INNOSPEC INC.
Form 10-Q
August 07, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

Commission file number 1-13879

INNOSPEC INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**98-0181725**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**
Innospec Manufacturing Park	
Oil Sites Road	
Ellesmere Port	
Cheshire	
United Kingdom	**CH65 4EY**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: 011-44-151-355-3611

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

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

Large accelerated filer ¨		Accelerated filer x
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 x

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

Class	**Outstanding as of July 31, 2008**
Common Stock, par value $0.01	23,595,331

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CAUTIONARY STATEMENT RELATIVE TO FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements which address operating performance, events or developments that we expect or anticipate will occur in the future, including, without limitation, all of the Company s guidance for sales, gross margins, net income, growth potential and other measures of financial performance. Although such statements are believed by management to be reasonable when made, caution should be exercised not to place undue reliance on forward-looking statements, which are subject to certain risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, actual results may differ materially from those expressed or implied by such forward-looking statements and assumptions. Risks, assumptions and uncertainties include, without limitation, changes in the terms of trading with significant customers or gain or loss thereof, changes in the costs and availability of energy, raw materials, and other inputs, our ability to continue to achieve organic growth in our fuel specialties and active chemicals businesses, our ability to successfully integrate any acquisitions in our non-Octane Additives businesses, the effects of changing government regulations and economic and market conditions, competition and changes in demand and business and legal risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations and market risks related to changes in interest rates and foreign exchange rates, government investigations, material fines or other penalties resulting from the Company s voluntary disclosure to the Office of Foreign Assets Control of the U.S. Department of the Treasury and the SEC, DOJ and SFO investigations into the Company s involvement in the United Nations Oil for Food Program, or other regulatory actions and other risks, uncertainties and assumptions identified in the Company s Annual Report on Form 10-K for the year ended December 31, 2007 and those identified in the Company s other reports filed with the Securities and Exchange Commission. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

PART I FINANCIAL INFORMATION

ITEM 1 Financial Statements

INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
(in millions except share and per share data)	**2008**	**2007**	**2008**	**2007**
Net sales (Note 2)	$ 145.3	$ 141.4	$ 314.0	$ 286.7
Cost of goods sold	(104.2)	(93.6)	(221.2)	(189.2)
Gross profit (Note 2)	41.1	47.8	92.8	97.5
Operating expenses				
Selling, general and administrative	(29.1)	(24.4)	(60.9)	(49.5)
Research and development	(3.9)	(3.4)	(7.6)	(6.6)
Restructuring charge	(1.1)	(1.3)	(1.6)	(2.0)
Amortization of intangible assets (Note 4)	(2.0)	(4.6)	(4.1)	(7.7)
Impairment of Octane Additives business goodwill (Note 5)	(1.0)	(3.3)	(2.1)	(7.7)
Profit on disposal	0.4		0.4	
	(36.7)	(37.0)	(75.9)	(73.5)
Operating income (Note 2)	4.4	10.8	16.9	24.0
Other net (expense)/income	(1.3)	1.5	(0.8)	1.6
Interest expense	(1.6)	(1.8)	(3.3)	(4.3)
Interest income	0.3	0.7	0.7	1.6
Income before income taxes	1.8	11.2	13.5	22.9
Income taxes (Note 6)	(1.0)	(4.4)	(5.4)	(10.1)
Net income	$ 0.8	$ 6.8	$ 8.1	$ 12.8
Earnings per share (Note 7):				
Basic	$ 0.03	$ 0.28	$ 0.34	$ 0.54
Diluted	$ 0.03	$ 0.27	$ 0.33	$ 0.52
Weighted average shares outstanding (in thousands) (Note 7):				
Basic	23,505	24,002	23,593	23,899
Diluted	24,130	24,875	24,225	24,846
Dividend declared per common share (Note 8):	$	$	$ 0.05	$ 0.045

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

INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(in millions, except per share data)	June 30 2008 (Unaudited)	December 31 2007
Assets		
Current assets		
Cash and cash equivalents	$ 16.4	$ 24.3
Accounts receivable (less allowance of $2.3 and $2.0, respectively)	88.1	94.2
Inventories		
Finished goods	103.4	100.4
Work in progress	11.9	12.6
Raw materials	32.2	19.6
Total inventories	147.5	132.6
Prepaid expenses	6.6	5.0
Prepaid income taxes	2.0	
Total current assets	260.6	256.1
Property, plant and equipment	124.7	119.4
Less accumulated depreciation	(61.1)	(53.2)
Net property, plant and equipment	63.6	66.2
Goodwill Octane Additives (Note 5)	10.6	12.7
Goodwill Other (Note 5)	139.3	139.1
Intangible assets (Note 4)	37.9	41.9
Pension asset (Note 3)	37.4	34.8
Deferred finance costs		0.3
Total assets	$ 549.4	$ 551.1

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

INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)

(in millions, except per share data)	**June 30 2008 (Unaudited)**	**December 31 2007**
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	$ 63.3	$ 50.9
Accrued liabilities	60.6	65.7
Accrued income taxes		6.9
Short-term borrowing (Note 9)	81.0	20.0
Current portion of plant closure provisions (Note 10)	5.2	4.4
Current portion of unrecognized tax benefits (Note 6)	8.5	12.6
Current portion of deferred income	0.1	0.1
Current portion of deferred income taxes	0.8	0.1
Total current liabilities	219.5	160.7
Long-term debt, net of current portion (Note 9)		61.0
Plant closure provisions, net of current portion (Note 10)	22.4	22.4
Unrecognized tax benefits, net of current portion (Note 6)	29.0	27.4
Deferred income taxes, net of current portion	4.7	7.3
Other non-current liabilities	0.2	
Deferred income, net of current portion	0.8	0.8
Minority interest	0.1	
Commitments and contingencies (Note 11)		
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	280.7	280.6
Treasury stock (5,965,013 and 5,777,417 shares at cost, respectively)	(65.1)	(58.2)
Retained earnings	128.4	121.5
Accumulated other comprehensive income	(71.6)	(72.7)
Total stockholders equity	272.7	271.5
Total liabilities and stockholders equity	$ 549.4	$ 551.1

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

INNOSPEC INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30	
(in millions)	**2008**	**2007**
Cash Flows from Operating Activities		
Net income	$ 8.1	$ 12.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11.6	14.7
Impairment of Octane Additives business goodwill (Note 5)	2.1	7.7
Deferred income taxes	(1.8)	(0.7)
(Profit)/loss on disposal of property, plant and equipment	(0.4)	
Changes in working capital:		
Accounts receivable and prepaid expenses	5.2	(8.8)
Inventories	(14.3)	(12.6)
Accounts payable and accrued liabilities	8.3	(6.6)
Excess tax benefit from stock based payment arrangements	(2.1)	
Income taxes and other current liabilities	(9.0)	(2.0)
Movement on plant closure provisions	0.6	(0.3)
Movement on pension asset/(liability)	(2.6)	(0.9)
Stock option compensation charge	2.0	1.3
Movement on other non-current liabilities	(4.5)	
Movement on deferred income		(2.4)
Net cash provided by operating activities	3.2	2.2
Cash Flows from Investing Activities		
Capital expenditures	(4.3)	(4.9)
Proceeds on disposal of property, plant and equipment	1.3	
Acquisition of intangible asset		(28.4)
Net cash (used in) investing activities	(3.0)	(33.3)
Cash Flows from Financing Activities		
Net receipt/(repayment) of revolving credit facility	16.0	(13.0)
Repayment of term loan	(20.0)	(15.0)
Receipt of short-term borrowing	4.0	
Payments on capital leases		(0.1)
Dividends paid	(1.2)	(1.1)
Excess tax benefit from stock based payment arrangements	2.1	
Issue of treasury stock	1.8	3.1
Repurchase of common stock	(10.5)	(10.0)
Net cash (used in) financing activities	(7.8)	(36.1)
Effect of exchange rate changes on cash	(0.3)	0.1
Net change in cash and cash equivalents	(7.9)	(67.1)
Cash and cash equivalents at beginning of period	24.3	101.9
Cash and cash equivalents at end of period	$ 16.4	$ 34.8

Amortization of deferred finance costs of $0.3m (2007 $0.6m) are included in depreciation and amortization in the cash flow statement but in interest in the income statement.

