

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

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2005

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-12019

**QUAKER CHEMICAL CORPORATION**

(Exact name of Registrant as specified in its charter)

**A Pennsylvania Corporation**  
(State or other jurisdiction of incorporation or organization)

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

**One Quaker Park, 901 Hector Street,  
Conshohocken, Pennsylvania**  
(Address of principal executive offices)

**19428**  
(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each Exchange on which registered
Common Stock, \$1.00 par value Stock Purchase Rights	New York Stock Exchange New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

State aggregate market value of common stock held by non-affiliates of the Registrant. (The aggregate market value is computed by reference to the last reported sale on the New York Stock Exchange on June 30, 2005): \$169,466,548.

Indicate the number of shares outstanding of each of the Registrant's classes of common stock as of the latest practicable date: 9,752,466 shares of Common Stock, \$1.00 Par Value, as of February 28, 2006.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held on May 10, 2006 are incorporated by reference into Part III.

## PART I

As used in this Report, the terms “Quaker,” the “Company,” “we” and “our” refer to Quaker Chemical Corporation, its subsidiaries, and associated companies, unless the context otherwise requires.

### Item 1. *Business.*

#### *General Description*

Quaker develops, produces, and markets a broad range of formulated chemical specialty products for various heavy industrial and manufacturing applications and, in addition, offers and markets chemical management services (“CMS”). Quaker’s principal products and services include: (i) rolling lubricants (used by manufacturers of steel in the hot and cold rolling of steel and by manufacturers of aluminum in the hot rolling of aluminum); (ii) corrosion preventives (used by steel and metalworking customers to protect metal during manufacture, storage, and shipment); (iii) metal finishing compounds (used to prepare metal surfaces for special treatments such as galvanizing and tin plating and to prepare metal for further processing); (iv) machining and grinding compounds (used by metalworking customers in cutting, shaping, and grinding metal parts which require special treatment to enable them to tolerate the manufacturing process, achieve closer tolerance and improve tool life); (v) forming compounds (used to facilitate the drawing and extrusion of metal products); (vi) hydraulic fluids (used by steel, metalworking, and other customers to operate hydraulically activated equipment); (vii) technology for the removal of hydrogen sulfide in various industrial applications; (viii) chemical milling maskants for the aerospace industry and temporary and permanent coatings for metal and concrete products; (ix) construction products such as flexible sealants and protective coatings for various applications; and (x) programs to provide chemical management services. Individual product lines representing more than 10% of consolidated revenues for any of the past three years are as follows:

	2005	2004	2003
Rolling lubricants	21.3%	22.3%	23.2%
Machining and grinding compounds	16.4%	15.0%	14.3%
Chemical management services	11.7%	13.6%	10.9%
Hydraulic fluids	10.4%	10.1%	10.7%
Corrosion preventives	9.5%	9.8%	9.1%

A substantial portion of Quaker’s sales worldwide are made directly through its own employees and its CMS programs with the balance being handled through value added resellers and agents. Quaker employees visit the plants of customers regularly and, through training and experience, identify production needs which can be resolved or alleviated either by adapting Quaker’s existing products or by applying new formulations developed in Quaker’s laboratories. Quaker makes little use of advertising but relies heavily upon its reputation in the markets which it serves. Generally, separate manufacturing facilities of a single customer are served by different personnel. As part of the Company’s chemical management services, certain third party product sales to customers are managed by the Company. Where the Company acts as a principal, revenues are recognized on a gross reporting basis at the selling price negotiated with the customers. Where the Company acts as an agent, such revenue is recorded using net reporting as service revenues, at the amount of the administrative fee earned by the Company for ordering the goods. Third party products transferred under arrangements resulting in net reporting totaled \$38.8 million, \$35.2 million, and \$26.6 million for 2005, 2004, and 2003, respectively. The Company recognizes revenue in accordance with the terms of the underlying agreements, when title and risk of loss have been transferred, collectibility is reasonably assured, and pricing is fixed or determinable. This generally occurs for product sales when products are shipped to customers or, for consignment arrangements upon usage by the customer and when services are performed. License fees and royalties are recognized in accordance with agreed upon terms, when performance obligations are satisfied, the amount is fixed or determinable, and collectibility is reasonably assured and are included in other income.

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### *Competition*

The chemical specialty industry comprises a number of companies of similar size as well as companies larger and smaller than Quaker. Quaker cannot readily determine its precise position in every industry it serves. Based on information available to Quaker, however, it is estimated that Quaker holds a leading and significant global position (among a group in excess of 25 other suppliers) in the market for process fluids to produce sheet steel. It is also believed that Quaker holds significant global positions in the markets for process fluids in portions of the automotive and industrial markets. Many competitors are in fewer and more specialized product classifications or provide different levels of technical services in terms of specific formulations for individual customers. Competition in the industry is based primarily on the ability to provide products that meet the needs of the customer and render technical services and laboratory assistance to customers and, to a lesser extent, on price.

### *Major Customers and Markets*

During 2005, Quaker's five largest customers (each composed of multiple subsidiaries or divisions with semi-autonomous purchasing authority) accounted for approximately 25% of its consolidated net sales with the largest customer (General Motors) accounting for approximately 9% of consolidated net sales. A significant portion of Quaker's revenues are realized from the sale of process fluids and services to manufacturers of steel, automobiles, appliances, and durable goods, and, therefore, Quaker is subject to the same business cycles as those experienced by these manufacturers and their customers. Furthermore, steel customers typically have limited manufacturing locations as compared to metalworking customers and generally use higher volumes of products at a single location. Accordingly, the loss or closure of a steel mill of a significant customer can have a material adverse effect on Quaker's business.

### *Raw Materials*

Quaker uses over 1,000 raw materials, including mineral oils and derivatives, animal fats and derivatives, vegetable oils and derivatives, ethylene derivatives, solvents, surface active agents, chlorinated paraffinic compounds, and a wide variety of other organic and inorganic compounds. In 2005, only three raw material groups (mineral oil and derivatives, animal fats and derivatives, and vegetable oils and derivatives) each accounted for as much as 10% of the total cost of Quaker's raw material purchases. The price of mineral oil can be affected by the price of crude oil and refining capacity. Accordingly, significant fluctuations in the price of crude oil can have a material effect upon the Company's business. Many of the raw materials used by Quaker are "commodity" chemicals, and, therefore, Quaker's earnings can be affected by market changes in raw material prices. Quaker has multiple sources of supply for most materials, and management believes that the failure of any single supplier would not have a material adverse effect upon its business. Reference is made to the disclosure contained in Item 7A of this Report.

### *Patents and Trademarks*

Quaker has a limited number of patents and patent applications, including patents issued, applied for, or acquired in the United States and in various foreign countries, some of which may prove to be material to its business. Principal reliance is placed upon Quaker's proprietary formulae and the application of its skills and experience to meet customer needs. Quaker's products are identified by trademarks that are registered throughout its marketing area.

### *Research and Development—Laboratories*

Quaker's research and development laboratories are directed primarily toward applied research and development since the nature of Quaker's business requires continual modification and improvement of formulations to provide chemical specialties to satisfy customer requirements. Research and development costs are expensed as incurred. Research and development expenses during 2005, 2004, and 2003 were \$14.2 million, \$13.8 million, and \$10.1 million, respectively.

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Quaker maintains quality control laboratory facilities in each of its manufacturing locations. In addition, Quaker maintains in Conshohocken, Pennsylvania, and Uithoorn, The Netherlands, laboratory facilities that are devoted primarily to applied research and development.

Most of Quaker's subsidiaries and associated companies also have laboratory facilities. Although not as complete as the Conshohocken or Uithoorn laboratories, these facilities are generally sufficient for the requirements of the customers being served. If problems are encountered which cannot be resolved by local laboratories, such problems may be referred to the laboratory staff in Conshohocken or Uithoorn.

#### *Regulatory Matters*

In order to facilitate compliance with applicable Federal, state, and local statutes and regulations relating to occupational health and safety and protection of the environment, the Company has an ongoing program of site assessment for the purpose of identifying capital expenditures or other actions that may be necessary to comply with such requirements. The program includes periodic inspections of each facility by Quaker and/or independent environmental experts, as well as ongoing inspections and training by on-site personnel. Such inspections are addressed to operational matters, record keeping, reporting requirements, and capital improvements. In 2005, capital expenditures directed solely or primarily to regulatory compliance amounted to approximately \$0.7 million compared to \$1.1 million and \$0.5 million in 2004 and 2003, respectively. In 2006, the Company expects to incur approximately \$0.8 million for capital expenditures directed primarily to regulatory compliance. Incorporated by reference is the information regarding AC Products, Inc. contained in Note 18 of Notes to Consolidated Financial Statements included in Item 8 of this Report.

#### *Number of Employees*

On December 31, 2005, Quaker's consolidated companies had 1,226 full-time employees of whom 517 were employed by the parent company and its U.S. subsidiaries and 709 were employed by its non-U.S. subsidiaries. Associated companies of Quaker (in which it owns 50% or less) employed 155 people on December 31, 2005.

#### *Product Classification*

The Company's reportable segments are as follows:

- (1) *Metalworking process chemicals*—industrial process fluids for various heavy industrial and manufacturing applications.
- (2) *Coatings*—temporary and permanent coatings for metal and concrete products and chemical milling maskants.
- (3) *Other chemical products*—other various chemical products.

Incorporated by reference is the segment information contained in Note 13 of Notes to Consolidated Financial Statements included in Item 8 of this Report.

#### *Non-U.S. Activities*

Since significant revenues and earnings are generated by non-U.S. operations, Quaker's financial results are affected by currency fluctuations, particularly between the U.S. dollar, the E.U. euro, and the Brazilian real, and the impact of those currency fluctuations on the underlying economies. Incorporated by reference is the foreign exchange risk information contained in Item 7A of this Report and the geographic information in Note 13 of Notes to Consolidated Financial Statements included in Item 8 of this Report.

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### *Quaker on the Internet*

Financial results, news and other information about Quaker can be accessed from the Company's Web site at <http://www.quakerchem.com>. This site includes important information on products and services, financial reports, news releases, and career opportunities. The Company's periodic and current reports, including exhibits and supplemental schedules filed therewith, and amendments to those reports, filed with the Securities and Exchange Commission ("SEC") are available on the Company's Web site, free of charge, as soon as reasonably practicable after they are electronically filed with or furnished to the SEC. Information that can be accessed through the Company's Web site is not incorporated by reference in this Report and accordingly you should not consider this information part of this Report.

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

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

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

- statements relating to our business strategy;
- our current and future results and plans; and
- statements that include the words "may," "could," "should," "would," "believe," "expect," "anticipate," "estimate," "intend," "plan" or similar expressions.

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

Any or all of the forward-looking statements in this Report, in Quaker's Annual Report to Shareholders for 2005, and in any other public statements we make may turn out to be wrong. This can occur as a result of inaccurate assumptions or as a consequence of known or unknown risks and uncertainties. Many factors discussed in this Report will be important in determining our future performance. Consequently, actual results may differ materially from those that might be anticipated from our forward-looking statements.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in Quaker's subsequent reports on Forms 10-K, 10-Q and 8-K should be consulted. These forward-looking statements are subject to risks, uncertainties and assumptions about us and our operations that are subject to change based on various important factors, some of which are beyond our control. A major risk is that the Company's demand is largely derived from the demand for its customers' products, which subjects the Company to uncertainties related to downturns in a customer's business and unanticipated customer production shutdowns. Other major risks and uncertainties include, but are not limited to, significant increases in raw material costs, worldwide economic and political conditions, foreign currency fluctuations, and terrorist attacks such as those that occurred on September 11, 2001, each of which is discussed in greater detail in Item 1A of this Report. Furthermore, the Company is subject to the same business cycles as those experienced by steel, automobile, aircraft, appliance, and durable goods manufacturers. These risks, uncertainties, and possible inaccurate assumptions relevant to our business could cause our actual results to differ materially from expected and historical results. Other factors

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beyond those discussed in this Report could also adversely affect us. Therefore, we caution you not to place undue reliance on our forward-looking statements. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

**Item 1A. Risk Factors**

***Changes to the industries and markets that Quaker serves could have a material adverse effect on the Company's liquidity, financial position and results of operations.***

The chemical specialty industry comprises a number of companies of similar size as well as companies larger and smaller than Quaker. It is estimated that Quaker holds a leading global position in the markets for process fluids to produce sheet steel and in portions of the automotive and industrial markets. The industry remains highly competitive, and a number of companies with significant financial resources and/or customer relationships compete with us to provide similar products and services. Our competitors may be positioned to offer more favorable pricing and service terms, resulting in reduced profitability and loss of market share for us. Historically, competition in the industry has been based primarily on the ability to provide products that meet the needs of the customer and render technical services and laboratory assistance to the customer and, to a lesser extent, on price. Success factors critical to the Company's business include successfully differentiating the Company's offering from its competition, operating efficiently and profitably as a globally integrated whole, and increasing market share and customer penetration through internally developed business programs and strategic acquisitions.

