QUAKER CHEMICAL CORP
Form 10-Q
October 26, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from______ to______

Commission file number 001-12019

QUAKER CHEMICAL CORPORATION

(Exact name of Registrant as specified in its charter)

Pennsylvania	**23-0993790**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

One Quaker Park, 901 E. Hector Street, Conshohocken, Pennsylvania	**19428 – 2380**

(Address of principal executive offices) **(Zip Code)**

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

Not Applicable

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

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 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 [X] 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 [X]		Accelerated filer [ ]	
	Non-accelerated filer [ ] (Do not check if smaller reporting company)		Smaller reporting company [ ]	

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

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

Number of Shares of Common Stock	
Outstanding on September 30, 2016	**13,257,066**

QUAKER CHEMICAL CORPORATION AND CONSOLIDATED SUBSIDIARIES

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited).

Quaker Chemical Corporation

Condensed Consolidated Statements of Income

(Dollars in thousands, except per share data)

	Unaudited			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	$ 190,428	$ 189,224	$ 555,420	$ 554,280
Cost of goods sold	119,649	117,895	345,531	346,006
Gross profit	70,779	71,329	209,889	208,274
Selling, general and administrative expenses	49,440	52,601	147,223	150,237
Operating income	21,339	18,728	62,666	58,037
Other income (expense), net	514	185	1,491	(97)
Interest expense	(758)	(697)	(2,226)	(1,891)
Interest income	551	422	1,444	1,117
Income before taxes and equity in net income of associated companies	21,646	18,638	63,375	57,166
Taxes on income before equity in net income of associated companies	6,121	4,541	19,664	15,624
Income before equity in net income of associated companies	15,525	14,097	43,711	41,542
Equity in net income (loss) of associated companies	826	738	1,389	(688)
Net income	16,351	14,835	45,100	40,854
Less: Net income attributable to noncontrolling interest	343	464	1,131	1,067
Net income attributable to Quaker Chemical Corporation	$ 16,008	$ 14,371	$ 43,969	$ 39,787
Per share data:				
Net income attributable to Quaker Chemical Corporation				
Common Shareholders – basic	$ 1.21	$ 1.08	$ 3.32	$ 2.99

Net income attributable to Quaker Chemical Corporation								
Common Shareholders – diluted	$	1.21	$	1.08	$	3.32	$	2.98
Dividends declared	$	0.345	$	0.320	$	1.010	$	0.940

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

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Quaker Chemical Corporation

Condensed Consolidated Statements of Comprehensive Income

(Dollars in thousands)

	Unaudited			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$ 16,351	$ 14,835	$ 45,100	$ 40,854
Other comprehensive (loss) income, net of tax				
Currency translation adjustments	(715)	(11,380)	(1,074)	(19,995)
Defined benefit retirement plans	460	706	1,641	3,133
Unrealized gain (loss) on available-for-sale securities	195	(687)	808	(958)
Other comprehensive (loss) income	(60)	(11,361)	1,375	(17,820)
Comprehensive income	16,291	3,474	46,475	23,034
Less: Comprehensive income attributable to noncontrolling interest	(520)	(97)	(1,217)	(606)
Comprehensive income attributable to Quaker Chemical Corporation	$ 15,771	$ 3,377	$ 45,258	$ 22,428

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

Quaker Chemical Corporation

Condensed Consolidated Balance Sheets

(Dollars in thousands, except par value and share amounts)

	Unaudited September 30, 2016	December 31, 2015
ASSETS		
Current assets		
Cash and cash equivalents	$ 99,024	$ 81,053
Accounts receivable, net	193,805	188,297
Inventories		
Raw materials and supplies	38,427	36,876
Work-in-process and finished goods	41,233	38,223
Prepaid expenses and other current assets	21,624	21,404
Total current assets	394,113	365,853
Property, plant and equipment, at cost	236,874	231,164
Less accumulated depreciation	(153,009)	(143,545)
Net property, plant and equipment	83,865	87,619
Goodwill	79,324	79,111
Other intangible assets, net	69,789	73,287
Investments in associated companies	23,448	20,354
Non-current deferred tax assets	17,621	23,468
Other assets	29,311	32,218
Total assets	$ 697,471	$ 681,910
LIABILITIES AND EQUITY		
Current liabilities		
Short-term borrowings and current portion of long-term debt	$ 730	$ 662
Accounts and other payables	78,579	71,543
Accrued compensation	17,687	19,166
Accrued restructuring	2,233	6,303
Other current liabilities	25,532	26,881
Total current liabilities	124,761	124,555
Long-term debt	75,607	81,439
Non-current deferred tax liabilities	11,776	11,400
Other non-current liabilities	71,629	83,273
Total liabilities	283,773	300,667
Commitments and contingencies (Note 15)		
Equity		
Common stock $1 par value; authorized 30,000,000 shares; issued and outstanding 2016 – 13,257,066 shares; 2015 – 13,288,113 shares	13,257	13,288