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

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, 2007	$ 0.3	$ 280.6	$ (58.2)	$ 121.5	$ (72.7)	$ 271.5
Net income				8.1		8.1
Dividend ($0.05 per share)				(1.2)		(1.2)
Derivatives (1)					(0.3)	(0.3)
Net CTA change (2)					1.4	1.4
Treasury stock re-issued		(0.4)	3.6			3.2
Treasury stock repurchased			(10.5)			(10.5)
Stock option compensation charge		0.5				0.5
Balance at June 30, 2008	$ 0.3	$ 280.7	$ (65.1)	$ 128.4	$ (71.6)	$ 272.7

(1) Changes in unrealized gains/(losses) on derivative instruments, net of tax.
(2) Changes in cumulative translation adjustment.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
(in millions)	2008	2007	2008	2007
Net income for the period	$ 0.8	$ 6.8	$ 8.1	$ 12.8
Changes in cumulative translation adjustment		0.6	1.4	1.6
Unrealized gains/(losses) on derivative instruments, net of tax	0.5	0.1	(0.3)	
Amortization of net actuarial losses, net of tax of $0.2 million and $0.3 million, respectively		0.3		0.7
Total comprehensive income	$ 1.3	$ 7.8	$ 9.2	$ 15.1

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

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes necessary for a comprehensive presentation of financial position, results of operations and cash flows. Certain revisions have been made to prior year components of cash flows from financing activities in the consolidated statements of cash flows to conform to current year classifications. This change in presentation did not result in a change to net cash (used in) financing activities.

It is our opinion, however, that all material adjustments have been made which are necessary for the financial statements to be fairly stated. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K filed on February 25, 2008.

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

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

NOTE 2 SEGMENTAL REPORTING

Innospec divides its business into three distinct segments for both management and reporting purposes: Fuel Specialties, Active Chemicals and Octane Additives. The Fuel Specialties and Active Chemicals businesses both operate in markets where we actively seek growth opportunities albeit their end customers are very different. The Octane Additives business, although still profitable, is characterized by substantial declining demand.

On June 23, 2008 the Company announced a further streamlining of its business into a unified, sales-led global business focused on rapidly meeting customers needs anywhere in the world. The Company will move to an integrated regional model and run its growth businesses as one streamlined business operating across three geographical regions Americas, EMEA (i.e. Europe, Middle East and Africa), and Asia-Pacific.

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(in millions)	Three Months Ended June 30 2008	Three Months Ended June 30 2007	Six Months Ended June 30 2008	Six Months Ended June 30 2007
Net sales				
Fuel Specialties	$ 94.3	$ 86.0	$ 208.9	$ 171.8
Active Chemicals	37.9	34.0	73.4	68.0
Octane Additives	13.1	21.4	31.7	46.9
	$ 145.3	$ 141.4	$ 314.0	$ 286.7
Gross profit				
Fuel Specialties	$ 32.3	$ 29.0	$ 71.7	$ 58.9
Active Chemicals	2.0	5.8	6.8	13.2
Octane Additives	6.8	13.0	14.3	25.4
	$ 41.1	$ 47.8	$ 92.8	$ 97.5
Operating income				
Fuel Specialties	$ 15.2	$ 14.4	$ 38.8	$ 28.7
Active Chemicals	(2.4)	1.0	(2.3)	3.6
Octane Additives	3.5	6.9	0.5	14.4
FAS 158/87 pension (charge)	(0.6)	(1.2)	(1.2)	(2.3)
Corporate costs	(9.6)	(5.7)	(15.6)	(10.7)
	6.1	15.4	20.2	33.7
Restructuring charge	(1.1)	(1.3)	(1.6)	(2.0)
Impairment of Octane Additives business goodwill	(1.0)	(3.3)	(2.1)	(7.7)
Profit on disposal	0.4		0.4	
Total operating income	4.4	10.8	16.9	24.0
Other net (expense)/income	(1.3)	1.5	(0.8)	1.6
Interest expense	(1.6)	(1.8)	(3.3)	(4.3)
Interest income	0.3	0.7	0.7	1.6
Income before income taxes	$ 1.8	$ 11.2	$ 13.5	$ 22.9

Corporate costs for the three and six months ended June 30, 2008 include the expensing of $3.9 million of advisory and financing costs related to two large potential acquisitions that the Company is now not pursuing.

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

(in millions)	Three Months Ended June 30 2008	2007	Six Months Ended June 30 2008	2007
Depreciation				
Fuel Specialties	$ 0.8	$ 0.5	$ 1.3	$ 1.0
Active Chemicals	1.4	0.7	2.6	2.1
Octane Additives	0.8	0.8	1.7	1.6
Corporate	0.8	0.9	1.6	1.7
Total	$ 3.8	$ 2.9	$ 7.2	$ 6.4
Amortization				
Fuel Specialties	$ 0.6	$ 0.6	$ 1.2	$ 0.9
Active Chemicals	0.3	0.4	0.7	0.7
Octane Additives	1.1	3.6	2.2	6.1
	$ 2.0	$ 4.6	$ 4.1	$ 7.7

NOTE 3 PENSION PLANS

The Company maintains a contributory defined benefit pension plan covering a number of its United Kingdom employees. The components of the net periodic cost were as follows:

(in millions)	Three Months Ended June 30 2008	2007	Six Months Ended June 30 2008	2007
Service cost	$ (1.4)	$ (1.3)	$ (2.8)	$ (2.6)
Interest cost on projected benefit obligation	(12.2)	(11.3)	(24.4)	(22.5)
Expected return on plan assets	13.0	11.9	26.0	23.8
Amortization of net actuarial losses		(0.5)		(1.0)
	$ (0.6)	$ (1.2)	$ (1.2)	$ (2.3)

At June 30, 2008, the Company has a pension asset of $37.4 million recorded in its balance sheet in accordance with FAS 158.

NOTE 4 INTANGIBLE ASSETS

(in millions)	Six Months Ended June 30 2008	2007
Gross cost at January 1	$ 115.3	$ 86.9
Acquisitions		28.4

Gross cost at June 30	115.3	115.3
Accumulated amortization at January 1	(73.4)	(56.7)
Amortization charge	(4.1)	(7.7)
Exchange effect	0.1	0.1
Accumulated amortization at June 30	(77.4)	(64.3)
Net book amount at June 30	$ 37.9	$ 51.0

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Ethyl

An intangible asset of $28.4 million was recognized in the second quarter of 2007 in respect of Ethyl foregoing their entitlement effective April 1, 2007 to a share of the future income stream under the sales and marketing agreements (TMAs) to market and sell tetra ethyl lead (TEL). The TMAs covered the sale of TEL for use in automotive gasoline and aviation gasoline which we disclose within our Octane Additives business segment and our Fuel Specialties business segment, respectively. We allocated the individual components of the intangible asset attributable to TEL for use in automotive gasoline and aviation gasoline by reference to the forecast future income streams and associated cash flows from those markets which Ethyl would have shared in. No residual value was attributed to the intangible asset. Accordingly, commencing April 1, 2007, the amount attributed to the Octane Additives business segment is being amortized straight-line to December 31, 2010 and the amount attributed to the Fuel Specialties business segment is being amortized straight-line to December 31, 2017. An amortization charge of $2.8 million was recognized in the first half year of 2008 (2007 $1.4 million).

Veritel

An intangible asset of $60.6 million was recognized in 2001, and amortized straight-line to December 31, 2007, in relation to amounts payable to Veritel Chemicals BV by our Swiss subsidiary pursuant to a marketing agreement effective July 1, 2001. The asset was fully amortized as at December 31, 2007. No amortization was recognized in the first half year of 2008 (2007 $5.0 million).

Others

The remaining intangible assets of $26.3 million relate to those recognized in the acquisition accounting in respect of Finetex (now merged into Innospec Active Chemicals LLC), Innospec Widnes Limited (previously known as Aroma Fine Chemicals Limited) and Innospec Fuel Specialties LLC (previously known as Octel Starreon LLC). These assets are being amortized straight-line over periods of up to 13 years. An amortization charge of $1.3 million was recognized in the first half year of 2008 (2007 $1.3 million).

