

INNOSPEC INC.
Form 10-Q
November 05, 2014
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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 September 30, 2014

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 1-13879

INNOSPEC INC.

(Exact name of registrant as specified in its charter)

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

98-0181725
**(I.R.S. Employer
Identification No.)**

8310 South Valley Highway
Suite 350
Englewood
Colorado
(Address of principal executive offices)

80112
(Zip Code)

Registrant's telephone number, including area code: (303) 792 5554

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

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

Class	Outstanding as of October 30, 2014
Common Stock, par value \$0.01	24,428,284

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CAUTIONARY STATEMENT RELATIVE TO FORWARD-LOOKING STATEMENTS

This Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts included or incorporated herein may constitute forward-looking statements. Such forward-looking statements include statements (covered by words like expects, estimates, anticipates, may, believes or similar words or expressions), for example, which relate to earnings growth potential, operating performance, events or developments that we expect or anticipate will or may occur in the future. Although forward-looking statements are believed by management to be reasonable when made, they are subject to certain risks, uncertainties and assumptions, and our actual performance or results may differ materially from these forward-looking statements. Additional information regarding risks, uncertainties and assumptions relating to Innospec and affecting our business operations and prospects are described in Innospec's Annual Report on Form 10-K for the year ended December 31, 2013, and other reports filed with the U.S. Securities and Exchange Commission. You are urged to review our discussion of risks and uncertainties that could cause actual results to differ from forward-looking statements under the heading Risk Factors in such reports. Innospec undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of ContentsPART I FINANCIAL INFORMATION**Item 1 Financial Statements****INNOSPEC INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)**

(in millions, except share and per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Net sales	\$ 228.2	\$ 192.8	\$ 670.2	\$ 577.2
Cost of goods sold	(154.6)	(135.4)	(462.3)	(396.6)
Gross profit	73.6	57.4	207.9	180.6
Operating expenses:				
Selling, general and administrative	(42.4)	(31.8)	(122.1)	(99.0)
Research and development	(6.0)	(5.7)	(17.3)	(16.6)
Impairment of Octane Additives segment goodwill	0.0	(0.4)	0.0	(1.0)
Total operating expenses	(48.4)	(37.9)	(139.4)	(116.6)
Operating income	25.2	19.5	68.5	64.0
Other net income/(expense)	1.0	(0.8)	2.2	(0.8)
Interest expense	(0.9)	(0.5)	(2.8)	(1.4)
Interest income	0.1	0.1	0.3	0.3
Income before income taxes	25.4	18.3	68.2	62.1
Income taxes	(4.6)	(4.3)	(12.0)	(13.0)
Net income	\$ 20.8	\$ 14.0	\$ 56.2	\$ 49.1
Earnings per share:				
Basic	\$ 0.85	\$ 0.59	\$ 2.30	\$ 2.09
Diluted	\$ 0.83	\$ 0.58	\$ 2.26	\$ 2.04
Weighted average shares outstanding (in thousands):				
Basic	24,420	23,621	24,394	23,518

Diluted	24,915	24,096	24,849	24,085
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The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

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INNOSPEC INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in millions)	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2014	2013	2014	2013
Net income	\$ 20.8	\$ 14.0	\$ 56.2	\$ 49.1
Other comprehensive income/(loss):				
Changes in cumulative translation adjustment	(6.0)	2.2	(6.2)	(1.6)
Changes in unrealized gains/(losses) on derivative instruments, net of tax of \$0.0, \$0.0, \$0.0 and \$0.0, respectively	0.0	0.0	0.0	(0.1)
Amortization of prior service credit, net of tax of \$0.1, \$0.1, \$0.2 and \$0.2, respectively	(0.2)	(0.2)	(0.8)	(0.7)
Amortization of actuarial net losses, net of tax of \$(0.2), \$(0.3), \$(0.8) and \$(1.0), respectively	1.1	1.4	3.3	4.0
Total other comprehensive income/(loss)	(5.1)	3.4	(3.7)	1.6
Total comprehensive income	\$ 15.7	\$ 17.4	\$ 52.5	\$ 50.7

