Limited (see Footnote 8 for acquisition information).

8. ACQUISITION

On September 13, 2001, the company acquired Manro Performance Chemicals Limited based in Stalybridge, United Kingdom. The Manro Performance Chemicals Limited manufactures surfactants for a wide range of customers, and specializes in anionic surfactants, hydrotropes and acid catalysts. This acquisition gives the company a critical mass in Europe. It brings an important market share for anionic surfactants in the United Kingdom and market share at some of the company's strategic multinational customers.

The acquisition was accounted for as a purchase in accordance with SFAS No. 141. The acquisition cost was \$24.6 million, which was \$1.2 million in excess of the fair value of Manro Performance Chemicals Limited net assets. The \$1.2 million excess acquisition cost over net assets was recorded as goodwill, which in accordance with SFAS No. 142, will not be amortized. The purchase price allocation was based on preliminary estimates of fair values of acquired net assets. Therefore, it may be revised at a later date. Fourth quarter adjustments to the actual purchase price are also anticipated. This acquisition was funded through the company's committed lines of credit. Results of operations of Manro Performance Chemicals Limited were immaterial to the company's third quarter consolidated financial results.

Presented below are the pro forma financial results prepared under the assumption that the acquisition of Manro Performance Chemicals Limited had been completed at the beginning of the year 2000. These pro forma financial results include the assumption that the acquisition price of \$24.6 million was funded through the company's committed lines of credit. Applied weighted average interest rates were 6.90 percent in the first nine months of 2000 and 5.22 percent in 2001 and 7.23 percent in the third quarter of 2000 and 4.30 percent in the third quarter of 2001.

PRO FORMA FINANCIAL RESULTS
Unaudited

(In thousands, except per share amounts)

	Three Months Ended September 30		Nine Months Ended September 30	
	2001 ----	2000 ----	2001 ----	2000 ----
Net Sales	\$ 184,233	\$ 186,359	\$ 565,305	\$ 559,775
Income Before Income Taxes	\$ 7,631	\$ 9,487	\$ 25,032	\$ 26,918
Net Income	\$ 4,663	\$ 5,835	\$ 15,295	\$ 16,555
Net Income Per Common Share:				
Basic	\$ 0.48 =====	\$ 0.61 =====	\$ 1.59 =====	\$ 1.70 =====
Diluted	\$ 0.46 =====	\$ 0.57 =====	\$ 1.51 =====	\$ 1.61 =====
Shares used to compute Earnings Per Common Share:				
Basic	9,260 =====	9,282 =====	9,255 =====	9,390 =====
Diluted	10,132 =====	10,152 =====	10,149 =====	10,282 =====

These pro forma statements represent the company's preliminary determination of adjustments associated with the purchase of Manro Performance Chemicals Limited and are based upon available information and certain assumptions that the company believes to be reasonable. Consequently, the amounts reflected in the Pro Forma Financial Results are subject to change, and the final amounts may differ.

9. RECLASSIFICATIONS

Certain amounts in the 2000 financial statements have been reclassified to conform to the 2001 presentation.

STEPAN COMPANY
Management's Discussion and Analysis of
Financial Condition and Results of Operations

The following is management's discussion and analysis of certain significant factors, which have affected the company's financial condition and results of operations during the interim period included in the accompanying condensed consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

Net cash from operations for the first three quarters of 2001 totaled \$40.6 million compared to \$32.5 million for the same period in 2000. Working capital requirements have absorbed \$3.0 million for the current year-to-date period, compared to \$12.5 million for the same period last year. Since December 31, 2000, accounts receivable and prepaid expenses have increased by \$1.5 million and \$0.4 million, respectively. Over the same period, inventories have decreased by \$1.1 million while accounts payable and accrued liabilities decreased by \$2.2 million.

Capital spending has totaled \$24.4 million, excluding the acquisition, for the nine months ended September 30, 2001, compared to \$19.2 million for the same period in 2000. For the full year 2001, capital expenditures are projected to be higher than the \$28.4 million recorded during 2000, due in part to capital expended on the implementation of an enterprise resource planning system.

On September 13, 2001, the Company announced the acquisition of Manro Performance Chemicals Limited, located in Stalybridge, UK. This acquisition was made for cash totaling \$24.6 million (including due diligence fees) and was funded through the Company's committed lines of credit. Fourth quarter adjustments to the purchase price are expected.

