

QUAKER CHEMICAL CORP  
Form 10-Q  
April 30, 2008  
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**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 March 31, 2008

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**  
(State or other jurisdiction of  
incorporation or organization)

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

**One Quaker Park, 901 Hector Street,**

**Conshohocken, Pennsylvania**  
(Address of principal executive offices)

**19428 0809**  
(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  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   
Non-accelerated filer

Accelerated filer   
Smaller reporting company

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

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

**Number of Shares of Common Stock**

**10,268,988**

**Outstanding on March 31, 2008**

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**QUAKER CHEMICAL CORPORATION AND CONSOLIDATED SUBSIDIARIES**

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**Table of Contents****Item 1. Financial Statements****Quaker Chemical Corporation****Condensed Consolidated Balance Sheet**

|  | <b>Unaudited<br/>(Dollars in thousands,<br/>except par value and<br/>share amounts)</b> |                               |
|--|---|-------------------------------|
|  | <b>March 31,<br/>2008</b>   | <b>December 31,<br/>2007*</b> |
| <b>ASSETS</b>  |   |                               |
| Current assets   |   |                               |
| Cash and cash equivalents  | \$ 20,527   | \$ 20,195                     |
| Accounts receivable, net   | 120,273   | 118,135                       |
| Inventories  |   |                               |
| Raw materials and supplies   | 25,880  | 24,447                        |
| Work-in-process and finished goods   | 38,679  | 36,291                        |
| Prepaid expenses and other current assets  | 16,057  | 14,433                        |
| <b>Total current assets</b>  | <b>221,416</b>  | <b>213,501</b>                |
| Property, plant and equipment, at cost   | 184,355   | 175,878                       |
| Less accumulated depreciation  | (120,648)   | (113,591)                     |
| Net property, plant and equipment  | 63,707  | 62,287                        |
| Goodwill   | 45,799  | 43,789                        |
| Other intangible assets, net   | 7,668   | 7,873                         |
| Investments in associated companies  | 7,959   | 7,323                         |
| Deferred income taxes  | 32,018  | 30,257                        |
| Other assets   | 40,476  | 34,019                        |
| <b>Total assets</b>  | <b>\$ 419,043</b>   | <b>\$ 399,049</b>             |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |   |                               |
| Current liabilities  |   |                               |
| Short-term borrowings and current portion of long-term debt  | \$ 3,875  | \$ 4,288                      |
| Accounts and other payables  | 68,519  | 67,380                        |
| Accrued compensation   | 9,730   | 17,287                        |
| Other current liabilities  | 17,701  | 17,396                        |
| <b>Total current liabilities</b>   | <b>99,825</b>   | <b>106,351</b>                |
| Long-term debt   | 89,235  | 78,487                        |
| Deferred income taxes  | 8,209   | 7,583                         |
| Other non-current liabilities  | 77,557  | 71,722                        |
| <b>Total liabilities</b>   | <b>274,826</b>  | <b>264,143</b>                |
| Minority interest in equity of subsidiaries  | 4,750   | 4,513                         |
| Shareholders' equity   |   |                               |
| Common stock \$1 par value; authorized 30,000,000 shares; issued 2008- 10,268,988, 2007- 10,147,239 shares | 10,269  | 10,147                        |
| Capital in excess of par value   | 11,844  | 10,104                        |
| Retained earnings  | 118,506   | 115,767                       |

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|  |            |            |
|--|------------|------------|
| Accumulated other comprehensive (loss)     | (1,152)    | (5,625)    |
| Total shareholders' equity                 | 139,467    | 130,393    |
| Total liabilities and shareholders' equity | \$ 419,043 | \$ 399,049 |

\* Condensed from audited financial statements.

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

**Table of Contents****Quaker Chemical Corporation****Condensed Consolidated Statement of Income**

|   | <b>Unaudited</b><br><b>(Dollars in thousands,</b><br><b>except per</b><br><b>share and share amounts)</b> |             |
|---|---|-------------|
|   | <b>Three Months Ended March 31,</b>   |             |
|   | <b>2008</b>   | <b>2007</b> |
| Net sales   | \$ 147,718  | \$ 124,891  |
| Cost of goods sold                                      | 104,083   | 86,345      |
| Gross margin  | 43,635  | 38,546      |
| Selling, general and administrative expenses            | 34,504  | 31,919      |
| Operating income  | 9,131   | 6,627       |
| Other income, net                                       | 161   | 327         |
| Interest expense  | (1,419)   | (1,554)     |
| Interest income   | 237   | 204         |
| Income before taxes                                     | 8,110   | 5,604       |
| Taxes on income   | 2,765   | 1,844       |
|   | 5,345   | 3,760       |
| Equity in net income of associated companies            | 112   | 125         |
| Minority interest in net income of subsidiaries         | (364)   | (348)       |
| Net income  | \$ 5,093  | \$ 3,537    |
| Per share data:   |   |             |
| Net income basic  | \$ 0.50   | \$ 0.36     |
| Net income diluted                                      | \$ 0.50   | \$ 0.35     |
| Dividends declared                                      | \$ 0.23   | \$ 0.215    |
| Based on weighted average number of shares outstanding: |   |             |
| Basic   | 10,085,859  | 9,907,683   |
| Diluted   | 10,179,539  | 10,024,905  |

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

**Table of Contents****Quaker Chemical Corporation****Condensed Consolidated Statement of Cash Flows**

|  | <b>Unaudited</b>                  |                |
|--|-----------------------------------|----------------|
|  | <b>(Dollars in thousands)</b>     |                |
|  | <b>For the Three Months Ended</b> |                |
|  | <b>March 31,</b>                  |                |
|  | <b>2008</b>                       | <b>2007</b>    |
| <b>Cash flows from operating activities</b>  |                                   |                |
| Net income   | \$ 5,093                          | \$ 3,537       |
| Adjustments to reconcile net income to net cash used in operating activities:                            |                                   |                |
| Depreciation   | 2,680                             | 2,719          |
| Amortization   | 300                               | 339            |
| Equity in net income of associated companies, net of dividends   | (112)                             | 44             |
| Minority interest in earnings of subsidiaries  | 364                               | 348            |
| Deferred income taxes  | 1,246                             | 361            |
| Deferred compensation and other, net   | 22                                | 267            |
| Stock-based compensation   | 376                               | 262            |
| (Gain) Loss on disposal of property, plant and equipment   | (35)                              | 5              |
| Insurance settlement realized  | (136)                             | (265)          |
| Pension and other postretirement benefits  | (2,458)                           | (869)          |
| Increase (decrease) in cash from changes in current assets and current liabilities, net of acquisitions: |                                   |                |
| Accounts receivable  | 1,159                             | (10,633)       |
| Inventories  | (2,374)                           | (3,019)        |
| Prepaid expenses and other current assets  | (3,037)                           | (873)          |
| Accounts payable and accrued liabilities   | (9,280)                           | 2,749          |
| <b>Net cash used in operating activities</b>   | <b>(6,192)</b>                    | <b>(5,028)</b> |
| <b>Cash flows from investing activities</b>  |                                   |                |
| Investments in property, plant and equipment   | (1,949)                           | (2,721)        |
| Proceeds from disposition of assets  | 65                                |                |
| Payments related to acquisitions   | (1,000)                           | (1,000)        |
| Insurance settlement received and interest earned  | 5,112                             | 143            |
| Change in restricted cash, net   | (4,976)                           | 122            |
| <b>Net cash used in investing activities</b>   | <b>(2,748)</b>                    | <b>(3,456)</b> |
| <b>Cash flows from financing activities</b>  |                                   |                |
| Net decrease in short-term borrowings  | (378)                             | (1,262)        |
| Proceeds from long-term debt   | 9,844                             | 5,277          |
| Repayment of long-term debt  | (251)                             | (225)          |
| Dividends paid   | (2,181)                           | (2,137)        |
| Stock options exercised, other   | 1,486                             | 1,809          |
| Distributions to minority shareholders   |                                   | (270)          |
| <b>Net cash provided by financing activities</b>   | <b>8,520</b>                      | <b>3,192</b>   |
| <b>Effect of exchange rate changes on cash</b>   | <b>752</b>                        | <b>17</b>      |
| <b>Net increase (decrease) in cash and cash equivalents</b>  | <b>332</b>                        | <b>(5,275)</b> |
| <b>Cash and cash equivalents at beginning of period</b>  | <b>20,195</b>                     | <b>16,062</b>  |