The business environment in which the Company operates remains challenging. The Company is subject to the same business cycles as those experienced by steel, automobile, aircraft, appliance, and durable goods manufacturers. A major risk is that the Company's demand is largely derived from the demand for its customers' products, which subjects the Company to uncertainties related to downturns in our customers' business and unanticipated customer production shutdowns or curtailments. Customer production within the steel and automotive industries has been recently slowing especially in the U.S. and European markets. The Company has limited ability to adjust its cost level contemporaneously with changes in sales and gross margins. Thus, a significant downturn in sales or gross margins due to weak end-user markets, loss of a significant customer, and/or rising raw material costs could have material adverse effect on the Company's liquidity, financial position and results of operations.

***Our business depends on attracting and retaining qualified management personnel.***

The unanticipated departure of any key member of our management team could have an adverse effect on our business. Given the relative size of the Company and the breadth of its global operations, there are a limited number of qualified management personnel to assume the responsibilities of management level employees should there be management turnover. In addition, because of the specialized and technical nature of our business, our future performance is dependent on the continued service of, and our ability to attract and retain qualified management, commercial and technical personnel. Competition for such personnel is intense, and we may be unable to continue to attract or retain such personnel.

***Inability to obtain sufficient price increases or contract concessions to offset increases in the costs of raw material could have a material adverse effect on the Company's liquidity, financial position and results of operations. Price increases implemented could result in the loss of customers.***

Quaker uses over 1,000 raw materials, including mineral oils and derivatives, animal fats and derivatives, vegetable oils and derivatives, ethylene derivatives, solvents, surface active agents, chlorinated paraffinic compounds, and a wide variety of other organic and inorganic compounds. In 2005, only three raw material groups (mineral oil and derivatives, animal fats and derivatives, and vegetable oils and derivatives) each accounted for as much as 10% of the total cost of Quaker's raw material purchases. The price of mineral oil can be affected by the price of crude oil and refining capacity. In addition, many of the raw materials used by Quaker are "commodity" chemicals. Accordingly, Quaker's earnings can be affected by market changes in raw material prices.

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Over the past three years, Quaker has experienced significant increases in its raw material costs, particularly crude-oil derivatives. For example, the price of crude-oil averaged \$57 per barrel in 2005 versus \$42 in 2004. In addition, refining capacity has also been constrained by hurricanes and other factors, which separately and further contributed to higher raw material costs and negatively impacted margins. In response, the Company has aggressively pursued price increases to offset the increased raw material costs. Although the Company has been successful in recovering a substantial amount of the raw material cost increases, it has experienced competitive as well as contractual constraints limiting pricing actions. The contractual limitations include certain of the Company's CMS contracts for which there are fixed fees that do not allow for adjustments, notwithstanding the increases in third party product purchase costs. In addition, as a result of the Company's pricing actions, customers may become more likely to consider competitor's products, some of which may be available at a lower cost. Significant loss of customers could result in a material adverse effect on the Company's results of operations.

***Bankruptcy of a significant customer could have a material adverse effect on our liquidity, financial position and results of operations.***

During 2005, our five largest customers (each composed of multiple subsidiaries or divisions with semi-autonomous purchasing authority) together accounted for approximately 25% of our consolidated net sales with the largest customer (General Motors) accounting for approximately 9% of consolidated net sales.

A significant portion of Quaker's revenues is derived from sales to customers in the U.S. steel industry, where a number of bankruptcies occurred during recent years. In addition, certain large industrial customers have also experienced financial difficulty. As part of the bankruptcy process, the Company's pre-petition receivables may not be realized, customer manufacturing sites may be closed or contracts voided. The bankruptcy of a major customer could have a material adverse effect on the Company's liquidity, financial position and results of operations. Steel customers typically have limited manufacturing locations as compared to metalworking customers and generally use higher volumes of products at a single location. The loss or closure of a steel mill or other major customer site of a significant customer could have a material adverse effect on Quaker's business.

***Failure to comply with any material provisions of our credit facility could have a material adverse effect on our liquidity, financial position and results of operations.***

The Company maintains a \$100.0 million unsecured credit facility (the "Credit Facility") with a group of lenders, which can be increased to \$125.0 million at the Company's option if lenders agree to increase their commitments and the Company satisfies certain conditions. The Credit Facility, which matures on September 30, 2010, provides the availability of revolving credit borrowings. In general, the borrowings under the Credit Facility bear interest at either a base rate or LIBOR rate plus a margin based on the Company's consolidated leverage ratio.

The Credit Facility contains limitations on capital expenditures, investments, acquisitions and liens, as well as default provisions customary for facilities of its type. While these covenants and restrictions are not currently considered to be overly restrictive, they could become more difficult to comply with as our business or financial conditions change. In addition, deterioration in the Company's results of operations or financial position could significantly increase borrowing costs.

Quaker is exposed to market rate risk for changes in interest rates, due to the variable interest rate applied to the Company's borrowings under its credit facilities. Accordingly, if interest rates rise significantly, the cost of debt to Quaker will increase, perhaps significantly, depending on the extent of Quaker's borrowings under the Credit Facility. At December 31, 2005, the Company had \$63.8 million outstanding under its credit facilities. In the fourth quarter of 2005, the Company entered into interest rate swaps in order to fix a portion of its variable rate debt and mitigate the risks associated with higher interest rates. The combined notional value of the swaps was \$15.0 million at December 31, 2005.

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***Failure to generate taxable income could have a material adverse effect on our financial position and results of operations.***

At the end of 2005, the Company had net U.S. deferred tax assets totaling \$15.3 million, excluding deferred tax assets relating to additional minimum pension liabilities. In addition, the Company has \$3.5 million in operating loss carryforwards related to certain of its foreign operations. The Company records valuation allowances when necessary to reduce its deferred tax assets to the amount that is more likely than not to be realized. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. However, in the event the Company were to determine that it would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to the deferred tax asset would be a non-cash charge to income in the period such determination was made, which could have a material adverse effect on the Company's financial statements.

The continued upward pressure in the Company's crude oil based raw materials has outpaced the Company's selling price increases, negatively impacting profitability. The Company continues to closely monitor this situation as it relates to its net deferred tax assets and the assessment of valuation allowances. The Company is implementing actions that could positively impact taxable income.

***Environmental laws and regulations and pending legal proceedings may materially and adversely affect the Company's liquidity, financial position and results of operations.***

The Company is a party to proceedings, cases, and requests for information from, and negotiations with, various claimants and Federal and state agencies relating to various matters including environmental matters. Incorporated herein by reference is the information concerning pending asbestos-related litigation against an inactive subsidiary and amounts accrued associated with certain environmental investigatory and non-capital remediation costs in Note 18 of Notes to Consolidated Financial Statements which appears in Item 8 of this Report.

***The scope of our international operations subject the Company to risks, including risks from changes in trade regulations, currency fluctuations, and political and economic instability.***

Since significant revenues and earnings are generated by non-U.S. operations, Quaker's financial results are affected by currency fluctuations, particularly between the U.S. dollar, the E.U. euro, and the Brazilian real, and the impact of those currency fluctuations on the underlying economies. During the past three years, sales by non-U.S. subsidiaries accounted for approximately 53% to 55% of the annual consolidated net sales. All these operations use the local currency as their functional currency. The Company generally does not use financial instruments that expose it to significant risk involving foreign currency transactions; however, the size of non-U.S. activities has a significant impact on reported operating results and attendant net assets. Therefore, as exchange rates vary, Quaker's results can be materially affected. Incorporated by reference is the foreign exchange risk information contained in Item 7A of this Report and the geographic information in Note 13 of Notes to Consolidated Financial Statements included in Item 8 of this Report.

Additional risks associated with the Company's international operations include but are not limited to the following:

- Changes in economic conditions from country to country,
- Changes in a country's political condition,
- Trade protection measures,
- Licensing and other legal requirements,
- Local tax issues,
- Longer payment cycles in certain foreign markets,
- Restrictions on the repatriation of our assets, including cash,



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- Significant foreign and United States taxes on repatriated cash,
  - The difficulties of staffing and managing dispersed international operations,
  - Less protective foreign intellectual property laws, and
  - Legal systems which may be less developed and predictable than those in the United States.

***Terrorist attacks, or other acts of violence or war may affect the markets in which we operate and our profitability.***

Terrorist attacks may negatively affect our operations. There can be no assurance that there will not be further terrorist attacks against the United States or United States businesses. Terrorist attacks or armed conflicts may directly impact our physical facilities or those of our suppliers or customers. Additional terrorist attacks may disrupt the global insurance and reinsurance industries with the result that we may not be able to obtain insurance at historical terms and levels for all of our facilities. Furthermore, additional attacks may make travel and the transportation of our supplies and products more difficult and more expensive and ultimately affect the sales of our products. The consequences of terrorist attacks or armed conflicts are unpredictable, and we may not be able to foresee events that could have an adverse effect on our business.

**Item 1B. *Unresolved Staff Comments.***

None.

**Item 2. *Properties.***

Quaker's corporate headquarters and a laboratory facility are located in Conshohocken, Pennsylvania. Quaker's other principal facilities are located in Detroit, Michigan; Middletown, Ohio; Placentia, California; Santa Fe Springs, California; Uithoom, The Netherlands; Santa Perpetua de Mogoda, Spain; Rio de Janeiro, Brazil; Tradate, Italy; and Wuxi, China. All the properties except Placentia, California and Santa Fe Springs, California are used by the metalworking segment. The Placentia, California and Santa Fe Springs, California properties are used by the coatings segment. With the exception of the Conshohocken, Placentia, Santa Fe Springs and Tradate sites, which are leased, all of these principal facilities are owned by Quaker and as of December 31, 2005 were mortgage free. Quaker also leases sales, laboratory, manufacturing, and warehouse facilities in other locations.

In January 2001, the Company contributed its Conshohocken, Pennsylvania property and buildings (the "Site") into a real estate joint venture (the "Venture") in exchange for a 50% interest in the Venture. The Venture did not assume any debt or other obligations of the Company and the Company did not guarantee nor was it obligated to pay any principal, interest or penalties on any of the Venture's indebtedness. The Venture renovated certain of the existing buildings at the Site, as well as built new office space. In December 2000, the Company entered into an agreement with the Venture to lease approximately 38% of the Site's available office space for a 15-year period commencing February 2002, with multiple renewal options. The Company believes the terms of this lease were no less favorable than the terms it would have obtained from an unaffiliated third party. In February 2005, the Venture sold its real estate assets to an unrelated third party, which resulted in \$4.2 million of proceeds to the Company after payment of the Venture's obligations.

In 2005, the Company completed the sale of its Villeneuve, France site. Quaker had ceased manufacturing operations at this facility in March 2002. Production was consolidated into its facilities in Uithoom, The Netherlands and Santa Perpetua de Mogoda, Spain.

Quaker's aforementioned principal facilities (excluding Conshohocken) consist of various manufacturing, administrative, warehouse, and laboratory buildings. Substantially all of the buildings (including Conshohocken) are of fire-resistant construction and are equipped with sprinkler systems. All facilities are primarily of masonry and/or steel construction and are adequate and suitable for Quaker's present operations. The Company has a program to identify needed capital improvements that are implemented as management considers necessary or

desirable. Most locations have various numbers of raw material storage tanks ranging from 7 to 66 at each location with a capacity ranging from 1,000 to 82,000 gallons and processing or manufacturing vessels ranging in capacity from 15 to 16,000 gallons.

Each of Quaker's 50% or less owned non-U.S. associated companies owns or leases a plant and/or sales facilities in various locations.

**Item 3. Legal Proceedings.**

The Company is a party to proceedings, cases, and requests for information from, and negotiations with, various claimants and Federal and state agencies relating to various matters including environmental matters. Incorporated herein by reference is the information concerning pending asbestos-related litigation against an inactive subsidiary and amounts accrued associated with certain environmental investigatory and non-capital remediation costs in Note 18 of Notes to Consolidated Financial Statements which appears in Item 8 of this Report. The Company is a party to other litigation which management currently believes will not have a material adverse effect on the Company's results of operations, cash flow, or financial condition.

**Item 4. Submission of Matters to a Vote of Security Holders.**

No matters were submitted to a vote of security holders during the last quarter of the period covered by this Report.

**Item 4(a). Executive Officers of the Registrant.**

Set forth below are the executive officers of the Company. Each of the executive officers is elected annually to a one-year term.

<u>Name, Age, and Present Position with the Company</u>	<u>Business Experience During Past Five Years and Period Served as an Officer</u>
Ronald J. Naples, 60 Chairman of the Board and Chief Executive Officer, and Director	Mr. Naples has served in his current position since 1997.
Michael F. Barry, 47 Senior Vice President and Managing Director—North America	Mr. Barry assumed his current position on January 1, 2006. He was Senior Vice President and Global Industry Leader—Metalworking and Coatings from July 2005 through December 2005. He was Vice President and Global Industry Leader—Industrial Metalworking and Coatings from January 2004 through June 2005 and Vice President and Chief Financial Officer from 1998 to August 2004.
D. Jeffrey Benoliel, 47 Vice President, Secretary and General Counsel	Mr. Benoliel has served in his current position since 2001.
José Luiz Bregolato, 60 Vice President and Managing Director—South America	Mr. Bregolato has served in his current position since 1993.
Mark A. Featherstone, 44 Vice President and Global Controller	Mr. Featherstone was elected to his current position on March 16, 2005, after holding the position of Global Controller since May 2001. Prior to joining the Company, he was Senior Vice President-Finance and Controller at Internet Partnership Group from April 2000 to March 2001.