Consolidated debt has increased by \$16.0 million, to \$122.1 million, since last year-end, mainly due to funding for Manro Performance Chemicals Limited acquisition. As of September 30, 2001, the ratio of long-term debt to long-term debt plus shareholders' equity was 41.0 percent compared to 38.5 percent at the end of 2000.

The company maintains contractual relationships with its domestic banks that provide for revolving credit of up to \$60 million, which may be drawn upon as needed for general corporate purposes. The company also meets short-term liquidity requirements through uncommitted domestic bank lines of credit. The company's foreign subsidiaries maintain committed and uncommitted bank lines of credit in their respective countries to meet working capital requirements as well as to fund capital expenditure programs and acquisitions.

The company anticipates that cash from operations and from committed credit facilities will be sufficient to fund anticipated capital expenditures, dividends and other planned financial commitments for the foreseeable future. Any substantial acquisitions would require additional funding.

There have been no material changes in the company's market risks since December 31, 2000.

RESULTS OF OPERATIONS

 Three Months Ended September 30, 2001 and 2000

Net income for the third quarter ended September 30, 2001, decreased to \$4.5 million, or \$0.44 per share diluted, from \$6.2 million, or \$0.61 per share diluted, for the same period in 2000. Net sales decreased two percent from \$176.6 million in the third quarter of 2000 to \$173.8 million in 2001. Net sales by segment were as follows:

(Dollars in thousands)	Three Months Ended September 30		
	2001	2000	% Change
	-----	-----	-----
Net Sales:			
Surfactants	\$ 134,379	\$ 131,605	+2%
Polymers	31,906	38,541	-17%
Specialty Products	7,544	6,462	+17%
	-----	-----	
Total	\$ 173,829	\$ 176,608	-2%
	=====	=====	

Surfactants net sales increased two percent from \$131.6 million in the third quarter of 2000 to \$134.4 million in the third quarter of 2001. Foreign operations accounted for the net sales improvement, reporting a \$5.4 million, or 19 percent, rise in revenue, due to a 13 percent increase in sales volume and a five percent increase in average selling prices. European and Mexican operations contributed most of the increase with sales volume gains of 14 percent and 59 percent, respectively. Domestic operations, which accounted for 74 percent of total surfactant revenues, reported a \$2.6 million, or a three percent, decline in net sales from \$102.5 million in 2000 to \$99.9 million in 2001. The decrease was due to a six percent drop in sales volume, which more than offset a four percent rise in average selling price. Lower demand for laundry and cleaning products accounted for most of the domestic volume decline.

Surfactants gross profit declined \$2.1 million, or 10 percent, to \$17.6 million in the third quarter of 2001 from \$19.7 million in the same period last year. Domestic operations reported a \$3.0 million, or 18 percent, drop in gross profit due to declines in sales volume and average margins. The decline in average margins was mainly due to weaker sales mix. The decrease in gross profit for domestic operations was partially offset by a \$0.9 million increase in gross profit for foreign operations. Mexican and European operations contributed \$0.4 million each to the rise in profit due to higher sales volume and improved average margins.

Polymers net sales for the third quarter of 2001 were \$31.9 million, down \$6.6 million, or 17 percent, from the \$38.5 million reported in the same period of 2000. The decline was due to a 19 percent drop in sales volume, driven primarily by a slowdown in the economy. Global polyurethane polyols net sales fell 13 percent to \$18.8 million for the third quarter of 2001 from \$21.6 million for the same period in 2000. The decline was due to a 15 percent decrease in sales volume, which more than offset a rise in the average selling price. Domestic operations accounted for most of the decline due to a 17 percent drop in sales volume. European net sales fell six percent due to declines in sales volume and average selling prices. Phthalic anhydride

(PA) net sales decreased 21 percent to \$8.1 million for the third quarter of 2001 from \$10.3 million for the third quarter of 2000. A 22 percent decline in sales volume accounted for the decrease. Polyurethane systems net sales fell 26 percent to \$5.0 million for the third quarter of 2001 from \$6.7 million for the third quarter of last year. A decrease in sales volume accounted for the decline.