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|  |           |           |
|--|-----------|-----------|
| Cash and cash equivalents at end of period | \$ 20,527 | \$ 10,787 |
|--|-----------|-----------|

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



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**Quaker Chemical Corporation**

**Notes to Condensed Consolidated Financial Statements**

**(Dollars in thousands, except per share amounts)**

**(Unaudited)**

**Note 1 Condensed Financial Information**

The condensed consolidated financial statements included herein are unaudited and have been prepared in accordance with generally accepted accounting principles in the United States for interim financial reporting and the United States Securities and Exchange Commission regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the financial statements reflect all adjustments (consisting only of normal recurring adjustments, except as discussed below) which are necessary for a fair statement of the financial position, results of operations and cash flows for the interim periods. The results for the three months ended March 31, 2008 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, 2007.

During the first quarter of 2008 and as required by SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, the Company changed the measurement date of its U.S. pension plan from November 30 to December 31 in order to coincide with the Company's fiscal year end. This change did not have a material impact to the Company's consolidated financial statements.

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 as service revenues, at the amount of the administrative fee earned by the Company for ordering the goods. Third-party products transferred under arrangements resulting in net reporting totaled \$8,588 and \$13,152 for the three months ended March 31, 2008 and 2007, respectively.

**Note 2 Recently Issued Accounting Standards**

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007) ( *SFAS 141(R)* ), *Business Combinations*, and Statement of Financial Accounting Standards No. 160 ( *SFAS 160* ), *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51*. *SFAS 141(R)* will significantly change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. Some of the changes, such as the accounting for contingent consideration, will introduce more volatility into earnings. *SFAS 160* will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. *SFAS 141(R)* will be applied prospectively. *SFAS 160* requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of *SFAS 160* shall be applied prospectively. *SFAS 141(R)* and *SFAS 160* are effective for fiscal years beginning on or after December 15, 2008. The Company is currently assessing the impact of these standards on its financial statements.

In March 2008, the FASB issued Statement of Financial Accounting Standard No. 161 ( *SFAS 161* ), *Disclosures about Derivative Instruments and Hedging Activities*. *SFAS 161* requires expanded disclosure about the Company's hedging activities and use of derivative instruments in its hedging activities. *SFAS 161* is effective for fiscal years beginning on or after December 15, 2008 and for interim periods within those fiscal years. The Company is currently assessing the impact of this standard on its financial statements.

**Note 3 Uncertain Income Tax Positions**

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109 ( *FIN 48* ). *FIN 48* prescribes the recognition threshold and measurement attributes for financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. *FIN 48* requires the determination of whether the benefits of tax positions will be more likely than not sustained upon audit based upon the technical merits of the tax position. For tax positions that are determined to be more likely than not sustained upon audit, a company recognizes the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement in the financial statements. For tax positions that are not determined to be more likely than not sustained upon audit, a company does not recognize any portion of the benefit in the financial statements. *FIN 48* also provides guidance on de-recognition, classification, penalties and interest, accounting in interim periods, disclosure, and transition. *FIN 48* is effective for

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fiscal years beginning after December 15, 2006. The Company adopted the provisions of FIN 48, effective January 1, 2007.

At December 31, 2007, the Company's cumulative liability for gross unrecognized tax benefits was \$10,861. As of March 31, 2008, the Company's cumulative liability for gross unrecognized tax benefits was \$11,814.

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**Quaker Chemical Corporation**

**Notes to Condensed Consolidated Financial Statements**

**(Dollars in thousands, except per share amounts)**

**(Unaudited)**

The Company continues to recognize interest and penalties associated with uncertain tax positions as a component of taxes on income in its Consolidated Statement of Income. The Company had accrued \$1,211 for cumulative interest and \$809 for cumulative penalties at December 31, 2007. The Company has recognized \$185 for interest and \$35 for penalties on its Consolidated Statement of Income for the three-month period ended March 31, 2008 and at that date the Company had accrued \$1,484 for cumulative interest and \$885 for cumulative penalties.

The Company and its subsidiaries are subject to U.S. Federal income tax, as well as the income tax of various state and foreign tax jurisdictions. Tax years that remain subject to examination by major tax jurisdictions include the United Kingdom from 2001, Brazil from 2002, the Netherlands and Spain from 2003, Italy and the United States from 2004, China and India from 2005, and various domestic state tax jurisdictions from 1993.

In 2007, the Internal Revenue Service commenced a routine examination of the Company's U.S. corporate income tax returns for the tax years ended December 31, 2005 and December 31, 2006. Based on the outcome of this examination, the Company may recognize changes to its unrecognized tax benefit.

In addition, the Company was under audit by the French tax authorities for tax years 2001 through 2004. The French tax authorities made several adjustments to the Company's transfer pricing transactions and inter-company charges. During the three-month period ended March 31, 2008, the Company resolved several of these issues through the French administrative appeals process and with Competent Authority as provided under the U.S./French tax treaty. As a result of this partial resolution of the issues, the Company recognized a \$381 decrease in its cumulative liability for gross unrecognized tax benefits for the period ended March 31, 2008.

**Note 4 Fair Value Measurements**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 ( SFAS 157 ), *Fair Value Measurement*. Subsequently, the FASB issued FASB Staff Position ( FSP ) 157-1 and FSP 157-2, which provided exceptions to applying the guidance to leasing transactions and to non-recurring nonfinancial assets and liabilities. Effective January 1, 2008, the Company adopted SFAS 157, with the exception of the application of the statement to non-recurring nonfinancial assets and nonfinancial liabilities. Non-recurring nonfinancial assets and nonfinancial liabilities for which we have not applied the provisions of SFAS 157 include those measured at fair value in goodwill impairment testing, indefinite lived intangible assets measured at fair value for impairment testing, asset retirement obligations initially measured at fair value, and those initially measured at fair value in a business combination. SFAS 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. This standard does not require any new fair value measurements, but rather applies to all other accounting pronouncements that require or permit fair value measurements.