NOTE 5 GOODWILL

	Six Months Ended June 30	
(in millions)	**2008**	**2007**
Gross cost at January 1	$ 449.9	$ 461.9
Impairment of Octane Additives business goodwill	(2.1)	(7.7)
Exchange effect	0.3	0.1
Gross cost at June 30	448.1	454.3
Accumulated amortization at January 1	(298.1)	(298.1)
Exchange effect	(0.1)	
Accumulated amortization at June 30	(298.2)	(298.1)
Net book amount at June 30	$ 149.9	$ 156.2
Octane Additives	$ 10.6	$ 17.1
Other	139.3	139.1
	$ 149.9	$ 156.2

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Impairment of Octane Additives business goodwill

Our Octane Additives business is the world s only producer of tetra ethyl lead (TEL). The Octane Additives business comprises sales of TEL for use in automotive gasoline and trading in respect of our environmental remediation business. Worldwide use of TEL has declined since 1973 following the enactment of the U.S. Clean Air Act of 1970 and similar legislation in other countries. The trend of countries exiting the leaded gasoline market has resulted in a general rate of decline in volume terms in the last few years of between 10% and 25% per annum.

In light of the continuing decline in the Octane Additives market globally, as the Company makes sales of Octane Additives in each quarter, the remaining sales and corresponding cash flows that can be derived from the Octane Additives business are reduced, and accordingly the fair value of the Octane Additives reporting unit is reduced. As a result the Company determined that quarterly impairment reviews be performed from January 1, 2004 and any impairment charge arising be recognized in the relevant quarter. Given the quantum and predictability of the remaining future cash flows from the Octane Additives business the Company expects goodwill impairment charges to be recognized in the income statement on an approximate straight-line basis to December 31, 2010.

NOTE 6 TAXATION

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

On adoption of FIN 48 the Company recognized an increase in its liability for unrecognized tax benefits of $3.1 million which was accounted for as an adjustment to opening retained earnings. A roll-forward of unrecognized tax benefits and associated accrued interest and penalties is as follows:

(in millions)	**Interest and penalties**	**Unrecognized tax benefits**	**Total**
Opening balance at January 1, 2008	$ 3.8	$ 36.2	$ 40.0
Additions for tax positions of prior periods	0.5	1.0	1.5
Settlements	(0.5)	(3.5)	(4.0)
Closing balance at June 30, 2008	3.8	33.7	37.5
Current	(1.6)	(6.9)	(8.5)
Non-current	$ 2.2	$ 26.8	$ 29.0

All of the $37.5 million of unrecognized tax benefits would impact our effective tax rate if recognized.

We recognize accrued interest and penalties associated with uncertain tax positions as part of income taxes in our consolidated statements of income.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As at June 30, 2008, the Company s subsidiaries in France and the United Kingdom are subject to tax authority investigations into their respective transfer pricing policies. The Company does not anticipate that adjustments arising out of these investigations would result in a material change to its financial position as at June 30, 2008.

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company and its U.S. subsidiaries remain open to examination by the IRS for years 1998 onwards due to the net operating losses in the period 1998 to 2002, although no examination is currently underway. The Company s subsidiaries in other major tax jurisdictions are open to examination including France (2004 onwards), Germany (2002 onwards), Switzerland (2005 onwards) and the United Kingdom (2002 onwards). We are currently under examination in various foreign jurisdictions.

NOTE 7 EARNINGS PER SHARE

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

	Three Months Ended June 30		Six Months Ended June 30	
	2008	**2007**	**2008**	**2007**
Numerator (millions of dollars):				
Net income available to common stockholders	$ 0.8	$ 6.8	$ 8.1	$ 12.8
Denominator (in thousands):				
Weighted average common shares outstanding	23,505	24,002	23,593	23,899
Dilutive effect of stock options and awards	625	873	632	947
Denominator for diluted earnings per share	24,130	24,875	24,225	24,846
Net income per share, basic:	$ 0.03	$ 0.28	$ 0.34	$ 0.54
Net income per share, diluted:	$ 0.03	$ 0.27	$ 0.33	$ 0.52

In the three and six months ended June 30, 2008, respectively, the average number of anti-dilutive options excluded from the calculation of diluted earnings per share were 28,366 and 44,484, respectively (2007 3,546 and 7,092, respectively).

NOTE 8 STOCKHOLDERS EQUITY AND SHARE BASED COMPENSATION PLANS

At June 30, 2008, the Company had authorized common stock of 40,000,000 shares (December 31, 2007 40,000,000). Issued shares at June 30, 2008, were 29,554,500 (December 31, 2007 29,554,500) and treasury stock amounted to 5,965,013 shares (December 31, 2007 5,777,417).

On February 22, 2008 the Company announced that its Board of Directors had declared a semi-annual dividend of 5 cents per share payable on April 4, 2008 to stockholders of record as of March 14, 2008.

The Company has five stock option plans, four of which expired by their respective terms in May 2008 at the end of their 10 year life. The Company submitted new plans for stockholder approval to replace those that expired and requested approval to reserve common stock for issuance under each of those plans. Two of these plans provide for the grant of stock options to key employees and one provides for the grant of stock options to non-employee directors. The fourth plan is a savings plan which provides for the grant of stock options to all Company employees provided they commit to make regular savings over a pre-defined period which can then be used to purchase common stock upon vesting of the options. Under the new plans vesting periods range from 27 months to 6 years and in all cases stock options granted expire within 10 years of the date of grant. All grants are at the sole discretion of the Compensation Committee of the Board of Directors. Grants may be priced at market value or at a premium or discount. The fifth plan provides for the grant of stock options to key executives on a

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

matching basis provided they use a proportion of their annual bonus to purchase common stock in the Company on the open market. All four of the plans submitted for stockholder approval were approved at the Company s Annual Meeting of Stockholders on May 6, 2008. The aggregate number of shares of common stock reserved for issuance which can be granted under all five plans is 1,790,000.

Under the rules of the plans which expired in May 2008 no further stock options will be granted and un-awarded shares of common stock previously allocated to these plans cannot be used for further grants. Stock options granted under the plans prior to the expiration date of the plan expire within 10 years of the date of grant.

The fair value of options is calculated using the Black-Scholes model. In some cases certain performance related options are dependent upon external factors such as the Company s share price. The fair value of these options is calculated using a Monte Carlo model.

The following assumptions were used to determine the fair value of options calculated using the Black-Scholes model:

	2008	2007
Dividend yield	0.5%	0.3%
Expected life	4 years	4 years
Volatility	50.1%	43.5%
Risk free interest rate	2.73%	4.47%

The following table summarizes the transactions of the Company s stock option plans for the three and six months ended June 30, 2008:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding at April 1, 2008	1,203,362	$ 4.10	
Grants at discount	1,400	$	$ 22.91
Exercised	(205,841)	$ 7.26	
Forfeitures	(3,370)	$	
Expired	(231)	$ 8.22	
Outstanding at June 30, 2008	995,320	$ 3.46	

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding at January 1, 2008	1,104,893	$ 3.56	
Grants at discount	174,847	$	$ 14.29
Grants at market value	64,472	$ 20.23	$ 7.77
Exercised	(344,291)	$ 5.22	
Forfeitures	(4,370)	$	
Expired	(231)	$ 8.22	
Outstanding at June 30, 2008	995,320	$ 3.46	

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about options outstanding at June 30, 2008:

Range of Exercise Price	Number outstanding at June 30, 2008	Weighted Average Remaining Life in Years	Weighted Average Exercise Price	Number Exercisable and fully vested at June 30, 2008	Weighted Average Remaining Life in Years	Weighted Average Exercise Price
$ 0 - $5	753,595	7.21	$ 0.14	62,226	4.03	$ 1.73
$ 5 - $10	146,587	3.66	$ 5.22	93,495	3.02	$ 7.57
$10 - $15	2,300	5.87	$ 11.50	2,300	5.87	$ 11.50
$20 - $25	64,472	9.65	$ 20.23			$
$25 - $30	28,366	8.65	$ 27.09			$
	995,320			158,021		

The aggregate intrinsic value of fully vested stock options is $0.4 million. Of the 158,021 stock options that are exercisable, 30,460 have performance conditions attached. The total compensation cost for the first half year of 2008 was $2.0 million (2007 $1.3 million). The total compensation cost related to nonvested stock options not yet recognized at June 30, 2008 is $9.3 million and this cost is expected to be recognized over the weighted-average period of 1.93 years.

We have not modified any stock option awards in 2008 or 2007. The total intrinsic value of options exercised in the first half year of 2008 was $1.3 million (2007 $1.7 million). The amount of cash received from the exercise of stock option awards in the first half year of 2008 was $1.8 million (2007 $3.1 million). The Company s policy is to issue shares from Treasury stock to holders of stock options who exercise those options. During the first half year of 2008 the new total fair value of shares vested was $1.2 million (2007 $1.1 million).