Polymers gross profit declined \$1.6 million, or 23 percent, from \$7.0 million in the third quarter of 2000 to \$5.4 million in the third quarter of 2001. PA's gross profit fell \$0.7 million, or 55 percent, to \$0.6 million for the third quarter of 2001 from \$1.3 million for the same period a year ago. Lower sales volume coupled with a decline in average margins accounted for the decrease in gross profit. Global polyurethane polyols gross profit dropped \$0.5 million, or 11 percent, to \$4.4 million for the third quarter of 2001 from \$4.9 million for the same period of 2000. Domestic gross profit decreased \$0.4 million due to lower sales volume, partially offset by higher average margins. European gross profit fell \$0.1 million on reduced average margins and lower sales volume. Market pressure and higher costs led to the decline in average margins. Polyurethane systems gross profit decreased 12 percent to \$1.2 million for the third quarter of 2001 from \$1.4 million a year ago. Lower sales volume, partially offset by margin improvement, led to the decline.

Specialty products reported \$7.5 million in net sales for the third quarter of 2001 compared to \$6.5 million a year ago. The rise was due to improved sales volume and higher average selling prices. Gross profit was \$3.5 million in the third quarter of 2001 compared to \$2.4 million in the third quarter of 2000. Increased sales of higher margin products accounted for the improvement.

Operating expenses for the third quarter of 2001 increased four percent from \$17.1 million in 2000 to \$17.9 million in 2001. Marketing expenses rose nine percent between quarters. Higher payroll costs and increased provision for bad debts led to the increase. Administrative expenses declined two percent between quarters. Administrative expenses included \$1.4 million in costs related to the implementation of an enterprise resource planning system offset by \$1.4 million in legal insurance recoveries. Research and development expenses increased five percent.

Interest expenses declined 13 percent between quarters, due primarily to lower overall borrowing rates.

Income from the Philippines joint venture increased to \$0.5 million in the third quarter of 2001 from \$0.2 million a year ago. The increase was due to a foreign exchange loss resulting from a devaluation of the Philippine peso in the third quarter of 2000.

Nine Months Ended September 30, 2001 and 2000

Net income for the first nine months ended September 30, 2001, was \$14.3 million, or \$1.41 per share diluted, compared to \$17.1 million, or \$1.67 per share diluted, for the same period in 2000. Net sales increased one percent to \$533.5 million in 2001 from \$529.5 million reported last year. Net sales by segment were as follows:

(Dollars in thousands)

Nine Months
Ended September 30

	2001	2000	% Change
Net Sales:			
Surfactants	\$ 415,165	\$ 405,852	+2%
Polymers	98,643	107,812	-9%
Specialty Products	19,645	15,829	+24%
Total	\$ 533,453	\$ 529,493	+1%

Surfactants net sales increased \$9.3 million, or two percent, from \$405.9 million in 2000 to \$415.2 million in 2001. Net sales for foreign surfactants operations increased 14 percent from \$90.3 million in 2000 to \$103.3 million in 2001, primarily due to higher sales volume. All foreign subsidiaries reported increased net sales. European and Colombian operations contributed most of the improvement due to higher sales volume and increased average selling prices. Domestic surfactants, which accounted for 75 percent of total surfactant revenues, reported a \$3.7 million, or one percent, decrease in revenue. A one percent decline in average selling prices coupled with a flat sales volume led to the decrease. Average selling prices declined due to product mix.

Surfactants gross profit decreased 10 percent between years from \$62.7 million in 2000 to \$56.7 million in 2001. Domestic operations reported a \$6.9 million decline in earnings, due to a drop in average margins. The decrease in average margins was mainly due to weaker sales mix and higher energy costs. Gross profit for foreign surfactants increased \$1.0 million, or eight percent, from \$11.3 million in 2000 to \$12.3 million in 2001. A 13 percent improvement in sales volume more than offset a decline in average margins.

Polymers net sales decreased \$9.2 million, or nine percent, from \$107.8 million in 2000 to \$98.6 million in 2001. Phthalic anhydride (PA) net sales dropped 23 percent to \$25.1 million in 2001 from \$32.5 million a year ago. A 29 percent decline in sales volume led to the drop in revenue and more than offset an eight percent increase in average selling prices. The higher average selling prices were attributable to increased raw material costs passed on to customers. Polyurethane systems net sales fell 13 percent to \$15.5 million for the current year from \$17.9 million a year ago. A 20 percent sales volume decline, partially offset by higher average selling prices, led to the fall in net sales. Global polyurethane polyols net sales rose one percent to \$58.1 million for the nine months in 2001 from \$57.4 million for the same period a year ago. Domestic operations accounted for the sales dollar increase. Higher average selling prices more than offset the effect of a four percent sales volume decline. European net sales decreased nine percent despite a sales volume increase of six percent. The average selling price dropped 14 percent and more than offset the impact of higher sales volume. Continued market pressures led to the drop in selling prices.