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

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

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Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

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The Company values its interest rate swaps, company-owned life insurance policies and various deferred compensation assets and liabilities at fair value. The Company's assets and liabilities subject to fair value measurement are as follows (in thousands):

|   | Fair Value<br>as of<br>March 31, 2008 | Fair Value Measurements at March 31, 2008<br>Using Fair Value Hierarchy |                 |           |
|---|---------------------------------------|---|-----------------|-----------|
|   |                                       | Level 1   | Level 2         | Level 3   |
| <b>Assets</b>   |                                       |   |                 |           |
| Company-owned life insurance                                | \$ 3,726                              | \$  | \$ 3,726        | \$        |
| Company-owned life insurance - deferred compensation assets | 2,229                                 |   | 2,229           |           |
| Other deferred compensation assets                          | 2,050                                 | 2,050   |                 |           |
| <b>Total</b>  | <b>\$ 8,005</b>                       | <b>\$ 2,050</b>   | <b>\$ 5,955</b> | <b>\$</b> |
| <b>Liabilities</b>  |                                       |   |                 |           |
| Deferred compensation liabilities                           | \$ 4,866                              | \$ 4,866  | \$              | \$        |
| Interest rate derivatives                                   | 2,251                                 |   | 2,251           |           |
| <b>Total</b>  | <b>\$ 7,117</b>                       | <b>\$ 4,866</b>   | <b>\$ 2,251</b> | <b>\$</b> |

The fair values of Company-owned life insurance ( COLI ) and COLI deferred compensation assets are based on quotes for like instruments with similar credit ratings and terms. The fair values of Other deferred compensation assets and liabilities are based on quoted prices in active markets. The fair values of interest rate derivatives are based on quoted market prices from various banks for similar instruments.

**Note 5 Stock-Based Compensation**

The Company applies Statement of Financial Accounting Standards No. 123 (revised 2004) ( SFAS 123(R) ), *Share-Based Payment*. SFAS 123(R) requires the recognition of the fair value of stock compensation in net income. The Company elected the modified prospective method in adopting SFAS 123(R). Under this method, the provisions of SFAS 123(R) apply to all awards granted or modified after the date of adoption.

The Company recognized approximately \$376 of share-based compensation expense and \$132 of related tax benefits in our unaudited condensed consolidated statement of operations for the three months ended March 31, 2008. The compensation expense was comprised of \$137 related to stock options, \$198 related to nonvested stock awards, \$11 related to the Company's Employee Stock Purchase Plan, and \$30 related to the Company's Director Stock Ownership Plan.

Based on our historical experience, we have assumed a forfeiture rate of 13% on the nonvested stock. Under the true-up provisions of SFAS 123R, we will record additional expense if the actual forfeiture rate is lower than we estimated, and we will record a recovery of prior expense if the actual forfeiture is higher than we estimated.

The Company has a long-term incentive program ( LTIP ) for key employees which provides for the granting of options to purchase stock at prices not less than market value on the date of the grant. Most options become exercisable between one and three years after the date of the grant for a period of time determined by the Company not to exceed seven years from the date of grant for options issued in 1999 or later and ten years for options issued in prior years. Beginning in 1999, the LTIP program provided for common stock awards, the value of which was

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generally derived from Company performance over a three-year period. Common stock awards issued in 2006, 2007 and 2008 under the LTIP program are subject only to time vesting over a three to five-year period. In addition, as part of the Company's Global Annual Incentive Plan ( GAIP ), nonvested shares may be issued to key employees, which generally vest over a two to five-year period.

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

Stock option activity under all plans is as follows:

|                               | Number of<br>Shares | Weighted Average<br>Exercise Price<br>per<br>Share | Weighted Average<br>Remaining Contractual<br>Term (years) |
|-------------------------------|---------------------|--|---|
| Balance at December 31, 2007  | 1,033,175           | \$ 21.36   |   |
| Options granted               | 145,184             | 19.45  |   |
| Options exercised             | (79,738)            | 20.83  |   |
| Options forfeited             |                     |  |   |
| Options expired               | (76,112)            | 17.80  |   |
| Balance at March 31, 2008     | 1,022,509           | \$ 21.40   | 3.8   |
| Exercisable at March 31, 2008 | 736,629             | \$ 21.62   | 2.8   |

The total intrinsic value of options exercised during the first quarter of 2008 was approximately \$196. Intrinsic value is calculated as the difference between the current market price of the underlying security and the strike price of a related option. As of March 31, 2008, the total intrinsic value of options outstanding was approximately \$10,115, and the total intrinsic value of exercisable options was approximately \$7,155.

A summary of the Company's outstanding stock options at March 31, 2008 is as follows:

| Range of Exercise Prices | Number<br>Outstanding<br>at 3/31/2008 | Weighted<br>Average<br>Contractual<br>Life | Weighted<br>Average<br>Exercise<br>Price | Number<br>Exercisable<br>at<br>3/31/2008 | Weighted<br>Average<br>Exercise<br>Price |
|--------------------------|---------------------------------------|--|--|--|--|
| \$15.97 - \$18.62        | 21,200                                | 0.5  | \$ 17.21                                 | 21,200                                   | \$ 17.21                                 |
| 18.63 - 21.28            | 566,109                               | 3.5  | 19.93                                    | 383,725                                  | 20.11                                    |
| 21.29 - 23.94            | 309,800                               | 4.7  | 22.48                                    | 209,304                                  | 22.17                                    |
| 23.95 - 26.60            | 125,400                               | 3.0  | 26.06                                    | 125,400                                  | 26.06                                    |
|                          | 1,022,509                             | 3.8  | 21.40                                    | 739,629                                  | 21.62                                    |

As of March 31, 2008, unrecognized compensation expense related to options granted during 2006 was \$164, for options granted during 2007 was \$458 and for options granted during 2008 was \$549.

During the first quarter of 2008, the Company granted 145,184 stock options under the Company's LTIP plan that are subject only to time vesting over a three-year period. The options were valued using the Black-Scholes model with the following assumptions: dividend yield of 4.1%, expected volatility of 30.31%, risk free interest rate of 3.15%, an expected term of 6 years, and a forfeiture rate of 3% over the remaining life of the options. Approximately \$32 of expense was recorded on these options during 2008. The fair value of these awards is amortized on a

straight-line basis over the vesting period of the awards.

Under the Company's LTIP plan, 72,110 shares of nonvested stock were outstanding at December 31, 2007. In the first quarter of 2008, 48,431 shares of nonvested stock were granted at a weighted average grant date fair value of \$19.45. None of these awards were vested or were forfeited and 120,541 were outstanding as of March 31, 2008. The fair value of the nonvested stock 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 for expected forfeitures based on historical experience for similar awards. As of March 31, 2008, unrecognized compensation expense related to these awards was \$1,490, to be recognized over a weighted average remaining period of 2.3 years.

Under the Company's GAIP plan, 42,500 shares of nonvested stock were granted during the second quarter of 2005 at a weighted average grant date fair value of \$20.12 per share. At December 31, 2007, 27,500 shares were outstanding. Through March 31, 2008, 13,750 shares vested and were issued, no shares were forfeited and 13,750 shares were outstanding. As of March 31, 2008, unrecognized compensation expense related to these awards was \$92, to be recognized over a weighted average remaining period of 1.5 years.