Capital in excess of par value		111,453		106,333
Retained earnings		351,560		326,740
Accumulated other comprehensive loss		(72,027)		(73,316)
Total Quaker shareholders’ equity		404,243		373,045
Noncontrolling interest		9,455		8,198
Total equity		413,698		381,243
Total liabilities and equity	$	697,471	$	681,910

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

Quaker Chemical Corporation

Condensed Consolidated Statements of Cash Flows

(Dollars in thousands)

	Unaudited For the Nine Months Ended September 30, 2016	Unaudited For the Nine Months Ended September 30, 2015
Cash flows from operating activities		
Net income	$ 45,100	$ 40,854
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,469	9,229
Amortization	5,319	4,998
Equity in undistributed (earnings) losses of associated companies, net of dividends	(1,314)	1,362
Deferred compensation and other, net	3,083	(551)
Stock-based compensation	4,942	4,500
Loss (gain) on disposal of property, plant, equipment and other assets	44	(95)
Insurance settlement realized	(809)	(549)
Pension and other postretirement benefits	(3,373)	2,204
(Decrease) increase in cash from changes in current assets and current liabilities, net of acquisitions:		
Accounts receivable	(5,926)	(4,039)
Inventories	(3,741)	(1,028)
Prepaid expenses and other current assets	(868)	(3,545)
Accounts payable and accrued liabilities	5,245	(2,521)
Change in restructuring liabilities	(4,194)	—
Net cash provided by operating activities	52,977	50,819
Cash flows from investing activities		
Investments in property, plant and equipment	(6,311)	(6,115)
Payments related to acquisitions, net of cash acquired	(3,244)	(23,990)
Proceeds from disposition of assets	54	130
Insurance settlement interest earned	24	28
Change in restricted cash, net	785	521
Net cash used in investing activities	(8,692)	(29,426)
Cash flows from financing activities		
Proceeds from long-term debt	—	30,668
Repayments of long-term debt	(6,842)	(304)
Dividends paid	(13,052)	(12,257)
Stock options exercised, other	64	947
Payments for repurchase of common stock	(5,859)	(4,989)
Excess tax benefit related to stock option exercises	167	400

Net cash (used in) provided by financing activities		(25,522)		14,465
Effect of foreign exchange rate changes on cash		(792)		(4,434)
Net increase in cash and cash equivalents		17,971		31,424
Cash and cash equivalents at beginning of period		81,053		64,731
Cash and cash equivalents at end of period	$	99,024	$	96,155

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

Quaker Chemical Corporation

Notes to Condensed Consolidated Financial Statements

(Dollars in thousands, except share and per share amounts, unless otherwise stated)

(Unaudited)

Note 1 – Condensed Financial Information

The condensed consolidated financial statements included herein are unaudited and have been prepared in accordance with generally accepted accounting principles in the United States ("U.S. GAAP") for interim financial reporting and the United States Securities and Exchange Commission ("SEC") regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the financial statements reflect all adjustments (consisting only of normal recurring adjustments, except certain material adjustments, as discussed below) which are necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods. The results for the nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company's Annual Report filed on Form 10-K for the year ended December 31, 2015. During the first quarter of 2016, the Company revised its Condensed Consolidated Balance Sheet for December 31, 2015, reducing non-current deferred tax assets and non-current deferred tax liabilities by $3.6 million each, to correct for offsetting deferred tax balances within related taxing jurisdictions. The Company considers such revision to be immaterial and the revision had no impact on reported equity, net income or net cash provided by operating activities.

Venezuela's economy has been considered hyper inflationary under U.S. GAAP since 2010, at which time the Company's Venezuela equity affiliate, Kelko Quaker Chemical, S.A. ("Kelko Venezuela"), changed its functional currency from the bolivar fuerte ("BsF") to the U.S. dollar. Accordingly, all gains and losses resulting from the remeasurement of Kelko Venezuela's monetary assets and liabilities to published exchange rates are required to be recorded directly to the Condensed Consolidated Statement of Income. As of December 31, 2014, there were three legally available exchange rates in Venezuela, the CADIVI (or the official rate, 6.3 BsF per U.S. dollar), the SICAD I and the SICAD II. Kelko Venezuela had access to the CADIVI for imported goods, had not been invited to participate in any SICAD I auctions and had limited access to the SICAD II mechanism. Accordingly, the Company measured its equity investment and other related assets with Kelko Venezuela at the CADIVI exchange rate at December 31, 2014. During the first quarter of 2015, the Venezuela government announced changes to its foreign exchange controls. There continued to be three exchange mechanisms, however, they consisted of the CADIVI, a combined SICAD I and SICAD II auction mechanism (the "SICAD") and a newly created, marginal currency system (the "SIMADI"). In light of the first quarter of 2015 changes to Venezuela's foreign exchange controls and the on-going economic challenges in Venezuela, the Company re-assessed Kelko Venezuela's access to U.S. dollars, the impact on the operations of Kelko Venezuela, and the impact on the Company's equity investment and other related assets, which resulted in revaluing its equity investment in Kelko Venezuela and other related assets to the SIMADI exchange rate of approximately 193 BsF per U.S. dollar as of March 31, 2015. This resulted in a charge of $2.8 million, or $0.21 per diluted share, recorded in the first quarter of 2015. As of December 31, 2015, the Company's equity investment in Kelko Venezuela was $0.2 million, valued at the SIMADI exchange rate, which was approximately 198 BsF per U.S. dollar.