The total options vested in the first half year of 2008 were 259,248 (2007 341,844).

An additional long term incentive plan designed to reward selected executives for delivering exceptional performance was recommended by the Compensation Committee, working with its advisors, and approved by the Board of Directors. Under this plan a discretionary bonus will be payable to eligible executives if the Innospec share performance out-performs that of competitors, as measured by the Russell 2000 Index, by a minimum of 10% over the three years from January 2008 to December 2010. The amount of bonus which can be earned will be a set cash amount for each one percentage point of out-performance. The maximum bonus under this plan, of $12 million in respect of the current participants, will be payable for an out-performance versus the Russell 2000 Index of 30%. No bonus is payable under this plan if the Innospec share price does not out-perform the Russell 2000 Index by more than 10% over the three year period. The fair value of these liability cash-settled stock appreciation rights is calculated on a quarterly basis using a Monte Carlo model. A corresponding compensation charge and liability of $0.4 million was recognized in the first half year of 2008.

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 9 DEBT

Long-term debt consists of the following:

(in millions)	June 30 2008	December 31 2007
Senior term loan	$ 55.0	$ 75.0
Revolving credit	22.0	6.0
Overdraft unsecured	4.0	
	81.0	81.0
Less current portion	(81.0)	(20.0)
	$	$ 61.0

On December 13, 2005 the Company entered into an agreement with a syndicate of banks for a new term loan of $100 million repayable over three and one half years. Of this term loan $10 million, $15 million and $20 million was repaid on July 31, 2006, January 31, 2007, and January 31, 2008, respectively. A final repayment of $55 million is due on June 12, 2009. An additional revolving credit facility was also agreed which will expire on June 12, 2009. This revolving credit facility was initially $67.1 million but was then increased by $32.9 million to $100 million on June 12, 2006 when The Royal Bank of Scotland PLC and National Australia Bank Limited joined the syndicate of lending banks. There was $77.0 million outstanding under this finance facility at June 30, 2008.

The finance facility contains terms which, if breached, would result in the loan becoming repayable on demand. It requires, among other matters, compliance with two financial covenant ratios. These ratios are (1) the ratio of net debt to EBITDA and (2) the ratio of net interest to EBITA. EBITDA and EBITA are non U.S. GAAP measures of liquidity defined in the finance facility. In the event that the ratio of net debt to EBITDA exceeds 2.0 then in addition to these covenants, the finance facility also requires a look forward test and an additional financial covenant ratio in the form of net operating cash flow before finance costs to scheduled debt amortization and interest costs. This look forward test was not applicable to the Company throughout the period to June 30, 2008 due to such ratio not being exceeded.

Management believes that the Company has not breached these covenants throughout the period to June 30, 2008. The finance facility is secured by a number of fixed and floating charges over certain assets of the Company and its subsidiaries.

No assets held under capital leases were capitalized during the first half year of 2008 and 2007. Capital repayments were made during the first half year of 2008 and 2007 of $nil and $0.1 million, respectively.

The following table presents the projected annual maturities for the next four years after June 30, 2008:

(in millions)	Term loan	Revolving credit facility	Overdraft-unsecured	Total
2008	$	$	$ 4.0	$ 4.0
2009	55.0	22.0		77.0
2010				
2011				
	$ 55.0	$ 22.0	$ 4.0	$ 81.0

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 10 PLANT CLOSURE PROVISIONS

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

Movements in the provisions are summarized as follows:

	Q2 YTD 2008				Q2 YTD 2007
(in millions)	**Severance**	**Other Restructuring**	**Remediation**	**Total**	**Total**
Total at January 1	$ 2.4	$ 0.6	$ 23.8	$ 26.8	$ 27.8
Charge for the period	0.9	0.7	1.2	2.8	3.1
Expenditure	(0.9)	(1.0)	(0.4)	(2.3)	(3.5)
Exchange effect	0.1		0.2	0.3	0.2
Total at June 30	2.5	0.3	24.8	27.6	27.6
Due within one year	(2.3)	(0.1)	(2.8)	(5.2)	(5.4)
Balance at June 30	$ 0.2	$ 0.2	$ 22.0	$ 22.4	$ 22.2

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

Severance

A charge of $0.9 million was recognized in respect of a reduction in EMEA ($0.7 million) and Americas headcount ($0.2 million).

Other restructuring

The $0.7 million charge relates to United Kingdom site clearance ($0.3 million), U.S. site clearance ($0.2 million) and relocation of our European Headquarters to the Ellesmere Port site ($0.2 million).

Remediation

The remediation provision represents the fair value of the Company s liability recognized under FAS 143, *Accounting for Asset Retirement Obligations*. The accretion expense recognized under FAS 143 in the first half year of 2008 was $1.2 million.

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

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 11 COMMITMENTS AND CONTINGENCIES

Oil for Food and related investigations

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

On October 10, 2007 and November 1, 2007, the SEC served two additional subpoenas on the Company. These additional subpoenas required the production of documents relating notably to the OFFP but also relating to transactions conducted by the Company or its subsidiaries with state owned or controlled entities between June 1, 1999 and the date of such subpoenas, concerning the use of foreign agents and the possibility of extra-contractual payments made to secure business with foreign governmental entities. In a co-ordinated investigation, the Company has also been contacted by the U.S. Department of Justice (DOJ) regarding the possibility of violations of relevant laws in the areas contained in the SEC subpoenas as well as additional preliminary inquiries regarding compliance with anti-trust laws applicable to U.S. and international tetra ethyl lead markets. The subjects into which the SEC and DOJ have inquired include areas that concern certain former and current executives of the Company including the current CEO. The Company, and its officers and directors, are cooperating with the SEC and DOJ investigation.

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

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

While the outcome of the OFFP investigation remains uncertain, a number of companies which have been the subject of OFFP investigations have been required to disgorge profits and pay civil fines and penalties up to $30 million. As a result of information discovered in the course of the investigation, we expect that we will be required to disgorge profits and pay fines and penalties relating to the OFFP that could be of similar or greater magnitude.

Also, significant additional disgorgements, penalties and fines could result from the SEC s and DOJ s inquiries relating to matters beyond the scope of the OFFP as well. However at this time management is not able to reasonably estimate the aggregate amount of any such disgorgements, fines and penalties.

On May 21, 2008, the United Kingdom s Serious Fraud Office (SFO) notified Innospec Limited, a wholly owned subsidiary of the Company, that it had commenced an investigation into contracts involving British companies under the OFFP. As part of this investigation, the SFO has asked the Company to produce documents in respect of the Company s participation in the OFFP between January 1, 1996 and December 31, 2003.

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Following receipt of the SFO s notice the Company has instructed counsel to advise and assist in relation to the investigation and the Company intends to co-operate with the SFO.

Because of the uncertainties associated with the ultimate outcome of these inquiries and the costs to the Company of responding and participating in these on-going investigations, no assurance can be given that the ultimate costs and sanctions that may be imposed upon us will not have a material adverse effect on our results of operations, financial position and cash flows from operating activities. At December 31, 2007 we had accrued $3.7 million in respect of probable future legal expenses and provided no additional accruals in respect of this matter. As part of our continuing commitment to co-operate with the SEC and DOJ and to respond to requests for documents, including the request for documents set out in the DOJ letter dated March 5, 2008, we accrued a further $6.8 million during the quarter ended March 31, 2008 in respect of probable future legal and other professional expenses and during the quarter ended June 30, 2008, the Company provided no additional accruals in respect of these matters. The provision for probable future legal and other professional fees and expenses amounts to $3.5 million at June 30, 2008. The Company will keep the amount of such provision under review.

<u>Bycosin disposal</u>

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

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

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

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Other legal matters

We are involved from time to time in claims and legal proceedings that result from, and are incidental to, the conduct of our business including product liability claims. There are no other material pending legal proceedings to which the Company or any of its subsidiaries is a party, or of which any of their property is subject, other than ordinary, routine litigation incidental to their respective businesses.

Guarantees

The Company and certain of the Company s consolidated subsidiaries are contingently liable for certain obligations of affiliated companies primarily in the form of guarantees of debt and performance under contracts entered into as a normal business practice. This included guarantees of non-U.S. excise taxes and customs duties. As at June 30, 2008, such contingent liabilities amounted to $6.3 million.