#### **Employee Stock Purchase Plan**

In 2000, the Board adopted an Employee Stock Purchase Plan ( ESPP ) whereby employees may purchase Company stock through a payroll deduction plan. Purchases are made from the plan and credited to each participant's account at the end of each month, the Investment Date. The purchase price of the stock is 85% of the fair market value on the Investment Date. The plan is compensatory



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

and the 15% discount is expensed on the Investment Date. All employees, including officers, are eligible to participate in this plan. A participant may withdraw all uninvested payment balances credited to a participant's account at any time by giving written notice to the Committee. An employee whose stock ownership of the Company exceeds five percent of the outstanding common stock is not eligible to participate in this plan.

**2003 Director Stock Ownership Plan**

In March 2003, our Board of Directors approved a stock ownership plan for each member of our Board to encourage the Directors to increase their investment in the Company. The Plan was effective on the date it was approved and remains in effect for a term of ten years or until it is earlier terminated by the Board. The maximum number of shares of Common Stock which may be issued under the Plan is 75,000, subject to certain conditions that the committee may elect to adjust the number of shares. As of March 31, 2008, the Committee has not made any elections to adjust the shares under this plan. Each Director is eligible to receive an annual retainer for services rendered as a member of the Board of Directors. Currently, each Director who owns less than 7,500 shares of Company Common Stock is required to receive 75% of the annual retainer in Common Stock and 25% of the annual retainer in cash. Each Director who owns 7,500 or more shares of Company Common Stock receives 20% of the annual retainer in Common Stock and 80% of the annual retainer in cash with the option to receive Common Stock in lieu of the cash portion of the retainer. The annual retainer is \$28. The number of shares issued in payment of the fees is calculated based on an amount equal to the average of the closing prices per share of Common Stock as reported on the composite tape of the New York Stock Exchange for the two trading days immediately preceding the retainer payment date. The retainer payment date is June 1. For the three months ended March 31, 2008 and 2007, the Company recorded approximately \$30 and \$31, respectively.

**Note 6 Earnings Per Share**

The following table summarizes earnings per share (EPS) calculations:

|   | <b>Three Months Ended March 31,</b> |             |
|---|-------------------------------------|-------------|
|   | <b>2008</b>                         | <b>2007</b> |
| Numerator for basic EPS and diluted EPS net income                                  | \$ 5,093                            | \$ 3,537    |
| Denominator for basic EPS weighted average shares                                   | 10,085,859                          | 9,907,683   |
| Effect of dilutive securities, primarily employee stock options and nonvested stock | 93,680                              | 117,222     |
| Denominator for diluted EPS weighted average shares and assumed conversions         | 10,179,539                          | 10,024,905  |
| Basic EPS   | \$ 0.50                             | \$ 0.36     |
| Diluted EPS   | \$ 0.50                             | \$ 0.35     |

The following number of stock options are not included in the earnings per share since in each case the exercise price is greater than the market price: 376,652 and 321,790 for the three months ended March 31, 2008 and 2007, respectively.

**Note 7 Business Segments**

The Company's reportable segments are as follows:

- (1) Metalworking process chemicals industrial process fluids for various heavy industrial and manufacturing applications.

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(2) Coatings temporary and permanent coatings for metal and concrete products and chemical milling maskants.

(3) Other chemical products other various chemical products.

Segment data includes direct segment costs as well as general operating costs.

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

The table below presents information about the reported segments:

|                                       | <b>Three Months Ended<br/>March 31,</b> |             |
|---------------------------------------|---|-------------|
|                                       | <b>2008</b>                             | <b>2007</b> |
| <b>Metalworking Process Chemicals</b> |   |             |
| Net Sales                             | \$ 137,415                              | \$ 116,348  |
| Operating Income                      | 18,411                                  | 17,513      |
| <b>Coatings</b>                       |   |             |
| Net Sales                             | 9,311                                   | 8,354       |
| Operating Income                      | 2,216                                   | 1,872       |
| <b>Other Chemical Products</b>        |   |             |
| Net Sales                             | 992                                     | 189         |
| Operating Income                      | (9)                                     | (60)        |
| <b>Total</b>                          |   |             |
| Net Sales                             | 147,718                                 | 124,891     |
| Operating Income                      | 20,618                                  | 19,325      |
| Non-operating expenses                | (11,187)                                | (12,359)    |
| Amortization                          | (300)                                   | (339)       |
| Interest expense                      | (1,419)                                 | (1,554)     |
| Interest income                       | 237                                     | 204         |
| Other income, net                     | 161                                     | 327         |
| Consolidated income before taxes      | \$ 8,110                                | \$ 5,604    |

Operating income comprises revenue less related costs and expenses. Non-operating items primarily consist of general corporate expenses identified as not being a cost of operation, interest expense, interest income, and license fees from non-consolidated affiliates.

**Note 8 Comprehensive Income**

The following table summarizes comprehensive income:

|  | <b>Three Months<br/>Ended March 31,</b> |             |
|--|---|-------------|
|  | <b>2008</b>                             | <b>2007</b> |
| Net income                                       | \$ 5,093                                | \$ 3,537    |
| Change in fair value of derivatives              | (746)                                   | (117)       |
| Unrealized gain on available-for-sale-securities | (187)                                   | 41          |
| SFAS 158 liability                               | 169                                     | 253         |
| Foreign currency translation adjustments         | 5,237                                   | 1,279       |

|                      |          |          |
|----------------------|----------|----------|
| Comprehensive income | \$ 9,566 | \$ 4,993 |
|----------------------|----------|----------|

**Note 9 Business Acquisitions**

In March 2005, the Company acquired the remaining 40% interest in its Brazilian joint venture for \$6,700. In addition, annual \$1,000 payments for four years are paid subject to the former minority partners' compliance with the terms of the purchase agreement. The third \$1,000 payment was made in February 2008 and was recorded as goodwill assigned to the Metalworking Process Chemicals segment.

**Note 10 Goodwill and Other Intangible Assets**

The changes in carrying amount of goodwill for the three months ended March 31, 2008 are as follows:

|                                  | <b>Metalworking</b>          |                 |              |
|----------------------------------|------------------------------|-----------------|--------------|
|                                  | <b>Process<br/>Chemicals</b> | <b>Coatings</b> | <b>Total</b> |
| Balance as of December 31, 2007  | \$ 35,708                    | \$ 8,081        | \$ 43,789    |
| Goodwill additions               | 1,000                        |                 | 1,000        |
| Currency translation adjustments | 1,010                        |                 | 1,010        |
| Balance as of March 31, 2008     | \$ 37,718                    | \$ 8,081        | \$ 45,799    |

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

Gross carrying amounts and accumulated amortization for definite-lived intangible assets as of March 31, 2008 and December 31, 2007 are as follows:

|                                     | Gross Carrying Amount |           | Accumulated Amortization |          |
|-------------------------------------|-----------------------|-----------|--------------------------|----------|
|                                     | 2008                  | 2007      | 2008                     | 2007     |
| Amortized intangible assets         |                       |           |                          |          |
| Customer lists and rights to sell   | \$ 8,529              | \$ 8,391  | \$ 3,537                 | \$ 3,340 |
| Trademarks and patents              | 1,788                 | 1,788     | 1,788                    | 1,788    |
| Formulations and product technology | 3,278                 | 3,278     | 1,998                    | 1,931    |
| Other                               | 3,420                 | 3,384     | 2,624                    | 2,509    |
| Total                               | \$ 17,015             | \$ 16,841 | \$ 9,947                 | \$ 9,568 |

The Company recorded \$300 and \$339 of amortization expense in the first three months of 2008 and 2007, respectively. Estimated annual aggregate amortization expense for the current year and subsequent five years is as follows:

|                                      |          |
|--------------------------------------|----------|
| For the year ended December 31, 2008 | \$ 1,191 |
| For the year ended December 31, 2009 | \$ 1,127 |
| For the year ended December 31, 2010 | \$ 903   |
| For the year ended December 31, 2011 | \$ 833   |
| For the year ended December 31, 2012 | \$ 735   |
| For the year ended December 31, 2013 | \$ 549   |

The Company has one indefinite-lived intangible asset of \$600 for trademarks recorded in connection with the Company's 2002 acquisition of Epmar.