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

Table of Contents**INNOSPEC INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(in millions, except share and per share data)	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	\$ 90.4	\$ 80.2
Short-term investments	4.9	6.6
Trade and other accounts receivable (less allowances of \$4.4 and \$2.0, respectively)	117.3	135.8
Inventories (less allowances of \$9.7 and \$9.5, respectively):		
Finished goods	118.9	95.3
Work in progress	1.9	1.9
Raw materials	51.1	61.7
Total inventories	171.9	158.9
Current portion of deferred tax assets	8.7	8.7
Prepaid expenses	3.8	5.8
Prepaid income taxes	0.6	11.4
Total current assets	397.6	407.4
Property, plant and equipment:		
Gross cost	159.8	175.1
Less accumulated depreciation	(99.1)	(114.7)
Net property, plant and equipment	60.7	60.4
Goodwill	187.9	187.9
Other intangible assets	120.2	126.8
Deferred finance costs	1.3	1.8
Deferred tax assets, net of current portion	6.1	8.6
Other non-current assets	0.8	1.8
Total assets	\$ 774.6	\$ 794.7

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

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INNOSPEC INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS - (Continued)

(in millions, except share and per share data)	September 30, 2014 (Unaudited)	December 31, 2013
<u>Liabilities and Stockholders' Equity</u>		
Current liabilities:		
Accounts payable	\$ 51.8	\$ 63.3
Accrued liabilities	65.3	73.5
Current portion of long-term debt	0.0	5.3
Current portion of plant closure provisions	4.1	6.2
Current portion of unrecognized tax benefits	0.0	6.8
Current portion of deferred tax liabilities	0.0	0.2
Current portion of deferred income	0.2	0.3
Total current liabilities	121.4	155.6
Long-term debt, net of current portion	115.0	142.7
Plant closure provisions, net of current portion	27.4	26.2
Unrecognized tax benefits, net of current portion	5.9	6.2
Deferred tax liabilities, net of current portion	10.8	9.5
Pension liabilities	29.2	39.0
Acquisition-related contingent consideration	4.9	4.6
Other non-current liabilities	1.5	0.3
Deferred income, net of current portion	1.0	1.2
Total liabilities	317.1	385.3
Stockholders' equity:		
Common stock, \$0.01 par value, authorized 40,000,000 shares, issued 29,554,500 shares	0.3	0.3
Additional paid-in capital	310.5	308.8
Treasury stock (5,126,216 and 5,207,947 shares at cost, respectively)	(72.8)	(73.3)
Retained earnings	377.1	327.5
Accumulated other comprehensive loss	(157.6)	(153.9)
Total stockholders' equity	457.5	409.4
Total liabilities and stockholders' equity	\$ 774.6	\$ 794.7

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

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INNOSPEC INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in millions)	Nine Months Ended September 30	
	2014	2013
<u>Cash Flows from Operating Activities</u>		
Net income	\$ 56.2	\$ 49.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21.1	13.4
Impairment of Octane Additives segment goodwill	0.0	1.0
Deferred taxes	1.9	0.9
Repayment of promissory note in civil complaint settlement	(5.0)	(5.0)
Excess tax benefit from stock-based payment arrangements	(0.7)	(2.9)
Cash contributions to defined benefit pension plans	(8.8)	(8.1)
Non-cash expense of defined benefit pension plans	3.0	2.6
Stock option compensation	1.7	1.9
Changes in assets and liabilities, net of effects of acquired and divested companies:		
Trade and other accounts receivable	17.4	7.2
Inventories	(14.8)	(24.5)
Prepaid expenses	2.0	(2.2)
Accounts payable and accrued liabilities	(20.0)	3.9
Accrued income taxes	10.7	(5.3)
Plant closure provisions	(0.7)	0.6
Unrecognized tax benefits	(7.2)	(0.3)
Other non-current assets and liabilities	2.2	(0.5)
Net cash provided by operating activities	59.0	31.8
<u>Cash Flows from Investing Activities</u>		
Capital expenditures	(9.5)	(6.6)
Business combinations, net of cash acquired	0.3	(50.6)
Internally developed software and other costs	(6.1)	(9.0)
Proceeds on disposal of property, plant and equipment	0.2	0.1
Purchase of short-term investments	(4.2)	(5.3)
Sale of short-term investments	5.8	4.1
Net cash provided by/(used in) investing activities	(13.5)	(67.3)
<u>Cash Flows from Financing Activities</u>		
Proceeds from revolving credit facility	8.0	86.0
Repayments of revolving credit facility	(35.0)	(18.0)
Repayments of term loans	(0.9)	0.0
Refinancing costs	(0.1)	(0.7)