Under the terms of the guarantee arrangements, generally the Company would be required to perform should the affiliated company fail to fulfil its obligations under the arrangements. In some cases, the guarantee arrangements have recourse provisions that would enable the Company to recover any payments made under the terms of the guarantees from securities held of the guaranteed parties assets.

The Company and its affiliates have numerous long-term sales and purchase commitments in their various business activities, which are expected to be fulfilled with no adverse consequences material to the Company.

Indemnities and warranties

In connection with the disposal of Octel Waste Management Limited on June 26, 2003, the Company provided certain warranties. The Company would be required to perform should the contingent liabilities in respect of the warranties become actual and could be required to make maximum future payments of £3.59 million ($7.1 million). There are no recourse provisions enabling recovery of any amounts from third parties nor are any assets held as collateral in respect of the warranties.

NOTE 12 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In April 2008, the FASB issued FASB Staff Position FAS 142-3, *Determination of Useful Life of Intangible Assets* (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FAS 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. Earlier adoption is not permitted. The Company is currently evaluating the impact that the adoption of FSP FAS 142-3 will have on its financial statements.

In March 2008, the FASB issued FAS 161, *Disclosures about Derivative Instruments and Hedging Activities*. FAS 161 requires enhanced disclosures surrounding the use and financial reporting of derivative

INNOSPEC INC. AND SUBSIDIARIES

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

instruments and hedging activities. This statement is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the impact that the adoption of FAS 161 will have on its financial statements.

In December 2007, the FASB issued FAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. This statement establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective prospectively, except for certain retrospective disclosure requirements, for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that the adoption of FAS 160 will have on its financial statements.

In December 2007, the FASB issued FAS 141R, *Business Combinations a replacement of FASB Statement No. 141*, which significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement is effective prospectively, except for certain retrospective adjustments to deferred tax balances, for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that the adoption of FAS 141R will have on its financial statements.

Effective January 1, 2008 the Company partially adopted FAS 157, *Fair Value Measurements* in respect of our pension plan assets and derivative instruments and this had no material impact on the Company s financial statements. The fair values of our pension plan assets and derivative instruments are valued based on quoted prices available in active markets for identical assets or liabilities (level 1 measurement) and have not changed on adoption of FAS 157. FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 permits companies that have not already issued either interim or annual financial statements reflecting its adoption to delay the effective adoption date in respect of non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FAS 157. Non-financial assets and non-financial liabilities would include all assets and liabilities other than those meeting the definition of a *financial asset* or *financial liability* as defined in FAS 159. The non-recurring, non-financial assets and liabilities for which FAS 157 has been deferred for adoption by the Company are property, plant and equipment, goodwill, intangible assets and plant closure provisions.

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

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS (Continued)

unobservable inputs (level 3 measurement). As required by FAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement requires judgement and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

Effective January 1, 2008, the Company adopted FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. FAS 159 expands the scope of what entities may carry at fair value by offering an irrevocable option to record many types of financial assets and liabilities at fair value. The Company chose not to implement this option accordingly the adoption of FAS 159 had no material impact on the Company s financial statements.

ITEM 2 Management s Discussion and Analysis of Financial Condition and Results of Operations for the Three and Six Months Ended June 30, 2008 and 2007

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

CRITICAL ACCOUNTING ESTIMATES

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

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

The policies and estimates that the Company considers the most critical in terms of complexity and subjectivity of assessment are those related to contingencies, environmental liabilities, goodwill, intangible assets (net of amortization), pensions, and deferred tax asset valuation allowance and uncertain income tax positions. These policies, with the exception of contingencies discussed below, have been discussed in the Company s 2007 Annual Report on Form 10-K.

Contingencies

The Company discloses information concerning contingent liabilities for which an unfavorable outcome is more than remote. The Company will record any loss related to contingent liabilities at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated. When the reasonable estimate is a range the recorded loss will be the best estimate within the range. If no amount in the range is a better estimate than any other amount the minimum amount of the range will be recorded. The Company records its legal and other related professional expenses within selling, general and administrative expenses as and when the associated course of action is committed to.

RESULTS OF OPERATIONS

(in millions)	Three Months Ended June 30 2008	Three Months Ended June 30 2007	Six Months Ended June 30 2008	Six Months Ended June 30 2007
Net sales				
Fuel Specialties	$ 94.3	$ 86.0	$ 208.9	$ 171.8
Active Chemicals	37.9	34.0	73.4	68.0
Octane Additives	13.1	21.4	31.7	46.9
	$ 145.3	$ 141.4	$ 314.0	$ 286.7
Gross profit				
Fuel Specialties	$ 32.3	$ 29.0	$ 71.7	$ 58.9
Active Chemicals	2.0	5.8	6.8	13.2
Octane Additives	6.8	13.0	14.3	25.4
	$ 41.1	$ 47.8	$ 92.8	$ 97.5
Operating income				
Fuel Specialties	$ 15.2	$ 14.4	$ 38.8	$ 28.7
Active Chemicals	(2.4)	1.0	(2.3)	3.6
Octane Additives	3.5	6.9	0.5	14.4
FAS 158/87 pension (charge)	(0.6)	(1.2)	(1.2)	(2.3)
Corporate costs	(9.6)	(5.7)	(15.6)	(10.7)
	6.1	15.4	20.2	33.7
Restructuring charge	(1.1)	(1.3)	(1.6)	(2.0)
Impairment of Octane Additives business goodwill	(1.0)	(3.3)	(2.1)	(7.7)
Profit on disposal	0.4		0.4	
Total operating income	4.4	10.8	16.9	24.0
Other net (expense)/income	(1.3)	1.5	(0.8)	1.6
Interest expense	(1.6)	(1.8)	(3.3)	(4.3)
Interest income	0.3	0.7	0.7	1.6
Income before income taxes	$ 1.8	$ 11.2	$ 13.5	$ 22.9

Three months to June 30, 2008:

(in millions except ratios)	2008	2007	Change	
Net sales:				
Fuel Specialties	$ 94.3	$ 86.0	$ 8.3	+10%
Active Chemicals	37.9	34.0	3.9	+11%
Octane Additives	13.1	21.4	(8.3)	-39%
	$ 145.3	$ 141.4	$ 3.9	+3%
Gross profit:				
Fuel Specialties	$ 32.3	$ 29.0	$ 3.3	+11%
Active Chemicals	2.0	5.8	(3.8)	-66%
Octane Additives	6.8	13.0	(6.2)	-48%
	$ 41.1	$ 47.8	$ (6.7)	-14%
Gross margin (%)				
Fuel Specialties	*34.3*	*33.7*	+0.6	
Active Chemicals	*5.3*	*17.1*	-11.8	
Octane Additives	*51.9*	*60.7*	-8.8	
Aggregate	*28.3*	*33.8*	-5.5	
Operating expenses:				
Fuel Specialties	$ (16.5)	$ (14.0)	$ (2.5)	+18%
Active Chemicals	(4.1)	(4.4)	0.3	-7%
Octane Additives	(2.2)	(2.5)	0.3	-12%
FAS 158/87 pension charge	(0.6)	(1.2)	0.6	-50%
Corporate costs	(9.6)	(5.7)	(3.9)	+68%
	$ (33.0)	$ (27.8)	$ (5.2)	+19%

Fuel Specialties

Net sales: the year on year increase of 10% was spread across the markets in which we operate as follows the Americas (up 7%), EMEA (up 18%), ASPAC (up 10%) and Avtel (down 14%). This growth was due to price and product mix (up 7 percentage points) and the favorable impact of exchange rates (up 5 percentage points) offset by lower volume (down 2 percentage points).

Americas benefited from strong sales of refinery products. Growth was focused in a richer price and product mix (up 8 percentage points) offset by lower volume (down 1 percentage point).

Europe, Middle East and Africa (EMEA) primarily benefited from the favorable impact of exchange rates (up 13 percentage points) and to a lesser extent volume (up 5 percentage points) due to strong sales of detergent and refinery products.

Asia Pacific (ASPAC) benefited from strong sales of detergent products. Growth was again focused in price and product mix (up 15 percentage points) and to a lesser extent the favorable impact of exchange rates (up 2 percentage points) offset by lower volume (down 7 percentage points).

The TEL for use in aviation gasoline (Avtel) business decline was primarily due to volume (down 31 percentage points) offset by a richer sales mix (up 17 percentage points). The results in the corresponding period last year were positively impacted by the more favorable pricing allowed, and the volumes sold, under the Ethyl settlement.