During the first quarter of 2016, the Venezuela government announced further changes to its foreign exchange controls, including eliminating the CADIVI, SICAD and SIMADI exchange rate mechanisms and replacing them with a new dual foreign exchange rate system, which consists of a protected "DIPRO" exchange rate, with a rate fixed at 10

Bsf per U.S. dollar and, also, a floating supplementary market exchange rate known as the "DICOM." The DIPRO rate is only available for payment of certain imports of essential goods in the food and health sectors while the DICOM governs all other transactions not covered by the DIPRO. In light of these changes to the foreign exchange controls during the first quarter of 2016, the Company again re-assessed Kelko Venezuela's access to U.S. dollars, the impact on the operations of Kelko Venezuela, and the impact on the Company's equity investment and other related assets. The Company did not believe it had access to the DIPRO and, therefore, believed the DICOM to be the exchange rate system available to Kelko Venezuela. As of March 31, 2016, the published rate for the DICOM was approximately 273 BsF per U.S. dollar, which resulted in a currency conversion charge of $0.1 million, or $0.01 per diluted share in the first quarter of 2016. As of September 30, 2016, the Company's equity investment in Kelko Venezuela was $0.1 million, valued at the DICOM exchange rate of approximately 658 BsF per U.S. dollar.

As part of the Company's chemical management services, certain third-party product sales to customers are managed by the Company. Where the Company acts as a principal, revenue is recognized on a gross reporting basis at the selling price negotiated with customers. Where the Company acts as an agent, such revenue is recorded using net reporting of service revenue, at the amount of the administrative fee earned by the Company for ordering the goods. Third-party products transferred under arrangements resulting in net reporting totaled $10.7 million and $32.8 million for the three and nine months ended September 30, 2016, respectively. Comparatively, third-party products transferred under arrangements resulting in net reporting totaled $12.1 million and $36.2 million for the three and nine months ended September 30, 2015, respectively.

Quaker Chemical Corporation

Notes to Condensed Consolidated Financial Statements - Continued

(Dollars in thousands, except share and per share amounts, unless otherwise stated)

(Unaudited)

Note 2 – Recently Issued Accounting Standards

The Financial Accounting Standards Board ("FASB") issued an accounting standard update in August 2016 to standardize how certain transactions are classified in the statement of cash flows. Specific transactions covered by the accounting standard update include debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate and bank owned life insurance policies, distributions received from equity method investments and beneficial interest in securitization transactions. The guidance within this accounting standard update is effective for annual and interim periods beginning after December 15, 2017. Early adoption is permitted, provided that all of the amendments are adopted in the same period. The guidance requires application using a retrospective transition method. The Company has not early adopted and is currently evaluating the potential impact of this guidance and an appropriate implementation strategy.

The FASB issued an accounting standard update in March 2016 involving several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, use of a forfeiture rate, and classification on the statement of cash flows. The guidance within this accounting standard update is effective for annual and interim periods beginning after December 15, 2016. Early adoption is permitted, however, if early adoption is elected, all amendments in the update must be adopted in the same period. When adopted, application of the guidance will vary based on each aspect of the update, including adoption under retrospective, modified retrospective or prospective approaches. The Company has not early adopted and is currently evaluating the potential impact of this guidance and an appropriate implementation strategy.

The FASB issued an accounting standard update in February 2016 regarding the accounting and disclosure for leases. Specifically, the update will require entities that lease assets to recognize the assets and liabilities for the rights and obligations created by those leases on the balance sheet, in most instances. The guidance within this accounting standard update is effective for annual and interim periods beginning after December 15, 2018, and should be applied on a modified retrospective basis for the reporting periods presented. Early adoption is permitted. The Company has not early adopted and is currently evaluating the potential impact of this guidance and an appropriate implementation strategy.

The FASB issued an accounting standard update in November 2015 regarding the classification of deferred taxes on the balance sheet. The update requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. The update does not change the existing requirement that only permits offsetting within a jurisdiction. The guidance within this accounting standard update is effective for annual and interim periods beginning after December 15, 2016, and may be applied either prospectively, for all deferred tax assets and liabilities, or retrospectively. Early adoption is permitted. The Company has not early adopted and is considering an appropriate implementation strategy. Adoption of the guidance will not have an impact on the Company’s earnings or cash flow but will result in a balance sheet reclassification between current and long-term assets and liabilities.

The FASB issued an accounting standard update in July 2015 regarding simplifying the measurement of inventory. The guidance is applicable for entities that measure inventory using the FIFO or average cost methods. Specifically, the update requires that inventory be measured at lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The amendments in this update are effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. This guidance should be applied prospectively with early adoption permitted. During the first quarter of 2016, the Company elected to early adopt this guidance without a material impact.