Polymers gross profit declined 11 percent from \$20.5 million in 2000 to \$18.3 million in 2001. Gross profit for PA declined 50 percent to \$2.5 million in the first nine months of 2001 from \$5.1 million a year ago. Lower sales volume and average margins accounted for the drop in earnings. Higher unit overhead costs resulting from decreased production volume led to the

the lower margins. Polyurethane systems gross profit decreased three percent due to a 20 percent drop in sales volume, which was partially offset by improved average margins. Global polyurethane polyols earnings increased \$0.7 million, or five percent, between years. Despite lower sales volume, domestic operations reported a \$1.2 million, or nine percent, increase in gross profit due to improved average margins. European gross profit fell \$0.6 million on reduced average margins. Market pressure and higher costs led to the decrease in margins.

Specialty products reported \$19.6 million in net sales for the nine months of 2001 compared to \$15.8 million for the same period of 2000. The increase was due to improved sales volume and higher average selling prices. Gross profit rose to \$7.1 million in 2001 from \$3.7 million in 2000. The increase was due to higher sales volume of higher margin products.

Operating expenses increased two percent between years. Administrative expenses rose three percent, primarily due to \$1.5 million costs associated with the implementation of an enterprise resource planning system and a \$0.9 million increase in legal expense, partially offset by \$2.0 million in legal insurance recoveries. Marketing expenses increased two percent and research and development expenses increased one percent.

Interest expenses declined 12 percent from year-to-year due to lower average debt levels coupled with lower overall borrowing rates.

Income from the Philippines equity joint venture increased to \$1.1 million in 2001 from \$0.5 million a year ago. The increase was due to a foreign exchange loss resulting from a devaluation of the Philippine peso in 2000.

OUTLOOK

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The balance of 2001 will continue to present challenges. The recent acquisition of Manro Performance Chemicals in Manchester, England, is expected to contribute to fourth quarter net income. However, the economy's slowness coupled with continued expenses related to the implementation of an enterprise resource planning system will make the company's previous earnings estimate of \$1.80 per share (diluted) difficult to achieve.

LEGAL AND ENVIRONMENTAL MATTERS

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The company is subject to extensive federal, state and local environmental laws and regulations. Although the company's environmental policies and practices are designed to ensure compliance with these laws and regulations, future developments and increasingly stringent environmental regulation could require the company to make additional unforeseen environmental expenditures. The company will continue to invest in the equipment and facilities necessary to comply with existing and future regulations. During the first nine months of 2001, company expenditures for capital projects related to the environment were \$1.0 million and should approximate \$1.5 million for the full year 2001. These projects are capitalized and typically depreciated over 10 years. Recurring costs associated with the operation and maintenance of facilities for waste

treatment and disposal and managing environmental compliance in ongoing operations at our manufacturing locations were \$5.7 million for the first nine months of 2001.

The company has been named by the government as a potentially responsible party at 16 waste disposal sites where cleanup costs have been or may be incurred under the federal Comprehensive Environmental Response, Compensation and Liability Act and similar state statutes. In addition, damages are being claimed against the company in general liability actions for alleged personal injury or property damage in the case of some disposal and plant sites. The company believes that it has made adequate provisions for the costs it may incur with respect to these sites. The company has estimated a range of possible environmental and legal losses from \$7.4 million to \$35.0 million at September 30, 2001. At September 30, 2001, the company's reserve was \$17.4 million for legal and environmental matters compared to \$16.6 million at December 31, 2000. During the first nine months of 2001, expenditures related to legal and environmental matters approximated \$1.6 million. For certain sites, estimates cannot be made of the total costs of compliance or the company's share of such costs; accordingly, the company is unable to predict the effect thereof on future results of operations. In the event of one or more adverse determinations in any annual or interim period, the impact on results of operations for those periods could be material. However, based upon the company's present belief as to its relative involvement at these sites, other viable entities' responsibilities for cleanup and the extended period over which any costs would be incurred, the company believes that these matters will not have a material effect on the company's financial position. Certain of these matters are discussed in Item 3, Legal Proceedings, in the 2000 Form 10-K Annual Report, and in other filings of the company with the Securities and Exchange Commission, which are available upon request from the company. See Footnote 3, Contingencies, in Notes to Condensed Consolidated Financial Statements, and Item 1, Legal Proceedings, in this Form 10-Q for a summary of the environmental proceedings related to the company's Maywood, New Jersey, and Ewan and D'Imperio environmental sites.