**Note 11 Pension and Other Postretirement Benefits**

The components of net periodic benefit cost are as follows:

|                                | Three Months Ended March 31, |         |                               |      |
|--------------------------------|------------------------------|---------|-------------------------------|------|
|                                | Pension Benefits             |         | Other Postretirement Benefits |      |
|                                | 2008                         | 2007    | 2008                          | 2007 |
| Service cost                   | \$ 654                       | \$ 609  | \$ 6                          | \$ 5 |
| Interest cost and other        | 1,593                        | 1,447   | 125                           | 135  |
| Expected return on plan assets | (1,547)                      | (1,251) |                               |      |
| Other amortization, net        | 212                          | 322     |                               |      |

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|                           |    |     |    |       |    |     |    |     |
|---------------------------|----|-----|----|-------|----|-----|----|-----|
| Net periodic benefit cost | \$ | 912 | \$ | 1,127 | \$ | 131 | \$ | 140 |
|---------------------------|----|-----|----|-------|----|-----|----|-----|

Employer Contributions:

The Company previously disclosed in its financial statements for the year ended December 31, 2007, that it expected to make minimum cash contributions of \$6,669 to its pension plans and \$1,000 to its other postretirement benefit plan in 2008. As of March 31, 2008, \$3,208 and \$318 of contributions have been made, respectively.

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

During the first quarter of 2008 and as required by SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, the Company changed the measurement date of its U.S. pension plan from November 30 to December 31 in order to coincide with the Company's fiscal year end. This change did not have a material impact to the Company's consolidated financial statements.

**Note 12 Commitments and Contingencies**

In April of 1992, the Company identified certain soil and groundwater contamination at AC Products, Inc. ( *ACP* ), a wholly owned subsidiary. In voluntary coordination with the Santa Ana California Regional Water Quality Board, ACP has been remediating the contamination, the principal contaminant of which is perchloroethylene ( *PERC* ). On or about December 18, 2004, the Orange County Water District ( *OCWD* ) filed a civil complaint in Superior Court, in Orange County, California against ACP and other parties potentially responsible for groundwater contamination. OCWD was seeking to recover compensatory and other damages related to the investigation and remediation of the contamination in the groundwater. Effective October 17, 2007, ACP and OCWD settled all claims related to this litigation. Pursuant to the settlement agreement with OCWD, ACP agreed to pay \$2,000 in two equal installments of \$1,000 (the first installment paid October 31, 2007 and the second installment paid on February 15, 2008). In addition to the \$2,000 payment, ACP agreed to operate the two existing groundwater treatment systems associated with its extraction wells P-2 and P-3 so as to hydraulically contain groundwater contamination emanating from ACP's site until such time as the concentrations of PERC are below the Federal maximum contaminant level for four consecutive quarterly sampling events. During the third quarter of 2007, the Company recognized a \$3,300 charge made up of \$2,000 for the settlement of the litigation, plus an increase in its reserve for its soil and water remediation program of \$1,300. As of March 31, 2008, the Company believes that the range of potential-known liabilities associated with ACP contamination, including the water and soil remediation program, is approximately \$2,400 to \$4,400, for which the Company has sufficient reserves.

The low and high ends of the range are based on the length of operation of the two extraction wells as determined by groundwater modeling with planned higher maintenance costs in later years if a longer treatment period is required. Costs of operation include the operation and maintenance of the extraction wells, groundwater monitoring, one-time expenses to insure P-3 is hydraulically containing the PERC plume and program management. The duration of the well operation was estimated based on historical trends in concentrations in the monitoring wells within the proximity of the applicable extraction wells. Also factored into the model was the impact of water injected into the underground aquifer from a planned recharge basin adjacent to the ACP site, as well as from an injection well to be installed and operated by OCWD as part of the groundwater treatment system for contaminants which are the subject of the aforementioned litigation. Based on the modeling, it is estimated that P-2 will operate for three and half years to up to five years and P-3 will operate for six years to up to nine years. Operation and maintenance costs were based on historical expenditures and estimated inflation. As mentioned above, a significantly higher maintenance expense was factored into the range if the system operates for the longer period. Also included in the reserve are anticipated expenditures to operate an on-site soil vapor extraction system.

The Company believes, although there can be no assurance regarding the outcome of other unrelated environmental matters, that it has made adequate accruals for costs associated with other environmental problems of which it is aware. Approximately \$99 and \$159 was accrued at March 31, 2008 and December 31, 2007, respectively, to provide for such anticipated future environmental assessments and remediation costs.

An inactive subsidiary of the Company that was acquired in 1978 sold certain products containing asbestos, primarily on an installed basis, and is among the defendants in numerous lawsuits alleging injury due to exposure to asbestos. The subsidiary discontinued operations in 1991 and has no remaining assets other than the proceeds from insurance settlements received. To date, the overwhelming majority of these claims have been disposed of without payment and there have been no adverse judgments against the subsidiary. Based on a continued analysis of the existing and anticipated future claims against this subsidiary, it is currently projected that the subsidiary's total liability over the next 50 years for these claims is approximately \$13,800 (excluding costs of defense). Although the Company has also been named as a defendant in certain of these cases, no claims have been actively pursued against the Company, and the Company has not contributed to the defense or settlement of any of these cases pursued against the subsidiary. These cases were handled by the subsidiary's primary and excess insurers who had agreed in 1997 to pay all defense costs and be responsible for all damages assessed against the subsidiary arising out of existing and future asbestos claims up to

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the aggregate limits of the policies. A significant portion of this primary insurance coverage was provided by an insurer that is now insolvent, and the other primary insurers have asserted that the aggregate limits of their policies have been exhausted. The subsidiary has challenged the applicability of these limits to the claims being brought against the subsidiary. In response to this challenge, two of the three carriers entered into separate settlement and release agreements with the subsidiary in late 2005 and in the first quarter of 2007 for \$15,000 and \$20,000, respectively. The payments under the latest settlement and release agreement are structured to be received over a four-year period with annual installments of \$5,000, the first of which was received early in the second quarter of 2007 and the second of



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**Quaker Chemical Corporation**