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Excess tax benefit from stock-based payment arrangements	0.7	2.9
Dividend paid	(6.6)	0.0
Issue of treasury stock	0.4	0.7
Repurchase of common stock	(0.9)	(3.7)
Net cash provided by/(used in) financing activities	(34.4)	67.2
Effect of foreign currency exchange rate changes on cash	(0.9)	(0.2)
Net change in cash and cash equivalents	10.2	31.5
Cash and cash equivalents at beginning of period	80.2	22.4
Cash and cash equivalents at end of period	\$ 90.4	\$ 53.9

Amortization of deferred finance costs of \$0.5 million (2013 \$0.3 million) are included in depreciation and amortization in the cash flow statement but in interest expense in the income statement.

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

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INNOSPEC INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

(Unaudited)

(in millions)	Common Stock	Additional Paid-In Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders Equity
Balance at December 31, 2013	\$ 0.3	\$ 308.8	\$ (73.3)	\$ 327.5	\$ (153.9)	\$ 409.4
Net income				56.2		56.2
Dividend paid (\$0.27 per share)				(6.6)		(6.6)
Changes in cumulative translation adjustment					(6.2)	(6.2)
Treasury stock re-issued		(0.7)	1.4			0.7
Treasury stock repurchased			(0.9)			(0.9)
Excess tax benefit from stock-based payment arrangements		0.7				0.7
Stock option compensation		1.7				1.7
Amortization of prior service credit, net of tax					(0.8)	(0.8)
Amortization of actuarial net losses, net of tax					3.3	3.3
Balance at September 30, 2014	\$ 0.3	\$ 310.5	\$ (72.8)	\$ 377.1	\$ (157.6)	\$ 457.5

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

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INNOSPEC INC. AND SUBSIDIARIES

NOTES TO THE UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X under the Securities Exchange Act of 1934. Accordingly, they do not include all the information and notes necessary for a comprehensive presentation of financial position, results of operations and cash flows.

It is our opinion, however, that all adjustments (consisting of normal, recurring adjustments, unless otherwise disclosed) have been made which are necessary for the financial statements to be fairly stated. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K filed on February 13, 2014.

The results for the interim period covered by this report are not necessarily indicative of the results to be expected for the full year.

We have reclassified certain prior period amounts to conform to the current period presentation.

When we use the terms the Corporation, Company, Registrant, we, us and our, we are referring to Innospec and its consolidated subsidiaries (Innospec) unless otherwise indicated or the context otherwise requires.

Table of Contents**NOTE 2 SEGMENTAL REPORTING**

Innospec divides its business into three segments for management and reporting purposes: Fuel Specialties, Performance Chemicals and Octane Additives. The Fuel Specialties and Performance Chemicals segments operate in markets where we actively seek growth opportunities although their ultimate customers are different. The Octane Additives segment continues to decline as expected as our one remaining customer transitions to unleaded fuel.