NEW ACCOUNTING STANDARDS

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In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001 for acquisitions entered into prior to June 30, 2001 and effective immediately for acquisitions entered into after June 30, 2001. The SFAS No. 142 addresses financial accounting and reporting for goodwill and other intangible assets subsequent to their acquisition. The new standard establishes that goodwill is no longer to be amortized. Instead, goodwill will be tested for impairment by applying a fair-value-based test each year, and more frequently, if circumstances indicate a possible impairment. If the carrying amount exceeds the implied fair value of that goodwill, an impairment loss shall be recognized. Equity-method goodwill is not, however, subject to the new impairment rules; the impairment guidance in existing rules for equity-method investments continues to apply. The standard also establishes new accounting guidelines for intangible assets that are determined to have an indefinite useful life. These assets are no longer subject to amortization, but shall be tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. If the carrying amount of an intangible asset exceeds the fair value, an impairment loss shall be

recognized in an amount equal to that excess. Any impairment as a result of initial adoption of SFAS No. 142 will be recorded in the cumulative effect of changes in accounting principles. The company has applied the provisions of SFAS No. 141 and SFAS No. 142 to the September 13, 2001, acquisition of Manro Performance Chemicals in Manchester, England (See Footnote 8, Acquisitions, in Notes to Condensed Consolidated Financial Statements). The provisions of SFAS No. 141 and SFAS No. 142 will be applied to acquisitions made prior to June 30, 2001, starting on January 1, 2002. The company estimates that approximately \$0.4 million of goodwill amortization will stop being recorded. Presently, it is unknown whether any intangible asset impairments will be recognized or whether the amortization of any identifiable intangible assets will be reduced. The company is currently assessing such matters.

In April 2001, the Emerging Issues Task Force (EITF) issued EITF Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products". EITF Issue No. 00-25 provides guidance regarding the reporting of consideration given by a vendor to a reseller of the vendor's products. This Issue requires certain considerations from vendor to a reseller of the vendor's products be considered: (a) as a reduction of the selling prices of the vendor's products and, therefore, be recorded as a reduction of revenue when recognized in the vendor's income statement, or (b) as a cost incurred by the vendor for assets or services received from the reseller and, therefore, be recorded as a cost or an expense when recognized in the vendor's income statement. EITF Issue No. 00-25 is effective for fiscal years beginning after December 15, 2001. The company's accounting policies are currently consistent with the guidance provided in this EITF. Therefore, adoption of this standard is not expected to have an impact on the company's statements of income or financial position.

OTHER

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Except for the historical information contained herein, the matters discussed in this document are forward looking statements that involve risks and uncertainties. The results achieved this quarter are not necessarily an indication of future prospects for the company. Actual results in future quarters may differ materially. Potential risks and uncertainties include, among others, fluctuations in the volume and timing of product orders, changes in demand for the company's products, changes in technology, continued competitive pressures in the marketplace, outcome of environmental contingencies, availability of raw materials, foreign currency fluctuations and the general economic conditions.

Item 1 - Legal Proceedings

As reported previously, the company's site in Maywood, New Jersey and property formerly owned by the company adjacent to its current site, were listed on the National Priorities List in September 1993 pursuant to the provisions of the Comprehensive Environmental Response Compensation and Liabilities Act (CERCLA) because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between the United States Environmental Protection Agency (USEPA) and the company for property formerly owned by the company, and the issuance of an order by USEPA to the company for property currently owned by the company, the company completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. In addition, the company submitted an FS Addendum to USEPA in October 2000. The company received comments from USEPA on the FS Addendum in June 2001, and submitted its response to these comments in September 2001. The company has been awaiting the issuance of a Record of Decision (ROD) from USEPA, which would relate to both the currently owned and formerly owned company property and would recommend the type of remediation required on each property. The final ROD will be issued sometime after the public comment period.