**Notes to Condensed Consolidated Financial Statements**

**(Dollars in thousands, except per share amounts)**

**(Unaudited)**

which was received in the first quarter of 2008. The subsequent installments are contingent upon whether or not Federal asbestos legislation is adopted by the due date of each annual installment. If Federal asbestos legislation is so enacted and such legislation eliminates the carrier's obligation to make the installment payment and requires the carrier to contribute into a trust or similar vehicle as a result of the policies issued to the subsidiary, the insurance carrier's obligation to make the subsequent installments will be cancelled. The proceeds of both settlements are restricted and can only be used to pay claims and costs of defense associated with the subsidiary's asbestos litigation. During the third quarter of 2007, the subsidiary and the remaining primary insurance carrier entered into a Claim Handling and Funding Agreement, under which the carrier will pay 27% of defense and indemnity costs incurred by or on behalf of the subsidiary in connection with asbestos bodily injury claims for a minimum of five years beginning July 1, 2007. At the end of the term of the agreement, the subsidiary may choose to again pursue its claim against this insurer regarding the application of the policy limits. The Company also believes, that if the coverage issues under the primary policies with the remaining carrier are resolved adversely to the subsidiary and all settlement proceeds were used, the subsidiary may have limited additional coverage from a state guarantee fund established following the insolvency of one of the subsidiary's primary insurers. Nevertheless, liabilities in respect of claims may exceed the assets and coverage available to the subsidiary.

If the subsidiary's assets and insurance coverage were to be exhausted, claimants of the subsidiary may actively pursue claims against the Company because of the parent-subsidiary relationship. Although asbestos litigation is particularly difficult to predict, especially with respect to claims that are currently not being actively pursued against the Company, the Company does not believe that such claims would have merit or that the Company would be held to have liability for any unsatisfied obligations of the subsidiary as a result of such claims. After evaluating the nature of the claims filed against the subsidiary and the small number of such claims that have resulted in any payment, the potential availability of additional insurance coverage at the subsidiary level, the additional availability of the Company's own insurance and the Company's strong defenses to claims that it should be held responsible for the subsidiary's obligations because of the parent-subsidiary relationship, the Company believes it is not probable that the Company will incur any material losses. All of the asbestos cases pursued against the Company challenging the parent-subsidiary relationship are in the early stages of litigation. The Company has been successful in the past having claims naming it dismissed during initial proceedings. Since the Company may be in this early stage of litigation for some time, it is not possible to estimate additional losses or range of loss, if any.

The Company is party to other litigation which management currently believes will not have a material adverse effect on the Company's results of operations, cash flows or financial condition.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

#### **Executive Summary**

Quaker Chemical Corporation is a worldwide developer, producer, and marketer of chemical specialty products and a provider of chemical management services ( CMS ) for various heavy industrial and manufacturing applications around the globe with significant sales to the steel and automotive industries.

The revenue growth in the first quarter of 2008 was primarily due to increased selling prices, higher volumes in foreign markets, as well as higher CMS revenues due to the 2007 renewal and renegotiation of several of the Company's contracts. Higher selling prices helped to partially offset higher raw material costs resulting in a 13.2% increase in gross margin dollars but with a decrease in gross margin as a percentage of sales as compared to the first quarter of 2007. Raw material costs continue to be higher as compared to the prior year and have continued to increase steadily and significantly thus far in 2008. The Company's selling, general and administrative expenses as a percentage of sales declined to 23.3% for the first quarter of 2008 compared to 25.6% for the first quarter of 2007. Inflationary cost increases were largely offset by lower legal and environmental costs and lower incentive compensation expense.

The net result was a considerable improvement in earnings per diluted share of \$0.50 for the first quarter of 2008, compared to \$0.35 for the first quarter of 2007. Notwithstanding the Company's improved performance, the continued strength of the business environment is subject to limited visibility due to continued raw material price volatility and an uncertain global economic environment. With crude oil in excess of \$100 per barrel and animal fats and vegetable oils impacted by increased biodiesel consumption, raw material prices continue to be a challenge. Any improvement in gross margin as a percentage of sales will depend in part upon a sustained period of stable or declining raw material costs. While demand is generally expected to remain stable, volume in certain markets was limited by customer end-market issues, including reduced vehicle sales experienced by some automotive customers and reduced steel demand, particularly in North America. The Company will remain focused on pursuing revenue opportunities, managing its raw material and other costs, and pursuing pricing initiatives.

#### **CMS Discussion**

In 2003, the Company began entering into new contracts under which it receives a set management fee and the costs that relate to those management fees were and are largely dependent on how well the Company controls product costs and achieves product conversions from other third-party suppliers to its own products. This approach came with new risks and opportunities, as the profit earned from the management fee is subject to movements in product costs as well as the Company's own performance. The Company believes this expanded approach is a way for Quaker to become an integral part of our customers' operational efforts to improve manufacturing costs and to demonstrate value that the Company would not be able to demonstrate as purely a product provider.

Consistent with the foregoing approach, the Company was awarded a series of multi-year CMS contracts, primarily at General Motors Powertrain, Chrysler and Ford manufacturing sites over the last several years. This business was an important step in building the Company's share and leadership position in the automotive process fluids market and has positioned the Company well for penetration of CMS opportunities in other metalworking manufacturing sites. This alternative approach had a dramatic impact on the Company's revenue and margins. Under the traditional CMS approach, where the Company effectively acts as an agent, revenues and costs from these sales are reported on a net sales or pass-through basis. The alternative structure is different in that the Company's revenue received from the customer is a fee for products and services provided to the customer, which are indirectly related to the actual costs incurred. As a result, the Company recognizes in the alternative structure in reported revenues the gross revenue received from the CMS site customer, and in cost of goods sold the third-party product purchases, which substantially offset each other until the Company achieves significant product conversions. As some contracts have been renewed or renegotiated, some of the contracts have reverted to a pass-through basis, while others have remained on a gross basis. Currently, the Company has a mix of contracts with both the traditional product pass-through structure and fixed priced contracts covering all services and products. The Company's offerings will continue to include both approaches to CMS depending on customer requirements and business circumstances.

#### **Liquidity and Capital Resources**

Quaker's cash and cash equivalents increased to \$20.5 million at March 31, 2008 from \$20.2 million at December 31, 2007. The increase resulted primarily from \$6.2 million of cash used in operating activities, \$2.7 million of cash used in investing activities, offset by \$8.5 million of cash provided by financing activities.

Net cash flows used in operating activities were \$6.2 million for the first three months of 2008, compared to \$5.0 million for the first three months of 2007. The increased use of cash was largely due to an increased investment in working capital compared to the prior year period. The Company remains focused on limiting the pace of its investment in working capital. Significant factors impacting the working capital accounts

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for the first three months of 2008 include the first quarter payment of the Company's annual incentive compensation, as well as the final \$1.0 million payment pursuant to the settlement agreement with AC Products, Inc., a

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wholly owned subsidiary and the Orange County Water District. See also Note 12 of Notes to Condensed Consolidated Financial Statements. In addition, the Company's higher net income was largely offset by increased pension contributions compared to the prior year. In 2007, the Company received a refund of pension premiums attributable to one of its foreign pension plans.