Name, Age, and Present Position with the Company	Business Experience During Past Five Years and Period Served as an Officer
Mark Harris, 51 Senior Vice President—Global Strategy and Marketing	Mr. Harris assumed his current position on January 1, 2006. He was Senior Vice President and Global Industry Leader—Steel from July 2005 through December 2005. He was Vice President and Global Industry Leader—Steel from January 2001 through June 2005.
Neal E. Murphy, 48 Vice President, Chief Financial Officer and Treasurer	Mr. Murphy was elected Vice President in July 2004 and was elected Chief Financial Officer and Treasurer in August 2004. Prior to joining the Company, he was Senior Vice President and Chief Financial Officer of International Specialty Products from February 2002 to July 2004. He was also President of PQ Europe from August 1999 to September 2001.
Jan F. Nieman, 45 Vice President and Managing Director—Asia/Pacific	Mr. Nieman was elected to his current position, effective February 1, 2005, after holding the position of Managing Director, Asia/Pacific since August 2003. He was also Global Business Unit Manager Value Added Resellers—Metalworking, Quaker Chemical B.V., the Company’s Dutch affiliate, from October 2000 to August 2003.
Wilbert Platzer, 44 Vice President and Managing Director—Europe	Mr. Platzer assumed his current position on January 1, 2006. He was Vice President – Global Industrial Metalworking from July 2005 through December 2005. He was Vice President—Worldwide Operations from January 2001 through June 2005.

**PART II**

**Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

The Company's common stock is listed on the New York Stock Exchange ("NYSE") under the trading symbol KWR. The following table sets forth, for the calendar quarters during the past two years, the range of high and low sales prices for the common stock as reported on the NYSE composite tape (amounts rounded to the nearest penny), and the quarterly dividends declared and paid:

	Price Range				Dividends Declared		Dividends Paid	
	2005		2004		2005	2004	2005	2004
	High	Low	High	Low				
First quarter	\$ 25.07	\$ 20.03	\$ 30.70	\$ 23.55	\$ 0.215	\$ 0.215	\$ 0.215	\$ 0.210
Second quarter	22.00	17.30	28.60	24.00	0.215	0.215	0.215	0.215
Third quarter	19.11	16.57	27.75	23.74	0.215	0.215	0.215	0.215
Fourth quarter	19.34	15.80	25.00	21.84	0.215	0.215	0.215	0.215

As of January 17, 2006, there were 1,013 shareholders of record of the Company's common stock, its only outstanding class of equity securities.

Every holder of Quaker common stock is entitled to one vote or ten votes for each share held of record on any record date depending on how long each share has been held. As of January 17, 2006, 9,726,425 shares of Quaker common stock were issued and outstanding. Based on the information available to the Company, on January 17, 2006, the holders of 997,148 shares of Quaker common stock would have been entitled to cast ten votes for each share, or approximately 53% of the total votes that would have been entitled to be cast as of that record date and the holders of 8,729,277 shares of Quaker common stock would have been entitled to cast one vote for each share, or approximately 47% of the total votes that would have been entitled to be cast as of that date. The number of shares that are indicated as entitled to one vote includes those shares presumed to be entitled to only one vote. Because the holders of these shares may rebut this presumption, the total number of votes entitled to be cast as of January 17, 2006 could be more than 18,700,757.

**Item 6. Selected Financial Data.**

The following table sets forth selected financial information for the Company and its consolidated subsidiaries:

	<u>2005<sup>(1)</sup></u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001<sup>(2)</sup></u>
	(In thousands, except per share amounts)				
<b>Summary of Operations:</b>					
Net sales	\$ 424,033	\$ 400,695	\$ 340,192	\$ 274,521	\$ 251,074
Income before taxes, equity income and minority interest	6,615	17,457	24,118	24,318	14,430
Net income	1,688	8,974	14,833	14,297	7,665
<b>Per share:</b>					
Net income-basic	\$ 0.17	\$ 0.93	\$ 1.58	\$ 1.56	\$ 0.85
Net income-diluted	\$ 0.17	\$ 0.90	\$ 1.52	\$ 1.51	\$ 0.84
Dividends declared	0.86	0.86	0.84	0.84	0.82
Dividends paid	0.86	0.855	0.84	0.835	0.82
<b>Financial Position:</b>					
Working capital	\$ 79,105	\$ 45,569	\$ 37,137	\$ 37,529	\$ 47,424
Total assets	331,995	324,893	289,467	213,858	179,666
Long-term debt	67,410	14,848	15,827	16,590	19,380
Shareholders' equity	105,907	122,587	112,352	88,055	80,899

Following amounts in thousands

- (1) The results of operation for 2005 include a net pre-tax charge for restructuring and related activities of \$10,320, proceeds from the sale of real estate by the Company's real estate joint venture of \$4,187, and a \$1,000 tax charge associated with the repatriation of accumulated earnings of its foreign subsidiaries.
- (2) The results of operations for 2001 include restructuring charges of \$4,039 after-tax; an additional provision for doubtful accounts related to the poor financial condition of certain customers of \$1,380 after-tax; an environmental charge of \$345 after-tax; and organizational structure charges of \$184 after-tax.

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**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

*Executive Summary*

Quaker Chemical Corporation is a worldwide developer, producer, and marketer of chemical specialty products and a provider of chemical management services for various heavy industrial and manufacturing applications around the globe, with significant sales to the steel and automotive industries. The business environment in which the Company operates remains challenging as significantly higher raw material and third-party finished product costs continue to negatively impact the Company's gross margins and the Company continues to experience sluggish demand in its U.S. and European markets.

The principal factors impacting 2005 earnings included higher raw material costs, a \$10.3 million pre-tax charge for restructuring and related activities, and a \$1.0 million tax charge attributable to the repatriation of accumulated earnings of its foreign subsidiaries. These costs were offset in part by \$4.2 million of pre-tax income from the sale of property by the Company's real estate joint venture and lower minority interest primarily as a result of the Company's first quarter 2005 acquisition of the remaining 40% interest in its Brazilian affiliate.

In 2005, Quaker took action to significantly reduce its base operating costs in the U.S. and Europe, which represent more mature markets for the Company. This restructuring included involuntary terminations, a freeze of the Company's U.S. pension plan, and a voluntary early retirement offering to eligible U.S. employees, resulting in a net \$10.3 million pre-tax charge. The Company believes this restructuring program will allow funding for continued operating expense investments and key growth initiatives. In addition, assuming a stable raw material cost situation in 2006, this action should allow gross margin improvement from the Company's pricing actions to flow to operating income. The Company will maintain its commitment to its globally integrated approach to our business and strategic initiatives.

Much of the revenue growth in 2005 was a reflection of the pricing actions taken by the Company to mitigate higher raw material costs incurred throughout 2004 and 2005. However, the pace and size of raw material cost increases continue to outpace the Company's selling price increases. Limited refining capacity to produce crude oil derivatives continues to impact margins. Also contributing to the gross margin decline was significantly higher third-party product purchase costs with respect to the Company's CMS contracts.

In the fourth quarter of 2005, the Company enhanced its capital structure by entering into a \$100 million credit facility. This facility enabled the consolidation of short-term debt into a longer-term facility and ensured liquidity to support future growth. Additional capital structure measures were taken in the form of substantial repatriation of accumulated foreign earnings. This action improved the balance between foreign and domestic debt levels, enabled better cash management, improved our global tax position, and lowered our consolidated borrowing costs. These foreign earnings repatriation actions resulted in a \$1.0 million largely non-cash tax charge in the fourth quarter.

In summary, the full year results reflect the challenging business environment in which the Company operates and our response to that environment. Continued softness in key markets especially in steel, continued high raw material costs, as well as competitive and contractual constraints limiting pricing actions continue to impact the Company's margins. Notwithstanding these limitations, the Company was able to recover a substantial portion of the raw material cost increases through selling price increases and renegotiate several of its CMS contracts to improve profitability. In addition, the Company also was awarded several new CMS contracts which provide for increased price protection. The Company remains focused on pursuing revenue opportunities, managing its raw material and other costs and aggressively pursuing price and cost savings initiatives.

*Critical Accounting Policies and Estimates*

Quaker's discussion and analysis of its financial condition and results of operations are based upon Quaker's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires Quaker to make estimates

and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, Quaker evaluates its estimates, including those related to customer sales incentives, product returns, bad debts, inventories, property, plant, and equipment, investments, intangible assets, income taxes, financing operations, restructuring, incentive compensation plans, pensions and other postretirement benefits, and contingencies and litigation. Quaker bases its estimates on historical experience and on various other assumptions 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.

Quaker believes the following critical accounting policies describe the more significant judgments and estimates used in the preparation of its consolidated financial statements:

1. Accounts receivable and inventory reserves and exposures—Quaker establishes allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of Quaker's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. As part of its terms of trade, Quaker may custom manufacture products for certain large customers and/or may ship product on a consignment basis. Further, a significant portion of Quaker's revenues is derived from sales to customers in the U.S. steel industry, where a number of bankruptcies have occurred during recent years. When a bankruptcy occurs, Quaker must judge the amount of proceeds, if any, that may ultimately be received through the bankruptcy or liquidation process. These matters may increase the Company's exposure should a bankruptcy occur, and may require writedown or disposal of certain inventory due to its estimated obsolescence or limited marketability. Reserves for customers filing for bankruptcy protection are generally established at 75-100% of the amount outstanding at the filing date, dependent on the Company's evaluation of likely proceeds from the bankruptcy process. Large and/or financially distressed customers are generally reserved for on a specific review basis while a general reserve is established for other customers based on historical experience. The Company's consolidated allowance for doubtful accounts was \$4.1 million and \$6.8 million at December 31, 2005 and 2004, respectively. Further, the Company recorded provisions for doubtful accounts of \$1.2 million, \$0.5 million and \$1.0 million in 2005, 2004 and 2003 respectively. An increase of 10% to the recorded provisions would have decreased the Company's pre-tax earnings by \$0.12 million, \$0.05 million and \$0.1 million in 2005, 2004 and 2003, respectively.

2. Environmental and litigation reserves—Accruals for environmental and litigation matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Accrued liabilities are exclusive of claims against third parties and are not discounted. Environmental costs and remediation costs are capitalized if the costs extend the life, increase the capacity or improve the safety or efficiency of the property from the date acquired or constructed, and/or mitigate or prevent contamination in the future. Estimates for accruals for environmental matters are based on a variety of potential technical solutions, governmental regulations and other factors, and are subject to a large range of potential costs for remediation and other actions. A considerable amount of judgment is required in determining the most likely estimate within the range, and the factors determining this judgment may vary over time. Similarly, reserves for litigation and similar matters are based on a range of potential outcomes and require considerable judgment in determining the most probable outcome. If no amount within the range is considered more probable than any other amount, the Company accrues the lowest amount in the range in accordance with generally accepted accounting principles. An inactive subsidiary of the Company is involved in asbestos litigation. If the Company ever concludes that it is probable it will be liable for any of the obligations of such subsidiary, then it will record the associated liabilities if they can be reasonably estimated. The Company will reassess this situation periodically in accordance with SFAS No. 5, "Accounting for Contingencies." See Note 18 of Notes to Consolidated Financial Statements which appears in Item 8 of this Report.

3. Realizability of equity investments—Quaker holds equity investments in various foreign companies, whereby it has the ability to influence, but not control, the operations of the entity and its future results.

Quaker records an investment impairment charge when it believes an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions, poor operating results of underlying investments, or devaluation of foreign currencies could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's current carrying value. These factors may result in an impairment charge in the future. The carrying amount of the Company's equity investments at December 31, 2005 was \$6.6 million and was comprised of three investments totaling \$3.6, \$2.2 and \$0.8 million, respectively.

4. Tax exposures and valuation allowances—Quaker records expenses and liabilities for taxes based on estimates of amounts that will be ultimately determined to be deductible in tax returns filed in various jurisdictions. The filed tax returns are subject to audit, often several years subsequent to the date of the financial statements. Disputes or disagreements may arise during audits over the timing or validity of certain items or deductions, which may not be resolved for extended periods of time. Quaker establishes reserves for potential tax audit and other exposures as transactions occur and reviews these reserves on a regular basis; however, actual exposures and audit adjustments may vary from these estimates. Quaker also records valuation allowances when necessary to reduce its deferred tax assets to the amount that is more likely than not to be realized. While Quaker has considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event Quaker were to determine that it would be able to realize its deferred tax assets in the future in excess of its net recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should Quaker determine that it would not be able to realize all or part of its net deferred tax assets in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made which could have a material adverse impact on the Company's financial statements. U.S. income taxes have not been provided on the undistributed earnings of non-U.S. subsidiaries since it is the Company's intention to continue to reinvest these earnings in those subsidiaries for working capital needs and growth initiatives. U.S. and foreign income taxes that would be payable if such earnings were distributed may be lower than the amount computed at the U.S. statutory rate due to the availability of tax credits.