The Company evaluates the performance of its segments based on operating income. The following table analyzes sales and other financial information by the Company's reportable segments:

(in millions)	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2014	2013	2014	2013
Net sales:				
Fuel Specialties	\$ 156.1	\$ 137.4	\$ 465.4	\$ 403.6
Performance Chemicals	57.0	47.9	172.5	140.2
Octane Additives	15.1	7.5	32.3	33.4
	\$ 228.2	\$ 192.8	\$ 670.2	\$ 577.2
Gross profit:				
Fuel Specialties	\$ 53.2	\$ 42.6	\$ 149.1	\$ 130.1
Performance Chemicals	13.7	11.1	42.6	32.9
Octane Additives	6.7	3.7	16.2	17.6
	\$ 73.6	\$ 57.4	\$ 207.9	\$ 180.6
Operating income:				
Fuel Specialties	\$ 24.5	\$ 22.3	\$ 67.8	\$ 66.4
Performance Chemicals	6.6	5.6	20.9	17.1
Octane Additives	4.9	2.1	12.0	13.0
Pension charge	(0.8)	(0.7)	(2.5)	(2.1)
Corporate costs	(10.0)	(9.4)	(29.7)	(29.4)
Impairment of Octane Additives segment goodwill	0.0	(0.4)	0.0	(1.0)
Total operating income	\$ 25.2	\$ 19.5	\$ 68.5	\$ 64.0

Restructuring charges separately disclosed in prior periods have been reclassified to corporate costs. We have reclassified the prior period amounts to conform to the current period presentation.

The pension charge relates to the United Kingdom defined benefit pension plan which is closed to future service accrual. The charges related to our other much smaller pension arrangements in the U.S. and overseas are included in the segment and income statement captions consistent with the related employees' costs.

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The following table presents a summary of the depreciation and amortization charges incurred by the Company's reportable segments:

(in millions)	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Depreciation:				
Fuel Specialties	\$ 1.0	\$ 0.5	\$ 3.2	\$ 1.7
Performance Chemicals	0.9	0.9	2.8	2.6
Octane Additives	0.1	0.1	0.3	0.5
Corporate	0.5	0.6	1.6	1.7
	\$ 2.5	\$ 2.1	\$ 7.9	\$ 6.5
Amortization:				
Fuel Specialties	\$ 1.9	\$ 1.6	\$ 6.2	\$ 4.8
Performance Chemicals	1.1	0.6	3.7	1.3
Octane Additives	0.0	0.2	0.0	0.5
Corporate	0.9	0.0	2.8	0.0
	\$ 3.9	\$ 2.4	\$ 12.7	\$ 6.6

NOTE 3 EARNINGS PER SHARE

Basic earnings per share is based on the weighted average number of common shares outstanding during the period. Diluted earnings per share includes the effect of options that are dilutive and outstanding during the period. Per share amounts are computed as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Numerator (in millions):				
Net income available to common stockholders	\$ 20.8	\$ 14.0	\$ 56.2	\$ 49.1
Denominator (in thousands):				
Weighted average common shares outstanding	24,420	23,621	24,394	23,518
Dilutive effect of stock options and awards	495	475	455	567
Denominator for diluted earnings per share	24,915	24,096	24,849	24,085
Net income per share, basic:	\$ 0.85	\$ 0.59	\$ 2.30	\$ 2.09

Net income per share, diluted:	\$ 0.83	\$ 0.58	\$ 2.26	\$ 2.04
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In the three and nine months ended September 30, 2014, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were 36,775 and 8,049, respectively. In the three and nine months ended September 30, 2013, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were nil and nil, respectively.

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The following table summarizes the goodwill movement year on year:

(in millions)	Nine Months Ended	
	September 30	September 30
	2014	2013
At January 1:		
Gross cost ⁽¹⁾	\$ 424.4	\$ 384.2
Accumulated impairment losses	(236.5)	(235.2)
Net book amount	\$ 187.9	\$ 149.0
Exchange effect	(0.3)	(0.1)
Acquisitions	0.0	17.0
Adjustments to purchase price allocation	0.3	0.4
Impairment losses	0.0	(1.0)
At September 30:		
Gross cost ⁽¹⁾	\$ 424.4	\$ 401.5
Accumulated impairment losses	(236.5)	(236.2)
Net book amount	\$ 187.9	\$ 165.3

⁽¹⁾ Gross cost for 2014 and 2013 is net of \$298.5 million of historical accumulated amortization.