Net cash flows used in investing activities were \$2.7 million for the first three months of 2008, compared to \$3.5 million used in investing activities for the first three months of 2007. The decreased use of cash was primarily due to lower capital expenditures related to the Company's manufacturing facility in China. In the first quarter of 2008, the Company made the third of four annual payments of \$1.0 million related to the 2005 acquisition of the remaining 40% interest in its Brazilian joint venture. In addition, the second of four annual \$5.0 million payments was received in the first quarter of 2008 pursuant to the settlement agreement and release entered into during the first quarter of 2007 by an inactive subsidiary of the Company and one of its insurance carriers. These proceeds are restricted and can only be used to pay claims and costs of defense associated with the subsidiary's asbestos litigation. The subsequent installments are contingent upon whether or not Federal asbestos legislation is adopted by the due date of each annual installment. If Federal asbestos legislation is so enacted, and such legislation eliminates the carrier's obligation to make the installment payment and requires the carrier to contribute into a trust or similar vehicle as a result of the policies issued to the subsidiary, then the insurance carrier's obligation to make the subsequent installments will be cancelled.

Net cash flows provided by financing activities were \$8.5 million for the first three months of 2008, as compared to \$3.2 million of cash provided by financing activities in the first three months of 2007. The increase was caused primarily by greater borrowings in 2008 used to fund the Company's working capital needs and first quarter payment of the Company's annual incentive compensation.

The Company had a net debt-to-total-capital ratio of 34% at March 31, 2008, compared to 43% at March 31, 2007 and 32% at December 31, 2007. At March 31, 2008, the Company had approximately \$84.4 million outstanding on its credit lines, compared to \$73.8 million at December 31, 2007. At March 31, 2008, the Company's gross FIN 48 liability, including penalties and interest, was \$14.2 million. The Company cannot determine a reliable estimate of the timing of the cash flows by period related to its FIN 48 liability. However, should the FIN 48 liability be paid, the amount of the payment may be reduced by offsetting benefits in other tax jurisdictions by \$5.2 million. The Company believes it is capable of supporting its operating requirements, including pension plan contributions, payment of dividends to shareholders, possible acquisitions and business opportunities, capital expenditures and possible resolution of contingencies, through internally generated funds supplemented with debt as needed.

**Operations**

**Comparison of First Quarter 2008 with First Quarter of 2007**

Net sales for the first quarter were \$147.7 million, up 18.3% from \$124.9 million for the first quarter 2007. The increase in net sales was attributable to volume growth, higher sales prices and foreign exchange rate translation. Volume growth was realized in virtually all the Company's regions, including higher revenue related to the Company's CMS channel. Foreign exchange rate translation increased revenues by approximately 8% for the first quarter of 2008, compared to the same period in 2007. Selling price increases were realized, in part as a result of an ongoing effort to offset higher raw material costs. CMS revenues were higher due to the full year impact of additional CMS accounts gained in 2007, as well as the renewal and restructuring of several of the Company's CMS contracts.

Gross margin dollars were up more than \$5.0 million, or 13.2% for the first quarter of 2008, compared to the same period in 2007. However, the gross margin percentage was 29.5% for the first quarter of 2008, compared to 30.9% for the first quarter of 2007. The Company's larger mix of CMS revenues reported on a gross versus pass-through basis decreased gross margin as a percentage of sales by approximately 0.5 percentage points. The remaining decline in gross margin as a percentage of sales is due to increased raw material costs in excess of price increases, as well as product and regional sales mix. The Company has announced and implemented a number of price increases to further aid in offsetting unprecedented levels in the Company's key raw material costs.

Selling, general and administrative expenses for the quarter increased \$2.6 million, compared to the first quarter of 2007. Foreign exchange rate translation accounted for the majority of the increase over the prior year. Inflationary increases were largely offset by lower legal and environmental costs and lower incentive compensation expense.

The decrease in other income was primarily due to foreign exchange rate losses in 2008 compared to gains in 2007. Net interest expense was lower due to lower average borrowings as well as lower interest rates.

The effective tax rate was 34.1% for the first quarter of 2008, compared to 32.9% for the first quarter of 2007. Many external and internal factors can impact this rate and the Company will continue to refine this rate, if necessary, as the year progresses. At the end of 2007, the Company had net U.S. deferred tax assets totaling \$16.8 million, excluding deferred tax assets relating to additional minimum pension liabilities. The

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Company records valuation allowances when necessary to reduce its deferred tax assets to the amount that is more likely than not to be realized. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. However, in the event the Company were to determine that it would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to the deferred tax assets would be a non-cash charge to income in the period such determination was made, which could have a material adverse impact on the Company's

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financial statements. The continued price pressure in the Company's raw materials has been negatively impacting profitability in certain taxing jurisdictions. The Company continues to closely monitor this situation as it relates to its net deferred tax assets and the assessment of valuation allowances. The Company is continuing to evaluate alternatives that could positively impact taxable income in these jurisdictions.

Net income for the first quarter of 2008 was \$5.1 million, up 44% compared to \$3.5 million for the first quarter of 2007, primarily as a result of increased sales and gross margin offset in part by higher selling, general and administrative expenses.

## **Segment Reviews Comparison of the First Quarter 2008 with First Quarter 2007**

### **Metalworking Process Chemicals**

Metalworking Process Chemicals consists of industrial process fluids for various heavy industrial and manufacturing applications and represented approximately 93% of the Company's net sales for the first quarter of 2008. Net sales were up \$21.1 million, or 18%, compared with the first quarter of 2007. Foreign currency translation positively impacted net sales by approximately 9%, driven by the euro to U.S. dollar, Brazilian real to U.S. dollar and Chinese renminbi to U.S. dollar exchange rates. The average euro to U.S. dollar exchange rate was 1.50 in the first quarter of 2008 compared to 1.31 in the first quarter of 2007, the average Brazilian real to U.S. dollar exchange rate was 0.58 in the first quarter of 2008 compared to 0.47 in the first quarter of 2007, and the average Chinese renminbi to U.S. dollar exchange rate was 0.14 in the first quarter of 2008 compared to 0.13 in the first quarter of 2007. Net sales were positively impacted by growth of 18.4% in Asia/Pacific, 10.2% in North America, 5.1% in Europe and 4.3% in South America, all on a constant currency basis. The growth in sales was attributable to higher sales prices and mix, volume growth and higher CMS sales due to the renegotiation of certain contracts in 2007. The increased selling prices were implemented, in part, to offset higher raw material costs. The \$0.9 million or 5% increase in this segment's operating income compared to the first quarter of 2007 on a sales increase of 18% is reflective of the pace at which raw material costs have continued to increase.

### **Coatings**

The Company's coatings segment, which represented approximately 6% of the Company's net sales for the first quarter of 2008, contains products that provide temporary and permanent coatings for metal and concrete products and chemical milling maskants. Net sales for this segment were up \$1.0 million, or 12%, for the first quarter of 2008 compared with the prior year period, primarily due to higher chemical milling maskant product sales sold to the aerospace industry. This segment's operating income was up \$0.3 million, consistent with the volume increases noted above.

### **Other Chemical Products**

Other Chemical Products, which represented approximately 1% of the Company's net sales for the first quarter of 2008, consists of sulfur removal products for industrial gas streams sold by the Company's Q2 Technologies joint venture. Net sales were up \$0.8 million, reflective of this segment's second quarter 2007 acquisition of Frontier Research and Chemicals Company. Operating income for the first quarter of 2008 was flat with the first quarter of 2007 at a slight loss.