5. Restructuring liabilities—Restructuring charges may consist of charges for employee severance, rationalization of manufacturing facilities and other items. In 2001, Quaker recorded restructuring and other exit costs, including involuntary termination of certain employees, in accordance with the Financial Accounting Standards Board's ("FASB") Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." Certain of these items, particularly those involving impairment charges for assets to be sold or closed, require significant estimates and assumptions in terms of estimated sale proceeds, date of sale, transaction costs and other matters, and these estimates can change based on market conditions and other factors. In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which nullified EITF Issue No. 94-3. The Company adopted the provisions of SFAS No. 146 effective for exit or disposal activities initiated after December 31, 2002. The principal difference between SFAS No. 146 and EITF 94-3 relates to its requirements for recognition of a liability for a cost associated with an exit or disposal activity. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for exit costs is recognized at the date of an entity's commitment to an exit plan.

6. Goodwill and other intangible assets—Goodwill and other intangible assets are evaluated in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Intangible assets, which do not have indefinite lives, are recorded at fair value and amortized over a straight-line basis based on third party valuations of the assets. Goodwill and intangible assets, which have indefinite lives, are no longer amortized and are required to be assessed at least annually for impairment. The Company compares the assets' fair value to their carrying value primarily based on future discounted cash flows in order to determine if an impairment charge is warranted. The estimates of future cash flows involve considerable management judgment and are based upon assumptions about expected future operating performance. Assumptions used in these forecasts are consistent with internal planning. The actual cash flows could differ from



management's estimates due to changes in business conditions, operating performance, and economic conditions. The Company completed its annual impairment assessment as of the end of the third quarter 2005, and no impairment charge was warranted. The Company's consolidated goodwill and indefinite-lived intangible assets at December 31, 2005 and 2004 were \$36.0 million and \$35.5 million, respectively. The Company's assumption of weighted average cost of capital and estimated future net operating profit after tax (NOPAT) are particularly important in determining whether an impairment charge has been incurred. The Company currently uses a weighted average cost of capital of 12% and, at September 30, 2005, this assumption would have had to increase by more than 4 percentage points before any of the Company's reporting units would fail step one of the SFAS No. 142 impairment analysis. Further, at September 30, 2005, the Company's estimate of future NOPAT would have had to decrease by more than 26% before any of the Company's reporting units would be considered potentially impaired.

7. Postretirement benefits—The Company provides certain pension and other postretirement benefits to employees and retirees. Independent actuaries, in accordance with accounting principles generally accepted in the United States, perform the required valuations to determine benefit expense and, if necessary, non-cash charges to equity for additional minimum pension liabilities. Critical assumptions used in the actuarial valuation include the weighted average discount rate, rates of increase in compensation levels and expected long-term rates of return on assets. If different assumptions were used, additional pension expense or charges to equity might be required. For 2005, the Company incurred such a non-cash charge to equity of \$3.5 million. The Company's pension plan year-end is November 30, which serves as the measurement date. The following table highlights the potential impact on the Company's pre-tax earnings due to changes in assumptions with respect to the Company's pension plans, based on assets and liabilities at December 31, 2005:

	1/2 Percentage Point Increase			1/2 Percentage Point Decrease		
	Foreign	Domestic	Total	Foreign	Domestic	Total
Discount rate	\$ (0.5)	\$ (0.2)	\$(0.7)	\$ 0.5	\$ 0.2	\$0.7
Expected rate of return on plan assets	\$ (0.2)	\$ (0.2)	\$(0.4)	\$ 0.2	\$ 0.2	\$0.4

#### *Recently Issued Accounting Standards*

In June 2005, the Financial Accounting Standards Board ("FASB") issued SFAS No. 154, "Accounting Changes and Error Corrections: ("SFAS 154"). SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principles unless it is impracticable to determine either period-specific effects or the cumulative effect of the change or, in the unusual instance, that a newly issued accounting pronouncement does not include explicit transition provisions. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will apply the requirements of the standard as needed.

In December 2004, the FASB issued its final standard on accounting for share-based payments, SFAS 123R (Revised 2004), Share-Based Payment ("SFAS 123R"). SFAS 123R requires companies to expense the fair value of employee stock options and other similar awards. The fair value of the awards are to be measured based on the grant-date fair value of the awards and the cost to be recognized over the period during which an employee is required to provide service in exchange for the award. SFAS 123R eliminates the alternative use of Accounting Principles Board No. 25's intrinsic value method of accounting for awards, which is the Company's current accounting policy for stock options. See Note 1 for the pro forma impact of compensation expense from stock options on net earnings and earnings per share. SFAS 123R is effective for the Company beginning January 1, 2006. The Company adopted the provisions of SFAS 123R on a prospective basis. The financial statement impact will be dependent on future stock-based awards and any unvested stock options outstanding. At the time of adoption, the Company will have approximately \$0.1 million of pre-tax expense to record related to unvested stock options.

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In December 2004, the FASB issued its final standard on accounting for exchanges on nonmonetary assets, SFAS 153, "Exchange of Nonmonetary Assets an amendment of APB Opinion No. 29" ("SFAS 153"). SFAS 153 requires that exchanges of nonmonetary assets be measured based on the fair value of assets exchanged for annual periods beginning after June 15, 2005. The adoption of SFAS 153 did not have a material impact on the Company's financial position, results of operations, or cash flows.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs an amendment of ARB 43, Chapter 4 ("SFAS 151"). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) in the determination of inventory carrying costs. The statement requires that such costs be recognized as a current period expense. SFAS 151 also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for fiscal years beginning after July 15, 2005. The adoption of SFAS 151 did not have a material impact on the company's financial position, results of operations, or cash flows.

#### *Liquidity and Capital Resources*

Quaker's cash and cash equivalents decreased to \$16.1 million at December 31, 2005 from \$29.1 million at December 31, 2004. The decrease was primarily from \$11.3 million cash provided by operating activities, offset by \$8.5 million cash used in investing activities and \$14.8 million cash used in financing activities.

Net cash flow provided by operating activities was \$11.3 million in 2005 versus \$3.4 million in 2004. The Company's lower 2005 net income was more than offset by significant improvements in the Company's working capital accounts as compared to 2004. The improvements in working capital accounts were driven by a significant increase in accounts payable and accrued liabilities. The largest gains in accounts payable occurred due to the timing of payments in North America and Europe. The change in estimated taxes on income was due to a \$3.0 million overpaid tax position at the end of 2004 relating to our European operations, which was realized in 2005.

Net cash used in investing activities was \$8.5 million in 2005 compared to \$6.6 million in 2004. The increased use of cash was primarily due to payments related to an acquisition, offset in part by proceeds from the disposition of partnership assets and lower capital expenditures. In March 2005, the Company acquired the remaining 40% interest in its Brazilian joint venture for \$6.7 million. The Company recorded a gain of \$3.0 million in the first quarter of 2005 in connection with the sale of real estate assets by the Company's real estate joint venture. The decrease in capital expenditures was due to lower spending on the Company's U.S. lab renovation and global ERP implementation. The Company also received \$1.9 million of cash proceeds in 2005 from the sale of its Villeneuve, France site. In 2004, the Company received \$1.9 million of cash proceeds primarily from the sale of real estate by the company's majority-owned Australian subsidiary.

In January 2001, the Company contributed its Conshohocken, Pennsylvania property and buildings (the "Site") into a real estate joint venture (the "Venture") in exchange for a 50% interest in the Venture. The Venture did not assume any debt or other obligations of the Company and the Company did not guarantee nor was it obligated to pay any principal, interest or penalties on any of the Venture's indebtedness. The Venture renovated certain of the existing buildings at the Site, as well as built new office space. In December 2000, the Company entered into an agreement with the Venture to lease approximately 38% of the Site's available office space for a 15-year period commencing February 2002, with multiple renewal options. The Company believes the terms of this lease were no less favorable than the terms it would have obtained from an unaffiliated third party. In February 2005, the Venture sold its real estate assets to an unrelated third party, which resulted in \$4.2 million of proceeds to the Company after payment of the Venture's obligations. The proceeds include a gain of \$3.0 million related to the sale by the Venture of its real estate holdings as well as \$1.2 million of preferred distributions.

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Net cash flows used in financing activities was \$14.8 million in 2005 versus \$7.4 million of cash provided by financing activities in 2004. Net repayments of debt of \$2.7 million in 2005 versus \$16.6 million of net borrowings of debt in 2004 primarily drove the change in cash flows from financing activities. The net borrowings in 2004 were primarily used to fund the Company's working capital needs as compared to 2005. In addition, higher distributions paid to minority shareholders of certain of the Company's affiliates contributed to the current year use of cash. The increase in distributions to minority shareholders was driven in large part by a distribution made prior to the Company's acquisition of the remaining 40% interest in its Brazilian joint venture described above.

Throughout 2004, the Company maintained various short-term credit facilities with multiple banks. At December 31, 2004, the Company's short-term credit facilities totaled \$95.0 million of which \$40.0 million was committed and \$55.0 million was uncommitted. In September 2005, the Company prepaid its senior unsecured notes due in 2007. The total amount of principal prepaid was \$8.6 million. In October 2005, the Company entered into a new syndicated multi-currency credit agreement that provides for financing in the United States and the Netherlands. This facility enabled the Company to consolidate the majority of its short-term debt into a longer-term facility. The new facility terminates on September 30, 2010. The new facility allows for revolving credit borrowings in a principal amount of up to \$100.0 million, which can be increased to \$125.0 million at the Company's option if lenders agree to increase their commitments and the Company satisfies certain conditions. In general, borrowings under the credit facility bear interest at either a base rate or LIBOR rate plus a margin based on the Company's consolidated leverage ratio. The provisions of the agreements require that the Company maintain certain financial ratios and covenants, all of which the Company was in compliance with as of December 31, 2005 and 2004. Under its most restrictive covenants, the Company could have borrowed an additional \$32.9 million at December 31, 2005. At December 31, 2005 and 2004, the Company had approximately \$63.8 million and \$57.1 million outstanding on these credit lines at a weighted average borrowing rate of 4.42% and 2.9%, respectively.

The Company believes that, in 2006, it is capable of supporting its operating requirements including pension plan contributions, payments of dividends to shareholders, possible acquisition opportunities, and possible resolution of contingencies, through internally generated funds supplemented with debt as needed.

In December 2005, an inactive subsidiary of the Company reached a settlement agreement and release with one of its insurance carriers for \$15.0 million. The proceeds of the settlement are restricted and can only be used to pay claims and costs of defense associated with this subsidiary's asbestos litigation. The subsidiary received \$7.5 million in December 2005, which was deposited into an interest bearing account, and will receive an additional \$7.5 million in December 2006 unless Federal asbestos legislation is adopted. Both the subsidiary and the insurance company acknowledge that as of the effective date of the settlement agreement and release it appears unlikely that Federal asbestos legislation will be enacted into law prior to the scheduled December 2006 payment. However, if the President of the United States signs into law the Federal asbestos legislation, the insurance carrier's obligation to make the second payment will be cancelled. The restrictions regarding the use of proceeds lapse after a period of 15 years. Due to the restricted nature of the proceeds, a corresponding deferred credit was established in Other non-current liabilities for an equal and offsetting amount, and will remain until the restrictions lapse or the funds are exhausted via payments of claims and costs of defense. See also Notes 16, 17 and 18 of Notes to Consolidated Financial Statements.

The following table summarizes the Company's contractual obligations at December 31, 2005, and the effect such obligations are expected to have on its liquidity and cash flow in future periods. Pension and other postretirement plan contributions beyond 2006 are not determinable since the amount of any contribution is heavily dependent on the future economic environment and investment returns on pension trust assets. The timing of payments related to other long-term liabilities, which consist primarily of deferred compensation agreements, cannot be readily determined due to their uncertainty. Interest obligations on the Company's short and long-term debt are excluded as the majority of the Company's debt is subject to variable interest rates. (Amounts in millions)

Contractual Obligations	Payments due by period						
	Total	2006	2007	2008	2009	2010	2011 and beyond
Short-term debt	\$ 4.364	\$ 4.364	\$ —	\$ —	\$ —	\$ —	\$ —
Long-term debt	66.510	0.524	0.547	0.572	0.197	59.496	5.174
Capital lease obligations	2.006	0.427	0.407	0.373	0.311	0.312	0.176
Non-cancelable operating leases	21.673	4.358	3.909	3.203	1.693	1.357	7.153
Purchase obligations	3.753	3.753	—	—	—	—	—
Pension and other postretirement plan contributions	9.148	9.148	—	—	—	—	—
Other long-term liabilities (primarily deferred compensation agreements)	7.355	—	—	—	—	—	7.355
Total contractual cash obligations	<u>\$ 114.809</u>	<u>\$ 22.574</u>	<u>\$ 4.863</u>	<u>\$ 4.148</u>	<u>\$ 2.201</u>	<u>\$ 61.165</u>	<u>\$ 19.858</u>

### Operations

#### CMS Discussion

During 2003, the Company began a new approach to its chemical management services (CMS) business consistent with the Company's strategic imperative to sell customer solutions—value—not just fluids. Under the Company's traditional CMS approach, the Company effectively acts as an agent whereby it purchases chemicals from other companies and resells the product to the customer at little or no margin and earns a set management fee for providing this service. Therefore, the profit earned on the management fee is relatively secure as the entire cost of the products is passed on to the customer. The new approach to CMS is dramatically different. The Company receives a set management fee and the costs that relate to those management fees are largely connected to how well the Company controls product costs and achieves product conversions from other third party suppliers to its own products. With this new approach come new risks and opportunities, as the profit earned from the management fee is subject to movements in product costs as well as the Company's own performance. The Company believes this new approach is a way for Quaker to become an integral part of our customers' operational efforts to improve manufacturing costs and to demonstrate value that the Company would not be able to demonstrate as purely a product provider.