Gross margin: the year on year increase of 0.6 percentage points was achieved despite the significant increase in raw material costs and the lower proportion of higher margin Avtel sales. This increase reflects the richer price and product mix and that we successfully passed raw material cost increases onto our customers.

Operating expenses: excluding the impact of $0.6 million of one-time professional fees in 2007 the year on year increase in operating expenses was $3.1 million or 23%. The underlying 23% increase was greater than the 10% sales growth primarily due to the adverse impact of the relative weakness of the U.S. dollar on our European Union euro denominated cost base and higher personnel-related costs. In addition, research and development expenses have been driven higher to support this expanding business increasing by $0.8 million or 33% between the corresponding periods.

Active Chemicals

Net sales: the year on year increase of 11% was spread across the markets in which we operate as follows the Americas (up 1%), EMEA (up 17%) and ASPAC (up 33%). This growth was due to volume (up 6 percentage points) and the favorable impact of exchange rates (up 5 percentage points).

Americas benefited from higher volume (up 16 percentage point), due to strong sales of fragrance products, offset by a poorer price and product mix (down 15 percentage points).

EMEA benefited from a richer price and product mix (up 11 percentage points) and the favorable impact of exchange rates (up 10 percentage points) offset by lower volume (down 4 percentage points). Strong polymer sales were largely offset by lower sales across the other four industry sectors.

Our ASPAC business currently represents less than 10% of our overall Active Chemicals business reflecting the embryonic stage of its development. Notwithstanding this, sales benefited from higher volume (up 25 percentage points), the favorable impact of exchange rates (up 6 percentage points) and a richer price and product mix (up 2 percentage points). Sales were driven higher by the strong performance in polymer and fragrance products consistent with our other geographical regions.

Gross margin: the year on year decline of 11.8 percentage points reflects price and product mix, primarily in respect of the greater proportion in 2008 of lower margin polymer sales, and the increased raw material and energy costs suffered across all the markets in which we operate. In addition, gross margin was adversely impacted by lower utilization and manufacturing efficiencies in our U.S. plants.

Operating expenses: the year on year decrease in operating expenses was $0.3 million or 7%. This decrease was achieved despite the 11% sales growth primarily due to lower personnel-related costs.

Octane Additives

Net sales: net sales declined 39% despite volumes declining only 38%. This reflected a poorer sales mix despite moderate price increases in 2008. In both 2008 and 2007 sales were focused in the Middle East and Africa.

Gross margin: the year on year decline was 8.8 percentage points. Moderate price increases achieved in 2008 have favorably impacted gross margin and limited the adverse impact of the poorer sales mix and lower TEL production volumes on the fixed cost base of the manufacturing site at Ellesmere Port, United Kingdom. In addition, following the settlement regarding the TEL sales and marketing agreements (TMAs) effective April 1, 2007, the gross margin in 2007 benefited from the $1.9 million unamortized balance at March 31, 2007 of the Ethyl prepayment for services to be provided under the TMAs being written off to cost of goods sold. This write off benefited gross margin by 8.9 percentage points.

Operating expenses: the year on year decrease in operating expenses was $0.3 million or 12% primarily in respect of general and administration costs.

Other Income Statement Captions

FAS 158/87 pension charge: this non-cash charge has declined by $0.6 million because, unlike the corresponding period in 2007, there was no amortization of net actuarial losses required.

Corporate costs: year on year corporate costs increased $3.9 million due to the expensing of $3.9 million of advisory and financing costs related to two large potential acquisitions that the Company is now not pursuing.

Restructuring charge: restructuring costs are comprised of the following:

(in millions)	2008	2007
Reduction in EMEA headcount	$ 0.7	$ 0.3
Reduction in Americas headcount	0.2	
U.S. site clearance	0.2	
United Kingdom site clearance		0.3
Additional payments in respect of the former CEO		0.3
Sundry other restructuring		0.4
	$ 1.1	$ 1.3

Amortization of intangible assets: the amortization charge has declined by a net $2.6 million. Of this reduction $2.5 million is due to the absence of the Veritel intangible asset amortization charge in 2008 since it was fully amortized as at December 31, 2007 and $0.1 million of sundry other amortization.

Impairment of Octane Additives business goodwill: the 2007 charge was higher than that recognized in 2008 primarily due to the higher operating income and associated cash flows in 2007. Since the end of the first quarter of 2007, we have updated the estimates used in the detailed forecast model to calculate the impairment charges to include effective April 1, 2007 the fact that we will no longer be sharing with Ethyl the profits from the sale of TEL outside North America.

Profit on disposal: in May 2008 the Company recognized $0.4 million profit following the disposal of surplus U.S. real estate.

Interest expense (net): the net interest charge increased by $0.2 million in 2008 to $1.3 million. This increase was primarily due to the fact that average net debt increased by approximately $8 million between the corresponding periods from $61 million to $69 million. The net interest charge however benefited from the U.S. base interest rates declining between the corresponding periods and a $0.2 million reduction in the deferred finance costs amortization charge.

Other net income/(expense): in 2008 other net (expense) of $1.3 million related to net foreign exchange losses of $1.0 million and net sundry other expenses of $0.3 million. The losses relate to net losses on foreign currency forward contracts and on translation of net assets in our European business, primarily due to the relative weakness of the U.S. dollar against the European Union euro. In 2007 other net income comprised $1.8 million of net foreign exchange gains offset by $0.3 million of net sundry other expenses.

Income taxes: tax relief is not available on the charge for impairment of Octane Additives business goodwill and accordingly we believe that the change in the effective rate of tax to 55.6% in 2008 from 39.3% in 2007 is best explained by adjusting for this non-deductible charge. This adjusted effective tax rate has increased by 5.4 percentage points due to the origin of profits and the continued increased profitability of our U.S. based Fuel Specialties business which incurs the standard federal tax rate of 35% together with state taxes. The adjusted effective tax rate has also been adversely impacted by the current assumption that significant legal and other professional fees may not be tax deductible.

(in millions)	2008	2007
Income before income taxes	$ 1.8	$ 11.2
Add back Impairment of Octane Additives business goodwill	1.0	3.3
	$ 2.8	$ 14.5
Income taxes	$ 1.0	$ 4.4
Adjusted effective tax rate	35.7%	30.3%

Six months to June 30, 2007:

(in millions except ratios)	2008	2007	Change	
Net sales:				
Fuel Specialties	$ 208.9	$ 171.8	$ 37.1	+22%
Active Chemicals	73.4	68.0	5.4	+8%
Octane Additives	31.7	46.9	(15.2)	-32%
	$ 314.0	$ 286.7	$ 27.3	+10%
Gross profit:				
Fuel Specialties	$ 71.7	$ 58.9	$ 12.8	+22%
Active Chemicals	6.8	13.2	(6.4)	-48%
Octane Additives	14.3	25.4	(11.1)	-44%
	$ 92.8	$ 97.5	$ (4.7)	-5%
Gross margin (%)				
Fuel Specialties	*34.3*	*34.3*		
Active Chemicals	*9.3*	*19.4*	*-10.1*	
Octane Additives	*45.1*	*54.2*	*-9.1*	
Aggregate	*29.6*	*34.0*	*-4.4*	
Operating expenses:				
Fuel Specialties	$ (31.8)	$ (29.3)	$ (2.5)	+9%
Active Chemicals	(8.4)	(8.9)	0.5	-6%
Octane Additives	(11.5)	(4.9)	(6.6)	+135%
FAS 158/87 pension charge	(1.2)	(2.3)	1.1	-48%
Corporate costs	(15.6)	(10.7)	(4.9)	+46%
	$ (68.5)	$ (56.1)	$ (12.4)	+22%

Fuel Specialties

Net sales: the year on year increase of 22% was spread across the markets in which we operate as follows the Americas (up 19%), EMEA (up 25%), ASPAC (up 28%) and Avtel (up 7%). This growth was due to volume (up 10 percentage points), price and product mix (up 7 percentage points) and the favorable impact of exchange rates (up 5 percentage points). This business is continuing to demonstrate its ability to leverage increased volume and improved pricing across its various markets.

Americas benefited from strong sales of detergent and refinery products. Growth was focused in volume (up 14 percentage points) and a richer price and product mix (up 5 percentage points).