## **Factors That May Affect Our Future Results**

(Cautionary Statements Under the Private Securities Litigation Reform Act of 1995)

Certain information included in this Report and other materials filed or to be filed by Quaker with the SEC (as well as information included in oral statements or other written statements made or to be made by us) contain or may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements can be identified by the fact that they do not relate strictly to historical or current facts. We have based these forward-looking statements on our current expectations about future events. These forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, anticipations, intentions, financial condition, results of operations, future performance and business, including:

statements relating to our business strategy;

our current and future results and plans; and

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statements that include the words may, could, should, would, believe, expect, anticipate, estimate, intend, pl  
expressions.

Such statements include information relating to current and future business activities, operational matters, capital spending, and financing sources. From time to time, forward-looking statements are also included in Quaker's periodic reports on Forms 10-K and 8-K, press releases and other materials released to the public.

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Any or all of the forward-looking statements in this Report and in any other public statements we make may turn out to be wrong. This can occur as a result of inaccurate assumptions or as a consequence of known or unknown risks and uncertainties. Many factors discussed in this Report will be important in determining our future performance. Consequently, actual results may differ materially from those that might be anticipated from our forward-looking statements.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in Quaker's subsequent reports on Forms 10-K, 10-Q and 8-K should be consulted. These forward-looking statements are subject to risks, uncertainties and assumptions about us and our operations that are subject to change based on various important factors, some of which are beyond our control. A major risk is that the Company's demand is largely derived from the demand for its customers' products, which subjects the Company to uncertainties related to downturns in a customer's business and unanticipated customer production planning shutdowns. Other major risks and uncertainties include, but are not limited to, significant increases in raw material costs, worldwide economic and political conditions, foreign currency fluctuations, and terrorist attacks such as those that occurred on September 11, 2001. Furthermore, the Company is subject to the same business cycles as those experienced by steel, automobile, aircraft, appliance, and durable goods manufacturers. These risks, uncertainties, and possible inaccurate assumptions relevant to our business could cause our actual results to differ materially from expected and historical results. Other factors beyond those discussed could also adversely affect us. Therefore, we caution you not to place undue reliance on our forward-looking statements. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Quaker is exposed to the impact of changes of interest rates, foreign currency fluctuations, changes in commodity prices, and credit risk.

*Interest Rate Risk.* Quaker's exposure to market rate risk for changes in interest rates relates primarily to its short and long-term debt. Most of Quaker's debt is negotiated at market rates which can be either fixed or variable. Accordingly, if interest rates rise significantly, the cost of debt to Quaker will increase. This can have an adverse effect on Quaker, depending on the extent of Quaker's borrowings. As of March 31, 2008, Quaker had \$84.4 million in borrowings under its credit facilities compared to \$73.8 million at December 31, 2007, at a weighted average borrowing rate of approximately 5.8%. The Company uses derivative financial instruments primarily for purposes of hedging exposures to fluctuations in interest rates. The Company does not enter into derivative contracts for trading or speculative purposes. The Company has entered into seven interest rate swaps in order to fix a portion of its variable rate debt. The swaps had a combined notional value of \$35.0 million and a fair value of \$(2.3) million and \$(1.1) million at March 31, 2008 and December 31, 2007, respectively. The counterparties to the swaps are major financial institutions. In February 2007, the Company completed a refinancing of its existing industrial development bonds to fix the interest rate of an additional \$5.0 million of debt.

*Foreign Exchange Risk.* A significant portion of Quaker's revenues and earnings is generated by its foreign operations. These foreign operations also hold a significant portion of Quaker's assets and liabilities. All such operations use the local currency as their functional currency. Accordingly, Quaker's financial results are affected by risks typical of global business such as currency fluctuations, particularly between the U.S. dollar, the Brazilian real, the Chinese renminbi and the E.U. euro. As exchange rates vary, Quaker's results can be materially affected.

The Company generally does not use financial instruments that expose it to significant risk involving foreign currency transactions; however, the size of non-U.S. activities has a significant impact on reported operating results and the attendant net assets. During the past three most recent fiscal years, sales by non-U.S. subsidiaries accounted for approximately 55% to 58% of the consolidated net annual sales.

In addition, the Company often sources inventory among its worldwide operations. This practice can give rise to foreign exchange risk resulting from the varying cost of inventory to the receiving location as well as from the revaluation of intercompany balances. The Company mitigates this risk through local sourcing efforts.

*Commodity Price Risk.* Many of the raw materials used by Quaker are commodity chemicals, and, therefore, Quaker's earnings can be materially adversely affected by market changes in raw material prices. In certain cases, Quaker has entered into fixed-price purchase contracts having a term of up to one year. These contracts provide for protection to Quaker if the price for the contracted raw materials rises, however, in certain limited circumstances, Quaker will not realize the benefit if such prices decline.

*Credit Risk.* Quaker establishes allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of Quaker's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Downturns in the overall economic climate may also tend to exacerbate specific customer financial issues. A significant portion of Quaker's revenues is derived from sales to customers in the U.S.





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steel and automotive industries, where a number of bankruptcies occurred during recent years and companies have experienced financial difficulties. When a bankruptcy occurs, Quaker must judge the amount of proceeds, if any, that may ultimately be received through the bankruptcy or liquidation process. In addition, as part of its terms of trade, Quaker may custom manufacture products for certain large customers and/or may ship product on a consignment basis. These practices may increase the Company's exposure should a bankruptcy occur, and may require write-down or disposal of certain inventory due to its estimated obsolescence or limited marketability. Customer returns of products or disputes may also result in similar issues related to the realizability of recorded accounts receivable or returned inventory.

**Item 4. Controls and Procedures.**

*Evaluation of disclosure controls and procedures.* Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Securities Exchange Act of 1934 (the Exchange Act) is accumulated and communicated to the issuer's management, including its principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation of such controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's principal executive officer and principal financial officer have concluded that the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)), are effective to reasonably assure that information required to be disclosed by the Company in the reports it files under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

*Changes in internal controls.* The Company is in the process of implementing a global ERP system. At the end of 2007, subsidiaries representing more than 75% of consolidated revenue were operational on the global ERP system. Additional subsidiaries and CMS sites have been implemented and are planned to be implemented during 2008. The Company is taking the necessary steps to monitor and maintain its internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during this period of change.

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**PART II. OTHER INFORMATION**

Items 1, 1A., 2, 3, 4 and 5 of Part II are inapplicable and have been omitted.

**Item 6. Exhibits**

(a) Exhibits

31.1 Certification of Chief Executive Officer of the Company pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934

31.2 Certification of Chief Financial Officer of the Company pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934

32.1 Certification of Ronald J. Naples Pursuant to 18 U.S. C. Section 1350

32.2 Certification of Mark A. Featherstone Pursuant to 18 U.S. C. Section 1350

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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.

QUAKER CHEMICAL CORPORATION  
(Registrant)

/s/ Mark A. Featherstone

**Mark A. Featherstone, officer duly authorized to sign this report,  
Vice President and Chief Financial Officer**

Date: April 30, 2008