With this new approach, the Company was awarded a series of multi-year CMS contracts primarily at General Motors Powertrain and DaimlerChrysler manufacturing sites in 2003, 2004 and 2005. This business was an important step in building the Company's share and leadership position in the automotive process fluids market and should position the Company well for penetration of CMS opportunities in other metalworking manufacturing sites. This new approach has also had a dramatic impact on the Company's revenue and margins. Under the traditional CMS approach, where the Company effectively acts as an agent, the revenue and costs from these sales are reported on a net sales or "pass-through" basis. As discussed above, the structure of the new CMS approach is different in that the Company's revenue received from the customer is a fee for products and services provided to the customer, which are indirectly related to the actual costs incurred. As a result, the Company recognizes in reported revenues the gross revenue received from the CMS site customer, and in cost of goods sold, the third party product purchases, which substantially offset each other until the Company achieves significant product conversions. There are two critical success factors for this new approach. First, is to create

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savings for a customer based on our ability to help apply the product better and improve the customer's own processes. Second, is to convert more of the product being used to Quaker product rather than a competitor's product. While the Company's U.S. CMS program contributed to profitability in 2005, overall performance was tempered by higher third-party product costs.

#### ***Comparison of 2005 with 2004***

Net sales for 2005 increased to \$424.0 million, up 6% from \$400.7 million for 2004. Approximately 4% of the sales increase was attributable to higher sales prices, while foreign exchange rate translation favorably impacted net sales by approximately 2%. Volume increases in Asia/Pacific were offset by softer demand in North America and Europe.

Gross profit (net sales less cost of goods sold) as a percentage of sales declined from 32.7% in 2004 to 30.6% in 2005. Higher prices for the Company's raw materials, particularly crude oil derivatives, and higher third-party product purchase costs with respect to the Company's CMS contracts, exceeded the pace at which price increases could be implemented through the year. Unfavorable product and regional mix also contributed to the decline in gross profit percentage.

Selling, general and administrative ("SG&A") expenses for 2005 increased \$2.8 million or approximately 3% from 2004. Foreign exchange rate translation accounted for approximately half of the increase with the remainder attributable to inflation, investments in growth initiatives and higher pension costs offset by other cost reduction efforts. SG&A as a percentage of sales decreased from 28.3% to 27.4%.

In the first quarter of 2005, the Company incurred a net pre-tax charge of \$1.2 million related to a reduction in its workforce. During the fourth quarter of 2005, the Company furthered this restructuring effort with the goal of significantly reducing operating costs in the U.S. and Europe. The fourth quarter program included involuntary terminations, a freeze of the Company's U.S. pension plan, and a voluntary early retirement offering to eligible U.S. employees. These actions resulted in a net pre-tax charge of \$9.1 million. The Company estimates 2006 savings resulting from these programs to be of a similar magnitude as the charges. These savings will substantially mitigate the increased cost of continued operating expense investments and key growth initiatives.

The increase in other income for 2005 was largely due to the \$4.2 million of proceeds received from the sale by the Company's real estate joint venture of its holdings as previously announced on February 17, 2005. The proceeds included a \$3.0 million gain relating to the sale by the venture of its real estate holdings, as well as \$1.2 million of preferred return distributions. Preferred distributions in 2004 totaled \$0.9 million. Foreign exchange gains in 2005 also contributed to the increase in other income. The increase in net interest expense in 2005 was due to higher average borrowings and higher interest rates on the Company's debt.

The effective tax rate was 50.4% versus 31.5% in 2004. The increase was primarily due to the Company's election, in the fourth quarter of 2005, to repatriate substantial accumulated foreign earnings which, primarily to improve its global capital structure, resulted in a \$1.0 million charge in tax expense.

At the end of 2005, the Company had net U.S. deferred tax assets totaling \$15.3 million, excluding deferred tax assets relating to additional minimum pension liabilities. The Company records valuation allowances when necessary to reduce its deferred tax assets to the amount that is more likely than not to be realized. The Company considers future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. However, in the event the Company were to determine that it would not be able to realize all or part of its U.S. net deferred tax assets in the future, an adjustment to the deferred tax asset would be a non-cash charge to income in the period such determination were made, which could have a material adverse impact on the Company's financial statements. The continued upward pressure in the Company's crude oil based raw materials has outpaced the Company's selling price increases, negatively impacting U.S. profitability. The Company continues to closely monitor this situation as it relates to its net deferred tax assets and the assessment of valuation allowances. The Company is continuing to evaluate alternatives that could positively impact U.S. taxable income.

The \$1.7 million decrease in minority interest in 2005 was primarily due to the Company's first quarter 2005 acquisition of the remaining 40% interest in its Brazilian affiliate.

### ***Segment Reviews—Comparison of 2005 with 2004***

#### ***Metalworking Process Chemicals:***

Metalworking Process Chemicals consists of industrial process fluids for various heavy industrial and manufacturing applications and represented approximately 93% of the Company's net sales in 2005. Net sales were up \$23.0 million, or 6%, compared with 2004. Favorable currency translation represented approximately 2 percentage points of the growth in this segment, driven by the Brazilian real to U.S. dollar exchange rate. The average Brazilian real to U.S. dollar rate was 0.41 in 2005 compared to 0.34 in 2004. The remaining net sales increase of 4% was due to 35% growth in Asia/Pacific, 7.2% growth in South America, 1% growth in North America, partially offset by decreases in our European net sales, which were down 3%, all on a constant currency basis. The growth in net sales is primarily attributable to the pricing actions taken by the Company throughout 2004 and 2005 to help in offsetting the continued escalation in raw material costs. Volume increases in Asia/Pacific were offset by volume declines in the Company's North American and European regions. The \$6.4 million decrease in this segment's operating income compared to 2004 is largely reflective of the pace at which raw material costs have escalated beyond the Company's pricing actions. This segment's operating income was also impacted by higher selling costs compared to the prior year.

#### ***Coatings:***

The Company's Coatings segment, which represented approximately 6% of Company's net sales for 2005, contains products that provide temporary and permanent coatings for metal and concrete products and chemical milling maskants. Net sales for this segment were up \$2.0 million, or 8% in 2005, compared with the prior year, primarily due to higher chemical milling maskant sales to the aerospace industry. Operating income decreased by \$0.1 million in 2005 compared to 2004 due to higher raw material and selling costs.

#### ***Other Chemical Products:***

Other Chemical Products, which represented approximately 1% of net sales in 2005, consists of sulfur removal products for industrial gas streams sold by the Company's Q2 Technologies joint venture. Net sales for 2005 decreased \$1.7 million or 31% due to a variety of market conditions, including special one-time sales to this segment's largest customer in 2004 affecting the yearly net sales comparison. This segment's operating income decreased by \$0.4 million, consistent with the noted volume decreases and higher raw material costs.

### ***Comparison of 2004 with 2003***

Consolidated net sales increased by 18% to \$400.7 million in 2004 from \$340.2 million in 2003. The impact from foreign exchange rate translation increased sales by approximately \$14.7 million, or 4%. The timing of the Company's 2003 acquisitions increased net sales by \$16.2 million, or 5%, and the Company's new chemical management services ("CMS") contracts, increased net sales by \$17.2 million, or 5%. The remaining 4% increase in net sales was attributable to growth in the Asia/Pacific and North and South American regions partially offset by lower sales in Europe. The decline in business in Europe was substantially caused by softness in sheet steel demand. Although the Company's market share in this region remained stable during 2004, the increased competitive pressures experienced in late 2003 also affected the yearly comparisons.

Gross profit (net sales less cost of goods sold) as a percentage of sales declined from 35.7% in 2003 to 32.7% in 2004. The new CMS contracts resulted in an increase in the Company's reported revenue of approximately \$17.2 million and a corresponding decrease in gross profit as a percentage of sales of approximately 1.3 percentage points. The remaining decline in gross profit as a percentage of sales was primarily due to increased raw material costs, as well as unfavorable product and geographic mix. Even though the Company experienced a four-year high in the pricing of its key raw material markets at the end of 2003, the

pricing of these key raw materials continued to escalate in 2004. While the Company benefited from the implementation of price increases announced during the third and fourth quarters of 2004, these gains were more than offset by the continued increase in raw material prices, particularly crude oil-based derivatives.

SG&A as reported for 2004 totaled \$113.5 million compared to \$97.2 million in 2003. Approximately 40% of the \$16.3 million increase was due to foreign exchange rate translation and the Company's 2003 acquisition activity, which impacted SG&A by approximately \$3.9 million and \$2.4 million, respectively. The majority of the remaining increase was due to costs associated with strategic initiatives, as well as a range of administrative costs such as Sarbanes-Oxley compliance, pension, incentive compensation, and higher sales commissions. The Company's strategic initiatives include expanding our presence in the Asia/Pacific region, further supporting our CMS business, the continued rollout of our global ERP system, and continuing development of new, complementary businesses.

During the fourth quarter of 2004, the Company began efforts to realign its organization and reduce costs by announcing the consolidation of its administrative facilities in Hong Kong with its Shanghai headquarters, resulting in a \$0.5 million pre-tax charge for restructuring and related activities.

The increase in other income in 2004 reflected a gain on the sale of real estate by the Company's majority-owned Australian subsidiary, as well as higher priority return distributions from the Company's real estate joint venture in Conshohocken. The increase in interest expense in 2004 was primarily due to higher debt balances outstanding during 2004 as well as higher short-term interest rates on the Company's credit facilities.

The Company's effective tax rate was 31.5% in 2004 and 31% in 2003. The effective tax rate is dependent on many internal and external factors and is assessed by the Company on a regular basis.

The \$0.8 million increase in minority interest expense in 2004 was primarily due to the gain on the sale of real estate relating to the Company's Australian operations mentioned above as well as a stronger performance from the Company's Brazilian joint venture.

### ***Segment Reviews—Comparison of 2004 with 2003***

#### ***Metalworking Process Chemicals:***

Metalworking Process Chemicals, which consists of industrial process fluids for various heavy industrial and manufacturing applications, represented approximately 93% of the Company's sales in 2004. Reported revenues in this segment were up approximately 18% compared with 2003. The Company's new CMS contracts accounted for approximately 6 percentage points of the revenue growth in this segment. The timing of the Company's 2003 acquisitions of Vulcan, Eural, and KS Chemie accounted for approximately 5 percentage points of the revenue growth in this segment. Currency translation increased sales by 5 percentage points, primarily due to the higher average Euro to U.S. dollar exchange rate of 1.24 in 2004 compared to 1.13 in 2003. The remaining net sales increase of 2% was primarily due to 17% growth in South America, 13% growth in Asia/Pacific, and 5% increase in the U.S. base business, offset by decreases in our European sales, which was down 3%, all on a constant currency basis. The operating income in this segment increased by \$1.8 million or 3%. The disparity between the increase in sales and operating income is largely reflective of the Company's new approach to its CMS business, discussed above. Further, this segment's operating income was negatively impacted by significantly higher raw material costs, unfavorable product and regional sales mix as well as higher selling costs.

#### ***Coatings:***

The Company's Coatings segment represented approximately 6% of the Company's sales in 2004 and contained products that provide temporary and permanent coatings for metal and concrete products and chemical milling maskants. Revenues for this segment were up approximately \$1.8 million or 8% for 2004 compared with the prior year primarily due to higher chemical milling maskant sales to the aerospace industry, as well as new customer penetration in roofing sealants. Operating income increased \$0.6 million over 2003, consistent with the noted volume increases.

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### ***Other Chemical Products:***

Other Chemical Products represents approximately 1% of total sales in 2004 and consists of sulfur removal products for industrial gas streams sold by the Company's Q2 Technologies joint venture. Sales for 2004 increased \$1.3 million primarily due to special one-time sales to this segment's largest customer. Operating income increased by \$0.2 million over the prior year, due to the noted volume increases offset by higher raw material costs.

### ***Restructuring and Related Activities***

In 2001, Quaker's management approved restructuring plans to realign the organization primarily in Europe and reduce operating costs (2001 program). Quaker's restructuring plans included the closing and sale of its manufacturing facilities in the U.K. and France. In addition, Quaker consolidated certain functions within its global business units and reduced administrative functions, as well as expensed costs related to abandoned acquisitions. Included in the restructuring charges were provisions for severance of 53 employees. Restructuring and related charges of \$5.854 million were recognized in 2001. The charge comprised \$2.807 million related to employee separations, \$2.450 million related to facility rationalization charges, and \$0.597 million related to abandoned acquisitions. Employee separation benefits varied depending on local regulations within certain foreign countries and included severance and other benefits. In January of 2005, the last severance payment under the 2001 program was made and the Company reversed \$0.117 million of unused restructuring accruals related to this program. In February 2005, the Company completed the sale of a portion of its Villeneuve, France site for \$0.647 million. In July 2005, the Company completed the sale of the remaining portion of its Villeneuve, France site for \$1.260 million, which completed all actions contemplated by this program. The Company reversed \$0.159 million of unused restructuring accruals related to this program in the fourth quarter of 2005.