EMEA primarily benefited from the favorable impact of exchange rates (up 13 percentage points) and higher volume (up 12 percentage points) due to strong sales of detergent and refinery products.

ASPAC benefited from strong sales of detergent, refinery and marine products. Growth was focused in price and product mix (up 24 percentage points) and to a lesser extent the favorable impact of exchange rates (up 2 percentage points) and higher volume (up 2 percentage points).

The Avtel business growth was primarily due to a richer sales mix (up 16 percentage points) offset by lower volume (down 9 percentage points). The results in the corresponding period last year were positively impacted by the more favorable pricing allowed, and the volumes sold, under the Ethyl settlement.

Gross margin: the year on year gross margin was unchanged despite the significant increase in raw material costs and the lower proportion of higher margin Avtel sales. This increase reflects the richer price and product mix and that we successfully passed raw material cost increases onto our customers.

Operating expenses: excluding the impact of $1.9 million of one-time professional fees in 2007 the year on year increase in operating expenses was $4.4 million or 16%. The underlying 16% increase was less than the 22% sales growth as we continued to leverage the infrastructure of this business. This was achieved despite the adverse impact of the relative weakness of the U.S. dollar on our European Union euro denominated cost base and higher personnel-related costs. In addition, research and development expenses have been driven higher to support this expanding business increasing by $1.2 million or 24% between the corresponding periods.

Active Chemicals

Net sales: the year on year increase of 8% was spread across the markets in which we operate as follows the Americas (up 6%), EMEA (up 6%) and ASPAC (up 33%). This growth was due to volume (up 7 percentage points) and the favorable impact of exchange rates (up 5 percentage points) offset by price and product mix (down 4 percentage points).

Americas benefited from higher volume (up 16 percentage point), due to strong sales of fragrance and personal care products, offset by a poorer price and product mix (down 10 percentage points). Custom manufacturing revenues declined primarily due to the slow down in the U.S. construction industry.

EMEA primarily benefited from the favorable impact of exchange rates (up 9 percentage points) and a richer price and product mix (up 1 percentage point) offset by lower volume (down 4 percentage points). Strong polymer sales were largely offset by lower sales across the other four industry sectors.

Our ASPAC business currently represents less than 10% of our overall Active Chemicals business reflecting the embryonic stage of its development. Notwithstanding this, sales benefited from higher volume (up 45 percentage points), the favorable impact of exchange rates (up 6 percentage points) offset by a poorer price and product mix (down 18 percentage points). Sales were driven higher by the strong performance in polymer and fragrance products consistent with our other geographical regions.

Gross margin: the year on year decline of 10.1 percentage points reflects price and product mix, primarily in respect of the greater proportion in 2008 of lower margin polymer sales, and the increased raw material and energy costs suffered across all the markets in which we operate. In addition, gross margin was adversely impacted by lower utilization and manufacturing efficiencies in our U.S. plants.

Operating expenses: the year on year decrease in operating expenses was $0.5 million or 6%. This decrease was achieved despite the 8% sales growth primarily due to lower personnel-related costs.

Octane Additives

Net sales: net sales declined 32% despite volumes declining only 27%. This reflected a poorer sales mix despite moderate price increases in 2008. In both 2008 and 2007 sales were focused in the Middle East and Africa.

Gross margin: the year on year decline was 9.1 percentage points. Following the settlement regarding the TMAs effective April 1, 2007 the profit share with Ethyl from this business which was charged within cost of goods sold has ceased. The cessation of the TMAs and moderate price increases achieved in 2008 have favorably impacted gross margin and limited the adverse impact of the poorer sales mix and lower TEL production volumes on the fixed cost base of the manufacturing site at Ellesmere Port, United Kingdom. In addition, following the settlement regarding the TMAs effective April 1, 2007, the gross margin in 2007 benefited from the $1.9 million unamortized balance at March 31, 2007 of the Ethyl prepayment for services to be provided under the TMAs being written off to cost of goods sold. This write off benefited gross margin by 4.1 percentage points.

Operating expenses: excluding the impact of $6.8 million of legal and other professional expenses accrued, relating to the SEC and DOJ s investigation of the United Nations Oil for Food Program to be incurred in the remainder of 2008, the year on year decrease in operating expenses was $0.2 million or 4% primarily in respect of general and administration costs.

Other Income Statement Captions

FAS 158/87 pension charge: this non-cash charge has declined by $1.1 million because, unlike the corresponding period in 2007, there was no amortization of net actuarial losses required.

Corporate costs: year on year corporate costs increased $4.9 million due to higher personnel-related costs and the expensing of $3.9 million of advisory and financing costs related to two large potential acquisitions that the Company is now not pursuing.

Restructuring charge: restructuring costs are comprised of the following:

(in millions)	2008	2007
Reduction in EMEA headcount	$ 0.7	$ 0.4
United Kingdom site clearance	0.3	0.8
Reduction in Americas headcount	0.2	
U.S. site clearance	0.2	
Relocation of our European Headquarters to the Ellesmere Port site	0.2	0.1
Additional payments in respect of the former CEO		0.3
Sundry other restructuring		0.4
	$ 1.6	$ 2.0

Amortization of intangible assets: the amortization charge has declined by a net $3.6 million. Of this reduction $5.0 million is due to the absence of the Veritel intangible asset amortization charge in 2008 since it was fully amortized as at December 31, 2007. This reduction has been offset by the amortization expense of $1.4 million in respect of the Ethyl intangible asset effective April 1, 2007.

Impairment of Octane Additives business goodwill: the 2007 charge was higher than that recognized in 2008 primarily due to the higher operating income and associated cash flows in 2007. Since the end of the first quarter of 2007, we have updated the estimates used in the detailed forecast model to calculate the impairment charges to include effective April 1, 2007 the fact that we will no longer be sharing with Ethyl the profits from the sale of TEL outside North America.

Profit on disposal: in May 2008 the Company recognized $0.4 million profit following the disposal of surplus U.S. real estate.

Interest expense (net): the net interest charge decreased by $0.1 million in 2008 to $2.6 million. This was despite the fact that average net debt increased by approximately $9 million between the corresponding periods from $54 million to $63 million. This decrease primarily reflects the fact that U.S. base interest rates declined between the corresponding periods and a $0.3 million reduction in the deferred finance costs amortization charge.

Other net income/(expense): in 2008 other net (expense) of $0.8 million related to net foreign exchange losses of $0.5 million and net sundry other expenses of $0.3 million. The losses relate to net losses on foreign currency forward contracts and on translation of net assets in our European business, primarily due to the relative weakness of the U.S. dollar against the European Union euro. In 2007 other net income comprised $2.0 million of net foreign exchange gains offset by $0.4 million of net sundry other expenses.

Income taxes: tax relief is not available on the charge for impairment of Octane Additives business goodwill and accordingly we believe that the change in the effective rate of tax to 40.0% in 2008 from 44.1% in 2007 is best explained by adjusting for this non-deductible charge. This adjusted effective tax rate has increased by 1.6 percentage points due to the origin of profits and the continued increased profitability of our U.S. based Fuel Specialties business which incurs the standard federal tax rate of 35% together with state taxes. The adjusted effective tax rate has also been adversely impacted by the current assumption that significant legal and other professional fees may not be tax deductible.

(in millions)	**2008**	**2007**
Income before income taxes	$ 13.5	$ 22.9
Add back Impairment of Octane Additives business goodwill	2.1	7.7
	$ 15.6	$ 30.6
Income taxes	$ 5.4	$ 10.1
Adjusted effective tax rate	34.6%	33.0%

LIQUIDITY AND FINANCIAL CONDITION

Working Capital

In the first half year of 2008 our working capital (defined by the Company as accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities rather than total current assets less total current liabilities) increased by $3.1 million. The $4.5 million decline in accounts receivable and prepaid expenses was focused heavily in our Octane Additives business as it collected significant year end receivables. The $14.9 million increase in inventories was focused in our growth Fuel Specialties business following the decision to build certain product inventories of strategic importance. During the first half year of 2008 we accrued a further $6.8 million in respect of probable future legal and other professional expenses relating to the SEC and DOJ s investigation of the United Nations Oil for Food Program (OFFP). Our increased accounts payable and accrued liabilities reflect this accrual. Due to the uncertainties associated with the OFFP and related investigations and the potential for the imposition of disgorgements, penalties and fines in the future, we may make additional accruals in later quarters.

Cash

At June 30, 2008 and December 31, 2007 we had cash and cash equivalents of $16.4 million and $24.3 million, respectively.