The FASB issued an accounting standard update in May 2015 regarding the required disclosures for entities that elect to measure the fair value of certain investments using the net asset value per share (or its equivalent) practical expedient in accordance with the fair value measurement authoritative guidance. The update removes the requirement to categorize within the fair value hierarchy, and also limits the requirement to make certain other disclosures, for all such investments. The amendments in this update are effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, and should be applied on a retrospective basis for the periods presented. Early adoption was permitted. During the first quarter of 2016, the Company adopted this guidance without a material impact.

The FASB issued an accounting standard update in April 2015 regarding the presentation of debt issuance costs on the balance sheet. The update requires capitalized debt issuance costs be presented on the balance sheet as a reduction to debt, rather than recorded as a separate asset. The amendments in this update are effective for annual and interim periods beginning after December 15, 2015 and should be applied on a retrospective basis for the periods presented. Early adoption was permitted. Also, in June 2015, the SEC staff announced that the guidance within this accounting standard update was not applicable to revolving debt arrangements or credit facilities. During the first quarter of 2016, the Company adopted this guidance without a material impact.

Quaker Chemical Corporation

Notes to Condensed Consolidated Financial Statements - Continued

(Dollars in thousands, except share and per share amounts, unless otherwise stated)

(Unaudited)

The FASB issued an accounting standard update in May 2014 regarding the accounting for and disclosure of revenue recognition. Specifically, the update outlined a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers, which will be common to both U.S. GAAP and International Financial Reporting Standards ("IFRS"). The guidance was effective for annual and interim periods beginning after December 15, 2016, and allowed for full retrospective adoption of prior period data or a modified retrospective adoption. Early adoption was not permitted. In August 2015, the FASB issued an accounting standard update to delay the effective date of the new revenue standard by one year, or, in other words, to be effective for annual and interim periods beginning after December 15, 2017. Entities will be permitted to adopt the new revenue standard early but not before the original effective date. In March 2016, the FASB issued an accounting standard update to clarify the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued an accounting standard update to clarify the identification of performance obligations and the licensing implementation guidance, while retaining the related principles for those areas. In May 2016, the FASB issued an accounting standard update to clarify guidance in certain areas and add some practical expedients to the guidance. The amendments in these 2016 updates do not change the core principle of the previously issued guidance in May 2014. As of September 30, 2016, the Company has begun its preliminary assessment for the implementation of this new revenue recognition guidance. Given this assessment is in its early stages, the Company is still assessing materiality and evaluating the potential impact of this guidance and an appropriate implementation strategy.

Note 3 – Restructuring and Related Activities

In response to continued weak economic conditions and market declines in many regions, Quaker's management approved a global restructuring plan (the "2015 Program") in the fourth quarter of 2015 to reduce its operating costs. The 2015 Program includes the re-organization of certain commercial functions, the consolidation of certain distribution, laboratory and administrative offices, and other related severance charges. In addition to these actions, the Company made a decision to make available-for-sale certain technology of one of its existing businesses, which also resulted in employee severance and $0.3 million of intangible assets being reclassified to other current assets as of December 31, 2015. During the nine months ended September 30, 2016, there has been no further update and the intangible assets continue to be available for sale and included in other current assets.

The 2015 Program includes provisions for the reduction of total headcount of approximately 65 employees globally. Employee separation benefits varied depending on local regulations within certain foreign countries and included severance and other benefits. The Company still expects to substantially complete all of the initiatives under the 2015 Program in 2016 and expects settlement of these charges to occur primarily in 2016 as well. The Company has not incurred additional restructuring expenses in connection with the 2015 Program during the first nine months of 2016, and at this time the Company does not expect material additional restructuring expenses beyond customary and routine adjustments to initial estimates for employee separation benefits.

Restructuring activity recognized in each reportable operating segment in connection with the 2015 Program is as follows:

	North	South

	America	EMEA	Asia/Pacific	America	Total
Accrued restructuring as of December 31, 2015	$ 1,867	$ 4,265	$ 135	$ 36	$ 6,303
Cash payments	(1,318)	(2,700)	(137)	(39)	(4,194)
Currency translation adjustments	—	119	2	3	124
Accrued restructuring as of September 30, 2016	$ 549	$ 1,684	$ —	$ —	$ 2,233

Note 4 – Business Segments

The Company's reportable operating segments are organized by geography as follows: (i) North America, (ii) Europe, Middle East and Africa ("EMEA"), (iii) Asia/Pacific and (iv) South America. Operating earnings, excluding indirect operating expenses, for the Company's reportable operating segments is comprised of revenues less costs of goods sold and selling, general and administrative expenses ("SG&A") directly related to the respective region's product sales. The indirect operating expenses consist of SG&A not directly attributable to the product sales of each respective reportable operating segment. Other items not specifically identified with the Company's reportable operating segments include interest expense, interest income, license fees from non-consolidated affiliates, amortization expense and other income (expense).