In 1985, the company entered into a Cooperative Agreement with the United States of America represented by the Department of Energy (Agreement). Pursuant to this Agreement, the Department of Energy (DOE) took title to radiological contaminated materials and was to remediate, at its expense, all radiological waste on the company's property in Maywood, New Jersey. The Maywood property (and portions of the surrounding area) were remediated by the DOE under the Formerly Utilized Sites Remedial Action Program, a federal program under which the U.S. Government undertook to remediate properties which were used to process radiological material for the U.S. Government. In 1997, responsibility for this clean-up was transferred to the United States Army Corps of Engineers (USACE). On January 29, 1999, the company received a copy of a USACE Report to Congress dated January 1998 in which the USACE expressed their intention to evaluate, with the USEPA, whether the company and/or other parties might be responsible for cost recovery or contribution claims related to the Maywood site. Subsequent to the issuance of that report, the USACE advised the company that it had requested legal advice from the Department of Justice as to the impact of the Agreement.

By letter dated July 28, 2000, the Department of Justice advised the company that the USACE and USEPA had referred to the Justice Department claims against the company for response costs incurred or to be incurred by the USACE, USEPA and the DOE in connection with the Maywood site and the Justice Department stated that the United States is entitled to recovery of its response costs from the company under CERCLA. The letter referred to both radiological and non-radiological hazardous waste at the Maywood site and stated that the United States has incurred unreimbursed response costs to date of \$138 million. Costs associated with radiological waste at the Maywood site, which the company believes represent all but a small portion of the amount referred to in the Justice Department letter, could be expected to aggregate substantially in excess of that amount. In the letter, the Justice Department invited the company to discuss

settlement of the matter in order to avoid the need for litigation. The company believes that its liability, if any, for such costs has been resolved by the aforesaid Agreement. Despite the fact that the company continues to believe that it has no liability to the United States for such costs, discussions with the Justice Department are currently ongoing to attempt to resolve this matter.

The company believes it has adequate reserves for claims associated with the Maywood site. However, depending on the results of the ongoing discussions regarding the Maywood site, the final cost of the remediation could differ from the current estimates.

As reported previously, the company has been named as a potentially responsible party (PRP) in the case USEPA v. Jerome Lightman (92 CV 4710 D. N. J.), which involves the Ewan and D'Imperio Superfund Sites, located in New Jersey. Trial on the issue of the company's liability at these sites was completed in March 2000. The company is awaiting a decision from the court. If the company is found liable at either site, a second trial as to the company's allocated share of clean-up costs at these sites will likely be held in 2002. The company believes it has adequate defenses to the issue of liability. In the event of an unfavorable outcome related to the issue of liability, the company believes it has adequate reserves. On a related matter, the company has filed an appeal to the United States Third Circuit Court of Appeals objecting to the lodging of a partial consent decree in favor of the United States Government in this action. Under the partial consent decree, the government recovered past costs at the site from all PRPs including the company. The company paid its assessed share but by objecting to the partial consent decree, the company is seeking to recover back the sums it paid.

Regarding the D'Imperio Superfund Site, USEPA has indicated it will seek penalty claims against the company based on the company's alleged noncompliance with the modified Unilateral Administrative Order. The company is currently negotiating with USEPA to settle its proposed penalty against the company. In addition, the company also received notice from the New Jersey Department of Environmental Protection (NJDEP) dated March 21, 2001, that NJDEP has indicated it will pursue cost recovery against the alleged responsible parties, including the company. The NJDEP's claims include costs related to remediation of the D'Imperio Superfund Site in the amount of \$434,405.53 and alleged natural resource damages in the amount of \$529,584.00 (as of November 3, 2000). The NJDEP has proposed settling such claims, with the company being responsible for a portion of these costs. The company is currently investigating its options with respect to both of these potential actions but does not believe that such settlements, if any, will have a material impact on the financial condition of the company.

As reported previously, the company received a Section 104(e) Request for Information from USEPA dated March 21, 2000, regarding the Lightman Drum Company Site located in Winslow Township, New Jersey. The company responded to this request on May 18, 2000. In addition, the company received a Notice of Potential Liability and Request to Perform RI/FS dated June 30, 2000, from USEPA. The company has decided that it will participate in the performance of the RI/FS. However, based on the current information known regarding this site, the company is unable to predict what its liability, if any, will be for this site.

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.

STEPAN COMPANY

/s/ Walter J. Klein

Walter J. Klein
Vice President - Finance
Principal Financial and Accounting Officer

Date: November 12, 2001