In 2003, Quaker's management approved a restructuring plan (2003 program). Included in the 2003 restructuring charge were provisions for severance for 9 employees totaling \$0.273 million. As of March 31, 2005, all severance payments were completed and the Company reversed \$0.059 million of unused restructuring accruals related to this program, which completed all actions contemplated by this program.

In 2004, Quaker's management approved a restructuring plan by announcing the consolidation of its administrative facilities in Hong Kong with its Shanghai headquarters (2004 program). Included in the 2004 restructuring charge were severance provisions for 5 employees totaling \$0.119 million and an asset impairment related to the Company's previous plans to implement its global ERP system at this location totaling \$0.331 million. As of March 31, 2005, all severance payments were completed, which completed all actions contemplated by this program.

In the first quarter of 2005, Quaker's management approved a restructuring plan (2005 1<sup>st</sup> Quarter Program). Included in the first quarter 2005 restructuring charge were provisions for severance for 16 employees totaling \$1.408 million. At December 31, 2005, all severance payments were completed. The Company reversed \$0.096 million of unused restructuring charges related to this program, which completed all actions contemplated by this program.

In the fourth quarter of 2005, Quaker's management approved a restructuring plan (2005 4<sup>th</sup> Quarter Program) with the goal of significantly reducing operating costs in the U.S. and Europe. The restructuring plan included involuntary terminations, a freeze of the Company's U.S. pension plan, and a voluntary early retirement window to certain U.S. employees, with enhanced pension and other postretirement benefits. Included in the restructuring charges were provisions for severance (voluntary and involuntary) of 55 employees. Restructuring and related charges of \$9.344 million were recognized in the fourth quarter of 2005. The charge comprised \$4.024 million related to severance for involuntary terminations, \$1.017 million related to one-time payments for voluntary early retirement, \$2.668 million related to the U.S. pension plan freeze and \$1.635 million for the enhanced pension and other postretirement benefits related to voluntary early retirement participants. The Company expects to complete the initiatives contemplated under this program during 2006. The charges related to the U.S. pension plan freeze and the enhanced pension and other postretirement benefits are not included in the following table, and are included as part of the accrued pension and other postretirement balances. See also Note 9 of Notes to Consolidated Financial Statements.



Accrued restructuring balances, included in other current liabilities and assigned to the Metalworking segment, are as follows (amounts in millions):

	Employee Separations	Facility Rationalization	Abandoned Acquisitions	Total
<b>2001 Program:</b>				
Restructuring charges	\$ 2.807	\$ 2.450	\$ 0.597	\$ 5.854
Asset impairment	—	(1.015)	—	(1.015)
Payments	(0.111)	(0.171)	(0.597)	(0.879)
Currency translation and other	0.001	0.012	—	0.013
December 31, 2001 ending balance	2.697	1.276	—	3.973
Payments	(1.374)	(0.752)	—	(2.126)
Currency translation and other	0.114	0.182	—	0.296
December 31, 2002 ending balance	1.437	0.706	—	2.143
Restructuring reversals	(0.156)	(0.060)	—	(0.216)
Payments	(0.832)	(0.204)	—	(1.036)
Currency translation and other	0.001	0.083	—	0.084
December 31, 2003 ending balance	0.450	0.525	—	0.975
Payments	(0.249)	(0.166)	—	(0.415)
Currency translation and other	0.016	0.027	—	0.043
December 31, 2004 ending balance	0.217	0.386	—	0.603
Restructuring reversals	(0.117)	(0.159)	—	(0.276)
Payments	(0.100)	(0.227)	—	(0.327)
December 31, 2005 ending balance	—	—	—	—
<b>2003 Program:</b>				
Restructuring charges	0.273	—	—	0.273
Payments	(0.047)	—	—	(0.047)
Currency translation and other	0.002	—	—	0.002
December 31, 2003 ending balance	0.228	—	—	0.228
Payments	(0.143)	—	—	(0.143)
Currency translation and other	0.012	—	—	0.012
December 31, 2004 ending balance	0.097	—	—	0.097
Restructuring reversals	(0.059)	—	—	(0.059)
Payments	(0.034)	—	—	(0.034)
Currency translation and other	(0.004)	—	—	(0.004)
December 31, 2005 ending balance	—	—	—	—
<b>2004 Program:</b>				
Restructuring charges	0.119	0.331	—	0.450
Asset impairment	—	(0.331)	—	(0.331)
December 31, 2004 ending balance	0.119	—	—	0.119
Payments	(0.119)	—	—	(0.119)
December 31, 2005 ending balance	—	—	—	—
<b>2005 1<sup>st</sup> Quarter Program:</b>				
Restructuring charges	1.408	—	—	1.408
Restructuring reversals	(0.096)	—	—	(0.096)
Payments	(1.312)	—	—	(1.312)
December 31, 2005 ending balance	—	—	—	—
<b>2005 4<sup>th</sup> Quarter Program:</b>				
Restructuring charges	5.041	—	—	5.041
Payments	(1.006)	—	—	(1.006)
Currency translation and other	(0.002)	—	—	(0.002)
December 31, 2005 ending balance	4.033	—	—	4.033
<b>Total restructuring December 31, 2005 ending balance</b>	<b>\$ 4.033</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 4.033</b>

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### *Environmental Clean-up Activities*

The Company is involved in environmental clean-up activities in connection with an existing plant location and former waste disposal sites. In April of 1992, the Company identified certain soil and groundwater contamination at AC Products, Inc. ("ACP"), a wholly owned subsidiary. Voluntarily in coordination with the Santa Ana California Regional Water Quality Board, ACP is remediating the contamination. The Company believes that the remaining potential-known liabilities associated with these matters range from approximately \$1.2 million to \$1.5 million, for which the Company has sufficient reserves. Notwithstanding the foregoing, the Company cannot be certain that liabilities in the form of remediation expenses, fines, penalties, and damages will not be incurred in excess of the amount reserved. See Note 18 of Notes to Consolidated Financial Statements which appears in Item 8 of this Report.

### *General*

The Company generally does not use financial instruments that expose it to significant risk involving foreign currency transactions; however, the size of non-U.S. activities has a significant impact on reported operating results and the attendant net assets. During the past three years, sales by non-U.S. subsidiaries accounted for approximately 53% to 55% of the consolidated net annual sales. See Note 13 of Notes to Consolidated Financial Statements which appears in Item 8 of this Report.

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

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

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

- statements relating to our business strategy;
- our current and future results and plans; and
- statements that include the words "may," "could," "should," "would," "believe," "expect," "anticipate," "estimate," "intend," "plan" or similar expressions.

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

Any or all of the forward-looking statements in this report, in Quaker's Annual Report to Shareholders for 2005 and in any other public statements we make may turn out to be wrong. This can occur as a result of inaccurate assumptions or as a consequence of known or unknown risks and uncertainties. Many factors discussed in this Report will be important in determining our future performance. Consequently, actual results may differ materially from those that might be anticipated from our forward-looking statements.

We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in Quaker's subsequent reports on Forms 10-K, 10-Q and 8-K should be consulted. These forward-looking statements are

subject to risks, uncertainties and assumptions about us and our operations that are subject to change based on various important factors, some of which are beyond our control. A major risk is that the Company's demand is largely derived from the demand for its customers' products, which subjects the Company to uncertainties related to downturns in a customer's business and unanticipated customer production shutdowns. Other major risks and uncertainties include, but are not limited to, significant increases in raw material costs, worldwide economic and political conditions, foreign currency fluctuations, and terrorist attacks such as those that occurred on September 11, 2001, each of which is discussed in greater detail in Item 1A of this Report. Furthermore, the Company is subject to the same business cycles as those experienced by steel, automobile, aircraft, appliance, and durable goods manufacturers. These risks, uncertainties, and possible inaccurate assumptions relevant to our business could cause our actual results to differ materially from expected and historical results. Other factors beyond those discussed in this Report could also adversely affect us. Therefore, we caution you not to place undue reliance on our forward-looking statements. This discussion is provided as permitted by the Private Securities Litigation Reform Act of 1995.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk.**

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

*Interest Rate Risk.* Quaker's exposure to market rate risk for changes in interest rates relates primarily to its short and long-term debt. Most of Quaker's debt is negotiated at market rates. Accordingly, if interest rates rise significantly, the cost of debt to Quaker will increase. This can have an adverse effect on Quaker, depending on the extent of Quaker's borrowings. As of December 31, 2005, Quaker had approximately \$63.8 million in borrowings under its credit facilities at a weighted average borrowing rate of approximately 4.42%. In the fourth quarter of 2005, the Company entered into three interest rate swaps in order to fix a portion of its variable rate debt. The combined notional value of the swaps was \$15.0 million and had a fair value of \$(0.1) million at December 31, 2005. See information included in the caption "Derivatives" of Note 1 of Notes to Consolidated Financial Statements which appears in Item 8 of this Report and is incorporated herein by reference.

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

The Company generally does not use financial instruments that expose it to significant risk involving foreign currency transactions; however, the size of non-U.S. activities has a significant impact on reported operating results and the attendant net assets. During the past three years, sales by non-U.S. subsidiaries accounted for approximately 53% to 55% of consolidated net annual sales.

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

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

*Credit Risk.* Quaker establishes allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of Quaker's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

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Downturns in the overall economic climate may also exacerbate specific customer financial issues. A significant portion of Quaker's revenues is derived from sales to customers in the U.S. steel industry, where a number of bankruptcies occurred during recent years. Through 2003, Quaker recorded additional provisions for doubtful accounts primarily related to bankruptcies in the U.S. steel industry. In addition, in the third quarter of 2005, the Company recorded additional provisions for doubtful accounts in connection with a customer bankruptcy. When a bankruptcy occurs, Quaker must judge the amount of proceeds, if any, that may ultimately be received through the bankruptcy or liquidation process. In addition, as part of its terms of trade, Quaker may custom-manufacture products for certain large customers and/or may ship product on a consignment basis. These practices may increase the Company's exposure should a bankruptcy occur, and may require writedown or disposal of certain inventory due to its estimated obsolescence or limited marketability. Customer returns of products or disputes may also result in similar issues related to the realizability of recorded accounts receivable or returned inventory.

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**Report of Independent Registered Public Accounting Firm**

To the Shareholders and Board of Directors  
of Quaker Chemical Corporation:

We have completed integrated audits of Quaker Chemical Corporation's 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

*Consolidated financial statements*

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Quaker Chemical Corporation and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

*Internal control over financial reporting*

Also, in our opinion, management's assessment, included in "Management's Report on Internal Control over Financial Reporting," appearing under Item 9A, that the Company maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance

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with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP  
Philadelphia, PA  
March 10, 2006

**QUAKER CHEMICAL CORPORATION**  
**CONSOLIDATED STATEMENT OF INCOME**

	Year Ended December 31,		
	2005	2004	2003
	(In thousands, except per share amounts)		
Net sales	\$424,033	\$400,695	\$340,192
Costs and expenses:			
Cost of goods sold	294,219	269,818	218,818
Selling, general, and administrative expenses	116,340	113,536	97,202
Restructuring and related activities, net	10,320	450	57
	<u>420,879</u>	<u>383,804</u>	<u>316,077</u>
Operating income	3,154	16,891	24,115
Other income, net	6,120	1,818	764
Interest expense	(3,681)	(2,363)	(1,576)
Interest income	1,022	1,111	815
Income before taxes, equity income and minority interest	6,615	17,457	24,118
Taxes on income	3,336	5,499	7,488
	3,279	11,958	16,630
Equity in net income of associated companies	618	890	1,244
Minority interest in net income of subsidiaries	(2,209)	(3,874)	(3,041)
Net income	<u>\$ 1,688</u>	<u>\$ 8,974</u>	<u>\$ 14,833</u>
Per share data:			
Net income—basic	\$ 0.17	\$ 0.93	\$ 1.58
Net income—diluted	\$ 0.17	\$ 0.90	\$ 1.52
Weighted average shares outstanding:			
Basic	9,679	9,606	9,381
Diluted	9,816	9,969	9,761

See notes to consolidated financial statements.