Quaker Chemical Corporation

Notes to Condensed Consolidated Financial Statements - Continued

(Dollars in thousands, except share and per share amounts, unless otherwise stated)

(Unaudited)

The following table presents information about the performance of the Company's reportable operating segments for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Net sales				
North America	$ 86,126	$ 90,010	$ 251,586	$ 258,977
EMEA	49,825	45,989	150,582	130,345
Asia/Pacific	45,892	46,067	130,555	138,913
South America	8,585	7,158	22,697	26,045
Total net sales	$ 190,428	$ 189,224	$ 555,420	$ 554,280
Operating earnings, excluding indirect operating expenses				
North America	$ 20,324	$ 21,893	$ 59,078	$ 59,938
EMEA	8,295	7,106	25,251	20,538
Asia/Pacific	11,737	11,250	33,865	33,874
South America	680	261	703	2,270
Total operating earnings, excluding indirect operating expenses	41,036	40,510	118,897	116,620
Indirect operating expenses	(17,967)	(20,031)	(50,912)	(53,585)
Amortization expense	(1,730)	(1,751)	(5,319)	(4,998)
Consolidated operating income	21,339	18,728	62,666	58,037
Other income (expense), net	514	185	1,491	(97)
Interest expense	(758)	(697)	(2,226)	(1,891)
Interest income	551	422	1,444	1,117
Consolidated income before taxes and equity in net income of associated companies	$ 21,646	$ 18,638	$ 63,375	$ 57,166

Inter-segment revenues for the three and nine months ended September 30, 2016 were $2.5 million and $6.3 million for North America, $5.3 million and $13.2 million for EMEA, $0.1 million and $0.5 million for Asia/Pacific and $0 and less than $0.1 million for South America, respectively. Inter-segment revenues for the three and nine months ended September 30, 2015 were $2.3 million and $6.9 million for North America, $5.2 million and $14.6 million for EMEA, $0.3 million and $0.5 million for Asia/Pacific and $0 and less than $0.1 million for South America, respectively. However, all inter-segment transactions have been eliminated from each reportable operating segment's net sales and earnings for all periods presented above.

Note 5 – Stock-Based Compensation

The Company recognized the following stock-based compensation expense in SG&A in its Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Stock options	$ 215	$ 164	$ 632	$ 548
Nonvested stock awards and restricted stock units	773	668	2,366	2,179
Employee stock purchase plan	21	19	64	56
Non-elective and elective 401(k) matching contribution in stock	473	449	1,749	1,624
Director stock ownership plan	37	31	131	93
Total stock-based compensation expense	$ 1,519	$ 1,331	$ 4,942	$ 4,500

The Company's estimated taxes payable as of September 30, 2016 and 2015, respectively, were sufficient to fully recognize $0.2 million and $0.4 million of excess tax benefits related to stock option exercises as cash inflows from financing activities in its Condensed Consolidated Statements of Cash Flows, for the nine months ended September 30, 2016 and 2015, respectively.

Quaker Chemical Corporation

Notes to Condensed Consolidated Financial Statements - Continued

(Dollars in thousands, except share and per share amounts, unless otherwise stated)

(Unaudited)

During the first quarter of 2016, the Company granted stock options under its LTIP plan that are subject only to time vesting over a three-year period. For the purposes of determining the fair value of stock option awards, the Company uses the Black-Scholes option pricing model and the assumptions set forth in the table below:

	2016
Number of options granted	67,444
Dividend yield	1.49%
Expected volatility	28.39%
Risk-free interest rate	1.08%
Expected term (years)	4.0

The fair value of these options is amortized on a straight-line basis over the vesting period. As of September 30, 2016, unrecognized compensation expense related to options granted was $1.3 million, to be recognized over a weighted average remaining period of 2.0 years. There were no stock options granted in the second or third quarters of 2016.

During the first nine months of 2016, the Company granted 28,471 nonvested restricted shares and 2,041 nonvested restricted stock units under its LTIP plan that are subject only to time vesting, generally over a three-year period. The fair value of these awards is based on the trading price of the Company's common stock on the date of grant. The Company adjusts the grant date fair value of these awards for expected forfeitures based on historical experience. As of September 30, 2016, unrecognized compensation expense related to the nonvested shares was $3.4 million, to be recognized over a weighted average remaining period of 1.6 years, and unrecognized compensation expense related to nonvested restricted stock units was $0.2 million, to be recognized over a weighted average remaining period of 1.9 years.