Debt

At June 30, 2008 we had a finance facility which provides for borrowings by us of up to $155.0 million including a term loan of $55.0 million and revolving credit facility of $100.0 million. The revolving credit facility can be drawn down upon until the finance facility expires on June 12, 2009. The finance facility also contains terms which, if breached, would result in the loan becoming repayable on demand. It requires, among other matters, compliance with two financial covenant ratios. These ratios are (1) the ratio of net debt to EBITDA and (2) the ratio of net interest to EBITA. EBITDA and EBITA are non U.S. GAAP measures of liquidity defined in the finance facility. In the event that the ratio of net debt to EBITDA exceeds 2.0 then in addition to these covenants, the finance facility also requires a look forward test and an additional financial covenant ratio in the form of net operating cash flow before finance costs to scheduled debt amortization and interest costs. This look forward test was not applicable to the Company throughout the period to June 30, 2008 due to such ratio not being exceeded.

As of June 30, 2008, the Company had $77.0 million of debt outstanding under its finance facility and was in compliance with all financial covenants therein. The debt profile as at June 30, 2008, including the finance facility, is set out below:

(in millions)	
2008	$ 4.0
2009	77.0
2010	
2011	
	81.0
Current portion of long-term debt	(81.0)
Long-term debt, net of current portion	$

ITEM 3 Quantitative and Qualitative Disclosures About Market Risk

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

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

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

The Company s exposure to market risk has been discussed in the Company s 2007 Annual Report on Form 10-K, and there have been no significant changes since that time.

ITEM 4 Controls and Procedures
Evaluation of Disclosure Controls and Procedures

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

Based upon this evaluation of disclosure controls and procedures, the Company s Chief Executive Officer and Chief Financial Officer have concluded that the Company s disclosure controls and procedures were effective as of June 30, 2008, in timely making known material information relating to the Company and the Company s consolidated subsidiaries required to be disclosed in the Company s reports filed or submitted under the Exchange Act.

Changes in Internal Controls over Financial Reporting

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

PART II OTHER INFORMATION

ITEM 1 Legal Proceedings
Oil for Food and related investigations

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

On October 10, 2007 and November 1, 2007, the SEC served two additional subpoenas on the Company. These additional subpoenas required the production of documents relating notably to the OFFP but also relating to transactions conducted by the Company or its subsidiaries with state owned or controlled entities between June 1, 1999 and the date of such subpoenas, concerning the use of foreign agents and the possibility of extra-contractual payments made to secure business with foreign governmental entities. In a co-ordinated investigation, the Company has also been contacted by the U.S. Department of Justice (DOJ) regarding the possibility of violations of relevant laws in the areas contained in the SEC subpoenas as well as additional preliminary inquiries regarding compliance with anti-trust laws applicable to U.S. and international tetra ethyl lead markets. The subjects into which the SEC and DOJ have inquired include areas that concern certain former and current executives of the Company including the current CEO. The Company, and its officers and directors, are cooperating with the SEC and DOJ investigation.

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

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

While the outcome of the OFFP investigation remains uncertain, a number of companies which have been the subject of OFFP investigations have been required to disgorge profits and pay civil fines and penalties up to $30 million. As a result of information discovered in the course of the investigation, we expect that we will be required to disgorge profits and pay fines and penalties relating to the OFFP that could be of similar or greater magnitude.

Also, significant additional disgorgements, penalties and fines could result from the SEC s and DOJ s inquiries relating to matters beyond the scope of the OFFP as well. However at this time management is not able to reasonably estimate the aggregate amount of any such disgorgements, fines and penalties.

On May 21, 2008, the United Kingdom s Serious Fraud Office (SFO) notified Innospec Limited, a wholly owned subsidiary of the Company, that it had commenced an investigation into contracts involving British companies under the OFFP. As part of this investigation, the SFO has asked the Company to produce documents in respect of the Company s participation in the OFFP between January 1, 1996 and December 31, 2003. Following receipt of the SFO s notice the Company has instructed counsel to advise and assist in relation to the investigation and the Company intends to co-operate with the SFO.

Because of the uncertainties associated with the ultimate outcome of these inquiries and the costs to the Company of responding and participating in these on-going investigations, no assurance can be given that the ultimate costs and sanctions that may be imposed upon us will not have a material adverse effect on our results of operations, financial position and cash flows from operating activities. At December 31, 2007 we had accrued $3.7 million in respect of probable future legal expenses and provided no additional accruals in respect of this matter. As part of our continuing commitment to co-operate with the SEC and DOJ and to respond to requests for documents, including the request for documents set out in the DOJ letter dated March 5, 2008, we accrued a further $6.8 million during the quarter ended March 31, 2008 in respect of probable future legal and other professional expenses and during the quarter ended June 30, 2008, the Company provided no additional accruals in respect of these matters. The provision for probable future legal and other professional fees and expenses amounts to $3.5 million at June 30, 2008. The Company will keep the amount of such provision under review.

Bycosin disposal

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

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

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

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

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

Patent actions

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

Other legal matters

We are involved from time to time in claims and legal proceedings that result from, and are incidental to, the conduct of our business including product liability claims. There are no other material pending legal proceedings to which the Company or any of its subsidiaries is a party, or of which any of their property is subject, other than ordinary, routine litigation incidental to their respective businesses.

ITEM 1A Risk Factors

Information regarding risk factors appears in Item 1A of the Company s 2007 Annual Report on Form 10-K, and there have been no material changes in the risk factors facing the Company since that time.

ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds

(c) The following table shows purchases of equity securities by the issuer or affiliated purchasers during the quarter:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of the Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Carried forward				$ 1.9 million
April 1 April 30	85,992	$ 21.89	85,992	$
May 1 May 31				$
June 1 June 30				$
Total	85,992	$ 21.89	85,992	$

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

During January 2008 the Company re-purchased 104,300 shares at a cost of $1.6 million.

On March 3, 2008 the Company announced that the Board of Directors had authorized a further stock re-purchase plan under Rule 10b5-1 to repurchase up to an additional $8.0 million of common stock. This plan commenced on March 3, 2008 and completed on April, 29, 2008.

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

ITEM 3 Defaults Upon Senior Securities

None.

ITEM 4 Submission of Matters to a Vote of Security Holders

The Annual Meeting of Stockholders of the Company was held on May 6, 2008 (the 2008 Annual Meeting). The following matters were submitted to a vote of the stockholders at the 2008 Annual Meeting and received the number of votes indicated for, against or withheld as well as the number of abstentions and broker non-votes as to each matter:

(i) Election of the following directors of the Company to serve until the 2011 Annual Meeting:

	Votes For	Votes Withheld
Peter Fearn	22,033,079	315,062
Joachim Roeser	22,135,184	212,957

(ii) Re-election of the following director of the Company to serve until the 2011 Annual Meeting:

	Votes For	Votes Withheld
Hugh G. C. Aldous	21,777,100	571,041

(iii) Ratification of the appointment of PricewaterhouseCoopers LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2008:

Votes For	Votes Against	Abstentions
21,757,151	573,249	17,741

(iv) Adoption of the following stock option plans:

Plan	Votes For	Votes Against	Abstentions	Broker Non-Votes
The Innospec Inc. Performance Related Stock Option Plan 2008	15,378,466	4,642,394	24,398	2,302,883
The Innospec Inc. Company Share Option Plan 2008	10,522,116	9,493,330	29,812	2,302,883
The Innospec Inc. Non-Employee Directors Stock Option Plan 2008	16,065,541	3,939,404	40,313	2,302,883
The Innospec Inc. Sharesave Plan 2008	14,940,994	5,068,697	35,567	2,302,883

There were no broker non-votes with respect to the election of directors, re-election of director or ratification of the Company s independent registered public accounting firm.

In addition to the Directors elected at the Annual Meeting of Stockholders, the terms of office of James M.C. Puckridge, Paul W. Jennings, Martin M. Hale and Dr. Robert E. Bew on the Board of Directors continue from the date of the Annual Meeting until the expiration of their respective terms.

ITEM 5 Other Information

None.

ITEM 6 Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

Date: August 7, 2008	By	/s/ PAUL W. JENNINGS **Paul W. Jennings** **President and Chief Executive Officer**
Date: August 7, 2008	By	/s/ IAN P. CLEMINSON **Ian P. Cleminson** **Executive Vice President and Chief Financial Officer**