**QUAKER CHEMICAL CORPORATION**  
**CONSOLIDATED BALANCE SHEET**

	December 31,	
	2005	2004
(In thousands, except par value and share amounts)		
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 16,121	\$ 29,078
Accounts receivable, net	93,943	88,249
Inventories	45,818	41,298
Deferred income taxes	4,439	4,373
Prepaid expenses and other current assets	5,672	8,189
Total current assets	165,993	171,187
Property, plant and equipment, net	56,897	62,888
Goodwill	35,418	34,853
Other intangible assets, net	8,703	8,574
Investments in associated companies	6,624	6,718
Deferred income taxes	24,385	18,825
Other assets	33,975	21,848
Total assets	<u>\$331,995</u>	<u>\$324,893</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities		
Short-term borrowings and current portion of long-term debt	\$ 5,094	\$ 60,695
Accounts payable	50,832	39,562
Dividends payable	2,091	2,079
Accrued compensation	9,818	9,313
Other current liabilities	19,053	13,969
Total current liabilities	86,888	125,618
Long-term debt	67,410	14,848
Deferred income taxes	4,608	5,588
Accrued pension and postretirement benefits	38,210	36,456
Other non-current liabilities	22,363	7,372
Total liabilities	219,479	189,882
Minority interest in equity of subsidiaries	6,609	12,424
Commitments and contingencies	—	—
Shareholders' equity		
Common stock, \$1 par value; authorized 30,000,000 shares; issued: 2005-9,726,385, 2004-9,668,751 shares	9,726	9,669
Capital in excess of par value	3,574	2,632
Retained earnings	111,317	117,981
Unearned compensation	—	(355)
Accumulated other comprehensive loss	(18,710)	(7,340)
Total shareholders' equity	105,907	122,587
Total liabilities and shareholders' equity	<u>\$331,995</u>	<u>\$324,893</u>

See notes to consolidated financial statements.

**QUAKER CHEMICAL CORPORATION**  
**CONSOLIDATED STATEMENT OF CASH FLOWS**

	Year Ended December 31,		
	2005	2004	2003
	(In thousands)		
<b>Cash flows from operating activities</b>			
Net income	\$ 1,688	\$ 8,974	\$ 14,833
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	9,163	8,610	6,677
Amortization	1,368	1,157	960
Equity in net income of associated companies	(618)	(890)	(844)
Minority interest in earnings of subsidiaries	2,209	3,874	3,041
Deferred income taxes	(4,476)	(1,872)	402
Deferred compensation and other, net	(25)	(39)	(418)
Restructuring and related activities	6,018	450	57
Gain on sale of partnership assets	(2,989)	—	—
Gain on sale of property, plant, and equipment	—	(509)	—
Pension and other postretirement benefits	(439)	(172)	428
Increase (decrease) in cash from changes in current assets and current liabilities, net of acquisitions:			
Accounts receivable	(9,600)	(6,254)	(14,604)
Inventories	(5,821)	(7,559)	(4,692)
Prepaid expenses and other current assets	161	(388)	(648)
Accounts payable and accrued liabilities	15,726	129	478
Restructuring liabilities	(2,798)	(558)	(1,083)
Estimated taxes on income	1,722	(1,596)	3,790
Net cash provided by operating activities	<u>11,289</u>	<u>3,357</u>	<u>8,377</u>
<b>Cash flows from investing activities</b>			
Capital expenditures	(6,989)	(8,643)	(12,608)
Dividends and distributions from associated companies	234	288	4,080
Payments related to acquisitions	(6,700)	—	(15,983)
Proceeds from partnership disposition of assets	2,989	—	—
Proceeds from disposition of assets	1,918	1,880	232
Insurance settlement received	7,508	—	—
Investment in restricted cash	(7,508)	—	—
Other, net	—	(75)	(87)
Net cash (used in) investing activities	<u>(8,548)</u>	<u>(6,550)</u>	<u>(24,366)</u>
<b>Cash flows from financing activities</b>			
Net (decrease) increase in short-term borrowings	(52,703)	17,683	30,581
Proceeds from long-term debt	59,525	2,564	—
Repayment of long-term debt	(9,566)	(3,679)	(2,570)
Dividends paid	(8,340)	(8,241)	(7,916)
Stock options exercised, other	436	1,009	4,328
Distributions to minority shareholders	(4,198)	(1,956)	(2,391)
Net cash (used in) provided by financing activities	<u>(14,846)</u>	<u>7,380</u>	<u>22,032</u>
Effect of exchange rate changes on cash	(852)	2,976	2,015
Net (decrease) increase in cash and cash equivalents	<u>(12,957)</u>	<u>7,163</u>	<u>8,058</u>
Cash and cash equivalents at beginning of year	<u>29,078</u>	<u>21,915</u>	<u>13,857</u>
Cash and cash equivalents at end of year	<u>\$ 16,121</u>	<u>\$ 29,078</u>	<u>\$ 21,915</u>
<b>Supplemental cash flow disclosures</b>			
Cash paid during the year for:			
Income taxes	\$ 5,584	\$ 4,809	\$ 3,633
Interest	3,354	2,201	1,680
Non-cash activities:			
Restricted insurance receivable (See also Note 16 of Notes to Consolidated Financial Statements)	\$ 7,500	\$ —	\$ —

See notes to consolidated financial statements.

**QUAKER CHEMICAL CORPORATION**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**

	Common stock	Capital in excess of par value	Retained earnings	Unearned compensation	Accumulated other comprehensive income (loss)	Treasury stock	Total
(In thousands, except per share amounts)							
Balance at December 31, 2002	\$9,664	\$ 626	\$110,448	\$ (1,245)	\$ (27,078)	\$(4,360)	\$ 88,055
Net income	—	—	14,833	—	—	—	14,833
Currency translation adjustments	—	—	—	—	13,441	—	13,441
Minimum pension liability	—	—	—	—	(2,159)	—	(2,159)
Unrealized gain on available-for-sale securities	—	—	—	—	390	—	390
Comprehensive income	—	—	—	—	—	—	26,505
Dividends (\$0.84 per share)	—	—	(7,973)	—	—	—	(7,973)
Shares issued upon exercise of options	—	1,351	—	—	—	3,287	4,638
Shares issued for employee stock purchase plan	—	138	—	—	—	180	318
Shares issued for long-term incentive awards	—	66	—	—	—	119	185
Amortization of unearned compensation	—	—	—	624	—	—	624
Balance at December 31, 2003	9,664	2,181	117,308	(621)	(15,406)	(774)	112,352
Net income	—	—	8,974	—	—	—	8,974
Currency translation adjustments	—	—	—	—	8,959	—	8,959
Minimum pension liability	—	—	—	—	(1,052)	—	(1,052)
Unrealized gain on available-for-sale securities	—	—	—	—	159	—	159
Comprehensive income	—	—	—	—	—	—	17,040
Dividends (\$0.86 per share)	—	—	(8,301)	—	—	—	(8,301)
Shares issued upon exercise of options	4	362	—	—	—	536	902
Shares issued for employee stock purchase plan	1	89	—	—	—	238	328
Amortization of unearned compensation	—	—	—	266	—	—	266
Balance at December 31, 2004	9,669	2,632	117,981	(355)	(7,340)	—	122,587
Net income	—	—	1,688	—	—	—	1,688
Currency translation adjustments	—	—	—	—	(7,897)	—	(7,897)
Minimum pension liability	—	—	—	—	(3,449)	—	(3,449)
Current period changes in fair value of derivatives	—	—	—	—	(71)	—	(71)
Unrealized gain on available-for-sale securities	—	—	—	—	47	—	47
Comprehensive income	—	—	—	—	—	—	(9,682)
Dividends (\$0.86 per share)	—	—	(8,352)	—	—	—	(8,352)
Shares issued upon exercise of options	40	382	—	—	—	—	422
Shares issued for employee stock purchase plan	17	309	—	—	—	—	326
Compensation plan (non-vested stock)	—	251	—	—	—	—	251
Amortization of unearned compensation	—	—	—	355	—	—	355
Balance at December 31, 2005	<u>\$9,726</u>	<u>\$ 3,574</u>	<u>\$111,317</u>	<u>\$ —</u>	<u>\$ (18,710)</u>	<u>\$ —</u>	<u>\$105,907</u>

See notes to consolidated financial statements.

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**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in thousands except per share amounts)**

**Note 1—Significant Accounting Policies**

**Principles of consolidation:** All majority-owned subsidiaries are included in the Company's consolidated financial statements, with appropriate elimination of intercompany balances and transactions. Investments in associated (less than majority-owned) companies are accounted for under the equity method. The Company's share of net income or losses of investments is included in the consolidated statement of income. The Company periodically reviews these investments for impairments and, if necessary, would adjust these investments to their fair value when a decline in market value is deemed to be other than temporary.

In January 2003, the Financial Accounting Standards Board ("FASB"), issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Certain Variable Interest Entities, ("VIEs"), which is an interpretation of Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements." FIN 46, as revised by FIN 46 (revised December 2003), addresses the application of ARB No. 51 to VIEs, and generally would require that assets, liabilities and results of the activities of a VIE be consolidated into the financial statements of the enterprise that is considered the primary beneficiary. The consolidated financial statements include the accounts of the Company and all of its subsidiaries in which a controlling interest is maintained and would include any VIEs if the Company was the primary beneficiary pursuant to the provisions of FIN 46 (revised December 2003). The Company determined that its real estate joint venture, which was always accounted for under the equity method, was a VIE but that the Company was not the primary beneficiary. In February 2005, the Venture sold its real estate assets, which resulted in \$4,187 of proceeds to the Company after payment of the partnership obligations. The proceeds include a gain of \$2,989 related to the sale by the Venture of its real estate holdings as well as \$1,198 of preferred distributions. These proceeds are included in other income. See also Note 3 of Notes to Consolidated Financial Statements.

**Translation of foreign currency:** Assets and liabilities of non-U.S. subsidiaries and associated companies are translated into U.S. dollars at the respective rates of exchange prevailing at the end of the year. Income and expense accounts are translated at average exchange rates prevailing during the year. Translation adjustments resulting from this process are recorded directly in shareholders' equity and will be included in income only upon sale or liquidation of the underlying investment. All non-U.S. subsidiaries use its local currency as its functional currency.

**Cash and cash equivalents:** The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

**Inventories:** Inventories are valued at the lower of cost or market value. Inventories are valued using the first-in, first-out ("FIFO") method. See also Note 5 of Notes to Consolidated Financial Statements.

**Long-lived assets:** Property, plant, and equipment are stated at cost. Depreciation is computed using the straight-line method on an individual asset basis over the following estimated useful lives: buildings and improvements, 10 to 45 years; and machinery and equipment, 3 to 15 years. The carrying value of long-lived assets is periodically evaluated whenever changes in circumstances or current events indicate the carrying amount of such assets may not be recoverable. An estimate of undiscounted cash flows produced by the asset, or the appropriate group of assets, is compared with the carrying value to determine whether an impairment exists. If necessary, the Company recognizes an impairment loss for the difference between the carrying amount of the assets and their estimated fair value. Fair value is based on current and anticipated future undiscounted cash flows. Upon sale or other dispositions of long-lived assets, the applicable amounts of asset cost and accumulated depreciation are removed from the accounts and the net amount, less proceeds from disposals is recorded to income. Expenditures for renewals and betterments, which increase the estimated useful life or capacity of the assets, are capitalized; expenditures for repairs and maintenance are expensed when incurred.

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**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

**Capitalized software:** The Company applies the Accounting Standards Executive Committee Statement of Position (SOP) 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." This SOP requires the capitalization of certain costs incurred in connection with developing or obtaining software for internal use. In connection with the implementation of the Company's global transaction system, approximately \$6,406 and \$9,288 of net costs were capitalized at December 31, 2005 and 2004, respectively. These costs are amortized over a period of five years once the assets are placed into service.

**Goodwill and other intangible assets:** On January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets." The new standard requires that goodwill and indefinite-lived intangible assets no longer be amortized. In addition, goodwill and indefinite-lived intangible assets are tested for impairment at least annually. These tests will be performed more frequently if there are triggering events. Definite-lived intangible assets are amortized over their estimated useful lives, generally for periods ranging from 5 to 20 years. The Company continually evaluates the reasonableness of the useful lives of these assets. See also Note 15 of Notes to Consolidated Financial Statements.

**Revenue recognition:** The Company recognizes revenue in accordance with the terms of the underlying agreements, when title and risk of loss have been transferred, collectibility is reasonably assured, and pricing is fixed or determinable. This generally occurs for product sales when products are shipped to customers or, for consignment arrangements upon usage by the customer and when services are performed. License fees and royalties are recognized in accordance with agreed upon terms, when performance obligations are satisfied, the amount is fixed or determinable, and collectibility is reasonably assured and are included in other income. As part of the Company's chemical management services, certain third-party product sales to customers are managed by the Company. Where the Company acts as a principal, revenues are recognized on a gross reporting basis at the selling price negotiated with customers. Where the Company acts as an agent, such revenue is recorded using net reporting as service revenues, at the amount of the administrative fee earned by the Company for ordering the goods. Third-party products transferred under arrangements resulting in net reporting totaled \$38,840, \$35,215, and \$26,617 for 2005, 2004, and 2003, respectively.

**Research and development costs:** Research and development costs are expensed as incurred. Research and development expenses are included in selling, general and administrative expenses, and during 2005, 2004, and 2003 were \$14,148, \$13,808, and \$10,050, respectively.

**Concentration of credit risk:** Financial instruments, which potentially subject the Company to a concentration of credit risk, principally consist of cash equivalents, short-term investments, and trade receivables. The Company invests temporary and excess funds in money market securities and financial instruments having maturities typically within 90 days. The Company has not experienced losses from the aforementioned investments. See also Note 4 of Notes to Consolidated Financial Statements.

**Environmental liabilities and expenditures:** Accruals for environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. If no amount in the range is considered more probable than any other amount, the Company records the lowest amount in the range in accordance with generally accepted accounting principles. Accrued liabilities are exclusive of claims against third parties and are not discounted. Environmental costs and remediation costs are capitalized if the costs extend the life, increase the capacity or improve safety or efficiency of the property from the date acquired or constructed, and/or mitigate or prevent contamination in the future.