Note 6 – Pension and Other Postretirement Benefits

The components of net periodic benefit cost for the three and nine months ended September 30, 2016 and 2015 are as follows:

	Three Months Ended September 30,				**Nine Months Ended September 30,**			
	Pension Benefits		**Other Postretirement Benefits**		**Pension Benefits**		**Other Postretirement Benefits**	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
Service cost	$ 672	$ 763	$ —	$ 1	$ 2,025	$ 2,297	$ 8	$ 12
Interest cost	1,111	1,256	28	47	3,344	3,772	106	146
Expected return on plan assets	(1,329)	(1,367)	—	—	(4,027)	(4,165)	—	—
Actuarial loss (gain) amortization	769	862	(30)	12	2,389	2,620	—	64
	(25)	(25)	—	—	(76)	(76)	—	—

Prior service cost amortization								
Net periodic benefit cost	$ 1,198	$ 1,489	$ (2)	$ 60	$ 3,655	$ 4,448	$ 114	$ 222

As of December 31, 2015, the Company elected to use a split discount rate (spot-rate approach) for the U.S. plans and certain foreign plans, which includes the method used to estimate the service and interest components of net periodic benefit cost for pension and other postretirement benefits beginning in the first quarter of 2016. This change resulted in a decrease in the service and interest components for pension cost in the three and nine months ended September 30, 2016 compared to the three and nine months ended September 30, 2015. Historically, the Company estimated service and interest cost components utilizing a single weighted-average discount rate derived from a specific yield curve used to measure the benefit obligation at the beginning of the period. Under the spot-rate approach, service and interest cost components have been estimated based on the application of the spot rates on a given yield curve at each future year to each plan's projected cash flows to measure the benefit obligation at the beginning of the period. The Company made this change to provide a more precise measurement of service and interest costs by improving the correlation between projected benefit cash flows and the corresponding spot yield curve rates. This change has been accounted for as a change in accounting estimate and, accordingly, accounted for prospectively.

Employer Contributions

The Company previously disclosed in its financial statements for the year ended December 31, 2015, that it expected to make minimum cash contributions of $7.5 million to its pension plans and $0.5 million to its other postretirement benefit plans in 2016. As of September 30, 2016, $6.6 million and $0.4 million of contributions have been made to the Company's pension plans and its postretirement benefit plans, respectively.

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Notes to Condensed Consolidated Financial Statements - Continued

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Note 7 – Other Income (Expense), Net

The components of other income (expense), net for the three and nine months ended September 30, 2016 and 2015 are as follows:

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2016	Nine Months Ended September 30, 2015
Income from third party license fees	$ 264	$ 161	$ 713	$ 619
Foreign exchange gains (losses), net	149	(79)	463	(978)
Gain on fixed asset disposals, net	3	21	7	76
Non-income tax refunds and other related credits	72	72	133	141
Other non-operating income	54	53	265	179
Other non-operating expense	(28)	(43)	(90)	(134)
Total other income (expense), net	$ 514	$ 185	$ 1,491	$ (97)

Note 8 – Income Taxes and Uncertain Income Tax Positions

The Company's effective tax rate for the nine months ended September 30, 2016 was 31.0% compared to 27.3% for the nine months ended September 30, 2015. The increase in the effective tax rate was primarily due to the Company recording earnings in one of its subsidiaries at a statutory tax rate of 25% during the nine months ended September 30, 2016, while it awaits recertification of a concessionary 15% tax rate, which was available to the Company during the nine months ended September 30, 2015.

As of September 30, 2016, the Company's cumulative liability for gross unrecognized tax benefits was $7.1 million. As of December 31, 2015, the Company's cumulative liability for gross unrecognized tax benefits was $11.0 million. In both the nine months ended September 30, 2016 and 2015, the Company recognized a decrease of $1.5 million in its cumulative liability for gross unrecognized tax benefits due to the expiration of the applicable statutes of limitations for certain tax years. During the nine months ended September 30, 2016, the Company recognized a decrease of $3.6 million in its cumulative liability for gross unrecognized tax benefits due to settlements with tax authorities. There were no similar settlements during the nine months ended September 30, 2015.

The Company continues to recognize interest and penalties associated with uncertain tax positions as a component of taxes on income before equity in net income of associated companies in its Condensed Consolidated Statements of Income. The Company recognized ($0.7) million and ($0.6) million for interest and ($0.1) million and $0.2 million for penalties in its Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2016, respectively. The Company recognized ($0.1) million and ($0.2) million for interest and less than ($0.1) million and $0.2 million for penalties in its Condensed Consolidated Statements of Income during the three and nine months ended September 30, 2015, respectively. As of September 30, 2016, the Company had accrued $0.9 million for cumulative interest and $2.1 million for cumulative penalties in its Condensed Consolidated Balance Sheets, compared to $1.5 million for cumulative interest and $1.9 million for cumulative penalties accrued at December 31, 2015.

The Company estimates that during the year ending December 31, 2016 it will reduce its cumulative liability for gross unrecognized tax benefits by approximately $2.0 million due to the expiration of the statute of limitations with regard to certain tax positions. This estimated reduction in the cumulative liability for unrecognized tax benefits does not consider any increase in liability for unrecognized tax benefits with regard to existing tax positions or any increase in cumulative liability for unrecognized tax benefits with regard to new tax positions for the year ending December 31, 2016.

The Company and its subsidiaries are subject to U.S. Federal income tax, as well as the income tax of various state and foreign tax jurisdictions. Tax years that remain subject to examination by major tax jurisdictions include Brazil from 2000, Italy from 2007, France from 2008, the Netherlands and the United Kingdom from 2010, Spain and China from 2012, the United States from 2013, and various domestic state tax jurisdictions from 1993.