The Bachman Group Companies Acquisition

On November 4, 2013, the Company acquired 100% of the voting equity interests in Bachman Services, Inc., Specialty Intermediates, Inc., Bachman Production Specialties, Inc. and Bachman Drilling & Production Specialties, Inc. (collectively *Bachman*). *Bachman* provide chemicals and services to the oil and gas industry and are based in Oklahoma City, Oklahoma. We purchased *Bachman* for a cash consideration of \$45.8 million and by the issuance of 319,953 shares of unregistered Innospec Inc. common stock to the previous owners with a fair value of approximately \$15 million, based on the Innospec share price on the closing date. We acquired the businesses in order to move us towards critical mass, and bring both good technology and market positioning in the oilfield specialties sector which forms part of our Fuel Specialties segment.

The following table summarizes the calculations of the total purchase price and the allocation of the purchase price to the assets acquired and liabilities assumed for *Bachman*:

(in millions)	Bachman
Other intangible assets	\$ 25.9
Goodwill	23.2

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Deferred tax on intangibles	(7.6)
Other net assets acquired, excluding cash of \$2.0 million	17.0
Purchase price, net of cash acquired	\$ 58.5

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In the second quarter of 2014, a \$0.3 million reduction in the purchase price was agreed with the previous owners of Bachman in respect of post-closing working capital adjustments, resulting in a corresponding reduction in other net assets acquired. Also in the second quarter of 2014, we finalized the calculations of the fair values of assets acquired and liabilities assumed in the acquisition of Bachman, resulting in a further \$0.3 million reduction in other net assets and a corresponding increase in goodwill.

Bachman, and the associated goodwill, are included within our Fuel Specialties segment for management and reporting purposes.

NOTE 5 OTHER INTANGIBLE ASSETS

The following table summarizes the other intangible assets movement year on year:

(in millions)	Nine Months Ended	
	September 30	
	2014	2013
Gross cost at January 1	\$ 175.5	\$ 106.2
Capitalization of internally developed software and other costs	6.1	9.0
Acquisitions	0.0	33.7
Exchange effect	0.0	0.1
Gross cost at September 30	181.6	149.0
Accumulated amortization at January 1	(48.7)	(37.6)
Amortization expense	(12.7)	(6.6)
Exchange effect	0.0	0.0
Accumulated amortization at September 30	(61.4)	(44.2)
Net book amount at September 30	\$ 120.2	\$ 104.8

Capitalization of internally developed software and other costs

We are continuing with the implementation of a new, company-wide, information system platform. At September 30, 2014, we had capitalized \$25.6 million (2013 \$19.1 million) in relation to this internally developed software.

Amortization expense

(in millions)	Nine Months Ended	
	September 30	
	2014	2013
Product rights	\$ (2.8)	\$ (0.3)
Brand names	(0.4)	0.0
Technology	(1.7)	(1.5)

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Customer relationships	(3.5)	(2.7)
Patents	(0.2)	(0.3)
Internally developed software	(2.8)	0.0
Non-compete agreements	(0.6)	(0.6)
Marketing related	(0.7)	(1.2)
Total	\$ (12.7)	\$ (6.6)

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NOTE 6 PENSION PLANS

The Company maintains a defined benefit pension plan (the Plan) covering a number of its current and former employees in the United Kingdom, although it does also have other much smaller pension arrangements in the U.S. and overseas. The Plan is closed to future service accrual but has a large number of deferred and current pensioners.

(in millions)	Three Months Ended September 30 2014	Nine Months Ended September 30 2013
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