In the fourth quarter of 2015, the Dutch tax authorities assessed the Company’s subsidiary, Quaker Chemical B.V., for additional income taxes related to the 2011 tax year and Quaker Chemical B.V. filed a protest of such assessment. During the third quarter of 2016 the Company settled with the Dutch tax authorities for matters related to transfer pricing issues for 2011, 2012, 2013, 2014, and 2015, with no change to the income tax returns as filed. In the first quarter of 2016, the French tax authorities gave notice that they were auditing the Company’s subsidiary Quaker Chemical S.A, and subsequently, during the second quarter of 2016, gave notice that they closed the audit with no additional tax assessed. Also, the Italian tax authorities have assessed additional tax due from the Company’s subsidiary, Quaker Italia S.r.l., relating to the tax years 2007, 2008, 2009 and 2010. In the first quarter of 2016, the Italian tax authorities delivered an audit report to Quaker Italia S.r.l. for the tax years 2011, 2012 and 2013 alleging additional tax due. As of

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Notes to Condensed Consolidated Financial Statements - Continued

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September 30, 2016, the Company believes it has adequate reserves, where merited, for uncertain tax positions with respect to all of these audits.

Note 9 – Earnings Per Share

The following table summarizes earnings per share calculations for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Basic earnings per common share				
Net income attributable to Quaker Chemical Corporation	$ 16,008	$ 14,371	$ 43,969	$ 39,787
Less: income allocated to participating securities	(130)	(121)	(373)	(351)
Net income available to common shareholders	$ 15,878	$ 14,250	$ 43,596	$ 39,436
Basic weighted average common shares outstanding	13,143,884	13,209,119	13,128,996	13,206,122
Basic earnings per common share	$ 1.21	$ 1.08	$ 3.32	$ 2.99
Diluted earnings per common share				
Net income attributable to Quaker Chemical Corporation	$ 16,008	$ 14,371	$ 43,969	$ 39,787
Less: income allocated to participating securities	(130)	(121)	(373)	(350)
Net income available to common shareholders	$ 15,878	$ 14,250	$ 43,596	$ 39,437
Basic weighted average common shares outstanding	13,143,884	13,209,119	13,128,996	13,206,122
Effect of dilutive securities	29,960	13,333	18,829	16,181
Diluted weighted average common shares outstanding	13,173,844	13,222,452	13,147,825	13,222,303
Diluted earnings per common share	$ 1.21	$ 1.08	$ 3.32	$ 2.98

The following aggregate numbers of stock options and restricted stock units are not included in the diluted earnings per share calculation since the effect would have been anti-dilutive: 0 and 3,465 for the three and nine months ended September 30, 2016, respectively, and 7,903 and 6,460 for the three and nine months ended September 30, 2015, respectively.

Note 10 – Goodwill and Other Intangible Assets

The Company completes its annual impairment test as of the end of the third quarter of each year, or more frequently if triggering events indicate a possible impairment in one or more of its reporting units. The Company continually evaluates financial performance, economic conditions and other relevant developments in assessing if an interim period impairment test for one or more of its reporting units is necessary. The Company completed its annual impairment assessment as of the end of the third quarter of 2016 and no impairment charge was warranted. The estimated fair value of each of the Company’s reporting units substantially exceeded its carrying value, with no reporting unit at risk for failing step one of the goodwill impairment test. In addition, the Company has recorded no impairment charges in its past. Changes in the carrying amount of goodwill for the nine months ended September 30, 2016 were as follows:

	North America	EMEA	Asia/Pacific	South America	Total
Balance as of December 31, 2015	$ 42,443	$ 19,280	$ 15,244	$ 2,144	$ 79,111
Goodwill additions (reductions)	98	(114)	—	—	(16)
Currency translation adjustments	(166)	137	(162)	420	229
Balance as of September 30, 2016	$ 42,375	$ 19,303	$ 15,082	$ 2,564	$ 79,324

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(Dollars in thousands, except share and per share amounts, unless otherwise stated)

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Gross carrying amounts and accumulated amortization for definite-lived intangible assets as of September 30, 2016 and December 31, 2015 were as follows:

	Gross Carrying Amount		Accumulated Amortization	
	2016	**2015**	**2016**	**2015**
Customer lists and rights to sell	$ 68,463	$ 67,435	$ 19,110	$ 15,806
Trademarks and patents	23,823	23,147	6,978	5,538
Formulations and product technology	5,808	5,808	4,221	4,082
Other	5,986	5,788	5,082	4,565
Total definite-lived intangible assets	$ 104,080	$ 102,178	$ 35,391	$ 29,991

The Company recorded $1.7 million and $5.3 million of amortization expense for the three and nine months ended September 30, 2016, respectively. Comparatively, the Company recorded $1.8 million and $5.0 million of amortization expense for the three and nine months ended September 30, 2015, respectively. Estimated annual aggregate amortization expense for the current year and subsequent five years is as follows:

For the year ended December 31, 2016	$ 6,995
For the year ended December 31, 2017	6,670
For the year ended December 31, 2018	6,449
For the year ended December 31, 2019	6,347
For the year ended December 31, 2020	6,068
For the year ended December 31, 2021	5,686

The Company has two indefinite-lived intangible assets totaling $1.1 million for trademarks at September 30, 2016 and December 31, 2015.

Note 11 – Debt

The Company's primary credit facility is a $300.0 million syndicated multicurrency credit agreement with a group of lenders, which matures in June 2018. The maximum amount available under this credit facility can be increased to $400.0 million at the Company's option if the lenders agree and the Company satisfies certain conditions. Borrowings under this credit facility generally bear interest at a base rate or LIBOR rate plus a margin. Access to this credit facility is dependent on meeting certain financial and other covenants, but primarily depends on the Company's consolidated leverage ratio calculation, which cannot exceed 3.50 to 1. As of September 30, 2016 and December 31, 2015, the Company's consolidated leverage ratio was below 1.0 to 1, and the Company was also in compliance with all of its other covenants. As of September 30, 2016 and December 31, 2015, the Company had $57.5 million and $62.9 million outstanding, respectively, under its credit facilities. The Company's other debt obligations were primarily industrial development bonds and municipality-related loans as of September 30, 2016 and December 31, 2015.

Note 12 – Equity

In May 2015, the Company's Board of Directors authorized a share repurchase program for the repurchase of up to $100.0 million of Quaker Chemical Corporation common stock (the "2015 Share Repurchase Program"). The 2015 Share Repurchase Program has no expiration date. The 2015 Share Repurchase Program provides a framework of conditions under which management can repurchase shares of the Company's common stock. The Company currently intends to repurchase shares to at least offset the dilutive impact of shares issued each year as part of its employee benefit and share based compensation plans, and could repurchase more if the Company considers the share price to be at a level that offers an advantageous return for its shareholders. The purchases may be made in the open market or in private and negotiated transactions and will be in accordance with applicable laws, rules and regulations. In connection with the 2015 Share Repurchase Program, the remaining unutilized 1995 and 2005 Board of Directors authorized share repurchase programs were terminated.

In connection with the 2015 Share Repurchase Program, the Company acquired 83,879 shares of common stock for $5.9 million, during the nine months ended September 30, 2016, and 59,110 shares of common stock for $5.0 million during the nine months ended September 30, 2015. The Company has elected not to hold treasury shares, and, therefore, has retired the shares as they are repurchased. It is the Company's accounting policy to record the excess paid over par value as a reduction in retained earnings for all shares repurchased.

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(Dollars in thousands, except share and per share amounts, unless otherwise stated)

(Unaudited)

The following tables present the changes in equity, net of tax, for the three and nine months ended September 30, 2016 and 2015:

	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Noncontrolling Interest	Total
Balance at June 30, 2016	$ 13,250	$ 109,751	$ 340,127	$ (71,790)	$ 8,895	$ 400,233
Net income	—	—	16,008	—	343	16,351
Amounts reported in other comprehensive (loss) income	—	—	—	(237)	177	(60)
Dividends ($0.345 per share)	—	—	(4,575)	—	—	(4,575)
Acquisition of noncontrolling interest	—	—	—	—	40	40
Share issuance and equity-based compensation plans	7	1,671	—	—	—	1,678
Excess tax benefit from stock option exercises	—	31	—	—	—	31
Balance at September 30, 2016	$ 13,257	$ 111,453	$ 351,560	$ (72,027)	$ 9,455	$ 413,698
Balance at June 30, 2015	$ 13,337	$ 103,082	$ 315,060	$ (60,771)	$ 7,818	$ 378,526
Net income	—	—	14,371	—	464	14,835
Amounts reported in other comprehensive loss	—	—	—	(10,994)	(367)	(11,361)
Repurchases of common stock	(40)	—	(3,319)	—	—	(3,359)
Dividends ($0.32 per share)	—	—	(4,256)	—	—	(4,256)
Share issuance and equity-based compensation plans	9	1,735	—	—	—	1,744
Excess tax benefit from stock option exercises	—	22	—	—	—	22
Balance at September 30, 2015	$ 13,306	$ 104,839	$ 321,856	$ (71,765)	$ 7,915	$ 376,151

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(Dollars in thousands, except share and per share amounts, unless otherwise stated)

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	Common Stock	Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Noncontrolling Interest	Total
Balance at December 31, 2015	$ 13,288	$ 106,333	$ 326,740	$ (73,316)	$ 8,198	$ 381,243
Net income	—	—	43,969	—	1,131	45,100
Amounts reported in other comprehensive income	—	—	—	1,289	86	1,375
Repurchases of common stock	(84)	—	(5,775)	—	—	(5,859)
Dividends ($1.01 per share)	—	—	(13,374)	—	—	(13,374)
Acquisition of noncontrolling interest	—	—	—	—	40	40
Share issuance and equity-based compensation plans	53	4,953	—			