**Comprehensive income (loss):** The Company presents comprehensive income (loss) in its Statement of Shareholders' Equity. The components of accumulated other comprehensive loss at December 31, 2005 include:

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

accumulated foreign currency translation adjustments of \$(5,548), minimum pension liability of \$(13,257), unrealized holding gains on available-for-sale securities of \$166, and the fair value of derivative instruments of \$(71). The components of accumulated other comprehensive loss at December 31, 2004 include: accumulated foreign currency translation adjustments of \$2,349 and minimum pension liability of \$(9,808) and unrealized holding losses on available-for-sale securities of \$119.

**Income taxes:** The provision for income taxes is determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax bases of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

**Stock-based compensation:** In December 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards ("SFAS") No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure." This standard amends the transition and disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation." As permitted by SFAS No. 148, the Company continues to account for stock option grants in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation expense has been recognized for stock options since all options granted had an exercise price equal to the market value of the underlying stock on the grant date.

The following tables illustrate the effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123. See also Note 11 of Notes to Consolidated Financial Statements.

	Year Ended December 31,		
	2005	2004	2003
Net income—as reported	\$1,688	\$8,974	\$14,833
Add: Stock-based employee compensation expense included in net income, net of related tax effects	347	301	485
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(832)	(887)	(996)
Pro forma net income	<u>\$1,203</u>	<u>\$8,388</u>	<u>\$14,322</u>
Earnings per share:			
Basic—as reported	\$ 0.17	\$ 0.93	\$ 1.58
Basic—pro forma	\$ 0.12	\$ 0.87	\$ 1.53
Diluted—as reported	\$ 0.17	\$ 0.90	\$ 1.52
Diluted—pro forma	\$ 0.12	\$ 0.84	\$ 1.47

**Derivatives:** The Company uses derivative financial instruments primarily for purposes of hedging exposures to fluctuations in interest rates. The Company does not enter into derivative contracts for trading or speculative purposes. In accordance with SFAS 133, "Accounting for Derivative Instruments and Hedging Activities," as amended and interpreted, all derivatives are recognized on the balance sheet at fair value. For derivative instruments designated as cash flow hedges, the effective portion of any hedge is reported in

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**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

Accumulated Other Comprehensive Income (Loss) until it is cleared to earnings during the same period in which the hedged item affects earnings. The Company uses no derivative instruments designated as fair value hedges.

In the fourth quarter of 2005, the Company entered into three interest rate swaps which convert a portion of its variable rate debt into fixed rate debt. The swaps have a notional amount of \$15,000 and at December 31, 2005 had a fair value of \$(71). The counterparties to the swaps are major financial institutions. The Company believes the swaps to be highly effective as defined in SFAS 133 and has designated them as cash flow hedges. Accordingly, the fair value of the swaps have been recorded in Accumulated Other Comprehensive Income (Loss).

**Recently issued accounting standards:**

In June 2005, the Financial Accounting Standards Board ("FASB") issued SFAS No. 154, "Accounting Changes and Error Corrections: ("SFAS 154"). SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principles unless it is impracticable to determine either period-specific effects or the cumulative effect of the change or, in the unusual instance, that a newly issued accounting pronouncement does not include explicit transition provisions. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will apply the requirements of the standard as needed.

In December 2004, the FASB issued its final standard on accounting for share-based payments, SFAS 123R (Revised 2004), Share-Based Payment ("SFAS 123R"). SFAS 123R requires companies to expense the fair value of employee stock options and other similar awards. The fair value of the awards are to be measured based on the grant-date fair value of the awards and the cost to be recognized over the period during which an employee is required to provide service in exchange for the award. SFAS 123R eliminates the alternative use of Accounting Principles Board No. 25's intrinsic value method of accounting for awards, which is the Company's current accounting policy for stock options. SFAS 123R is effective for the Company beginning January 1, 2006. The Company adopted the provisions of SFAS 123R on a prospective basis. The financial statement impact will be dependent on future stock-based awards and any unvested stock options outstanding. At the time of adoption, the Company will have approximately \$90 of pre-tax expense to record related to unvested stock options.

In December 2004, the FASB issued its final standard on accounting for exchanges on nonmonetary assets, SFAS 153, "Exchange of Nonmonetary Assets an amendment of APB Opinion No. 29" ("SFAS 153"). SFAS 153 requires that exchanges of nonmonetary assets be measured based on the fair value of assets exchanged for annual periods beginning after June 15, 2005. The adoption of SFAS 153 did not have a material impact on the Company's financial position, results of operations, or cash flows.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs an amendment of ARB 43 Chapter 4 ("SFAS 151"). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) in the determination of inventory carrying costs. The statement requires that such costs be recognized as a current period expense. SFAS 151 also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. This statement is effective for fiscal years beginning after July 15, 2005. The adoption of SFAS 151 did not have a material impact on the Company's financial position, results of operations, or cash flows.

**Accounting estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts

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**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

of assets, liabilities, and disclosure of contingencies at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. Actual results could differ from such estimates.

**Reclassifications:** Certain reclassifications of prior years' data have been made to improve comparability.

**Note 2—Restructuring and Related Activities**

In 2001, Quaker's management approved restructuring plans to realign the organization primarily in Europe and reduce operating costs (2001 program). Quaker's restructuring plans included the closing and sale of its manufacturing facilities in the U.K. and France. In addition, Quaker consolidated certain functions within its global business units and reduced administrative functions, as well as expensed costs related to abandoned acquisitions. Included in the restructuring charges were provisions for severance of 53 employees. Restructuring and related charges of \$5,854 were recognized in 2001. The charge comprised \$2,807 related to employee separations, \$2,450 related to facility rationalization charges, and \$597 related to abandoned acquisitions. Employee separation benefits varied depending on local regulations within certain foreign countries and included severance and other benefits. In January of 2005, the last severance payment under the 2001 program was made and the Company reversed \$117 of unused restructuring accruals related to this program. In February 2005, the Company completed the sale of a portion of its Villeneuve, France site for \$647. In July 2005, the Company completed the sale of the remaining portion of its Villeneuve, France site for \$1,260, which completed all actions contemplated by this program. The Company reversed \$159 of unused restructuring accruals related to this program in the fourth quarter of 2005.

In 2003, Quaker's management approved a restructuring plan (2003 program). Included in the 2003 restructuring charge were provisions for severance for 9 employees totaling \$273. As of March 31, 2005, all severance payments were completed and the Company reversed \$59 of unused restructuring accruals related to this program, which completed all actions contemplated by this program.

In 2004, Quaker's management approved a restructuring plan by announcing the consolidation of its administrative facilities in Hong Kong with its Shanghai headquarters (2004 program). Included in the 2004 restructuring charge were severance provisions for 5 employees totaling \$119 and an asset impairment related to the Company's previous plans to implement its global ERP system at this location totaling \$331. As of March 31, 2005, all severance payments were completed, which completed all actions contemplated by this program.

In the first quarter of 2005, Quaker's management approved a restructuring plan (2005 1<sup>st</sup> Quarter Program). Included in the first quarter 2005 restructuring charge were provisions for severance for 16 employees totaling \$1,408. At December 31, 2005, all severance payments were completed. The Company reversed \$96 of unused restructuring charges related to this program, which completed all actions contemplated by this program.

In the fourth quarter of 2005, Quaker's management approved a restructuring plan (2005 4<sup>th</sup> Quarter Program) with the goal of significantly reducing operating costs in the U.S. and Europe. The restructuring plan included involuntary terminations, a freeze of the Company's U.S. pension plan, a voluntary early retirement window to certain U.S. employees, with enhanced pension and other postretirement benefits. Included in the restructuring charges were provisions for severance (voluntary and involuntary) of 55 employees. Restructuring and related charges of \$9,344 were recognized in the fourth quarter of 2005. The charge comprised \$4,024 related to severance for involuntary terminations, \$1,017 related to one-time payments for voluntary early retirement, and \$2,668 related to the U.S. pension plan freeze and \$1,635 for the enhanced pension and other postretirement benefits related to voluntary early retirement participants. The Company expects to complete the initiatives contemplated under this program during 2006. The charges related to the U.S. pension plan freeze and the enhanced pension and other postretirement benefits are not included in the following table, and are included as part of the accrued pension and other postretirement balances. See also Note 9 of Notes to Consolidated Financial Statements.



**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

Accrued restructuring balances, included in other current liabilities and assigned to the Metalworking segment, are as follows:

	<u>Employee Separations</u>	<u>Facility Rationalization</u>	<u>Abandoned Acquisitions</u>	<u>Total</u>
<b>2001 Program:</b>				
Restructuring charges	\$ 2,807	\$ 2,450	\$ 597	\$ 5,854
Asset impairment	—	(1,015)	—	(1,015)
Payments	(111)	(171)	(597)	(879)
Currency translation and other	1	12	—	13
December 31, 2001 ending balance	<u>2,697</u>	<u>1,276</u>	<u>—</u>	<u>3,973</u>
Payments	(1,374)	(752)	—	(2,126)
Currency translation and other	114	182	—	296
December 31, 2002 ending balance	<u>1,437</u>	<u>706</u>	<u>—</u>	<u>2,143</u>
Restructuring reversals	(156)	(60)	—	(216)
Payments	(832)	(204)	—	(1,036)
Currency translation and other	1	83	—	84
December 31, 2003 ending balance	<u>450</u>	<u>525</u>	<u>—</u>	<u>975</u>
Payments	(249)	(166)	—	(415)
Currency translation and other	16	27	—	43
December 31, 2004 ending balance	<u>217</u>	<u>386</u>	<u>—</u>	<u>603</u>
Restructuring Reversals	(117)	(159)	—	(276)
Payments	(100)	(227)	—	(327)
December 31, 2005 ending balance	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>2003 Program:</b>				
Restructuring charges	273	—	—	273
Payments	(47)	—	—	(47)
Currency translation and other	2	—	—	2
December 31, 2003 ending balance	<u>228</u>	<u>—</u>	<u>—</u>	<u>228</u>
Payments	(143)	—	—	(143)
Currency translation and other	12	—	—	12
December 31, 2004 ending balance	<u>97</u>	<u>—</u>	<u>—</u>	<u>97</u>
Restructuring reversals	(59)	—	—	(59)
Payments	(34)	—	—	(34)
Currency translation and other	(4)	—	—	(4)
December 31, 2005 ending balance	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>2004 Program:</b>				
Restructuring charges	119	331	—	450
Asset impairment	—	(331)	—	(331)
December 31, 2004 ending balance	<u>119</u>	<u>—</u>	<u>—</u>	<u>119</u>

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
(Dollars in thousands except per share amounts)

	<u>Employee Separations</u>	<u>Facility Rationalization</u>	<u>Abandoned Acquisitions</u>	<u>Total</u>
Payments	(119)	—	—	(119)
December 31, 2005 ending balance	—	—	—	—
<b>2005 1<sup>st</sup> Quarter Program:</b>				
Restructuring charges	1,408	—	—	1,408
Restructuring reversals	(96)	—	—	(96)
Payments	(1,312)	—	—	(1,312)
December 31, 2005 ending balance	—	—	—	—
<b>2005 4<sup>th</sup> Quarter Program:</b>				
Restructuring charges	5,041	—	—	5,041
Payments	(1,006)	—	—	(1,006)
Currency translation and other	(2)	—	—	(2)
December 31, 2005 ending balance	4,033	—	—	4,033
<b>Total restructuring December 31, 2005 ending balance</b>	<b>\$ 4,033</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 4,033</b>

**Note 3—Investments in Associated Companies**

Investments in associated (less than majority-owned) companies are accounted for under the equity method. Summarized financial information of the associated companies, in the aggregate, is as follows:

	<u>December 31,</u>		
	<u>2005</u>	<u>2004</u>	
Current assets	\$22,063	\$24,034	
Noncurrent assets	4,844	29,074	
Current liabilities	11,153	11,614	
Noncurrent liabilities	291	26,671	
	<u>Year Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net sales	\$44,507	\$48,104	\$41,034
Gross margin	17,677	22,216	19,566
Operating income	3,430	5,440	4,370
Net income	1,202	2,194	1,253

In January 2001, the Company contributed its Conshohocken, Pennsylvania property and buildings (the "Site") into a real estate joint venture (the "Venture") in exchange for a 50% interest in the Venture. The Venture did not assume any debt or other obligations of the Company and the Company did not guarantee nor was it obligated to pay any principal, interest or penalties on any of the Venture's indebtedness. The Venture renovated certain of the existing buildings at the Site, as well as built new office space. In December 2000, the Company entered into an agreement with the Venture to lease approximately 38% of the Site's available office space for a 15-year period commencing February 2002, with multiple renewal options. The Company believes the terms of this lease were no less favorable than the terms it would have obtained from an unaffiliated third party. In

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February 2005, the Venture sold its real estate assets to an unrelated third party, which resulted in \$4,187 of proceeds to the Company after payment of the Venture's obligations. The proceeds include a gain of \$2,989 related to the sale by the Venture of its real estate holdings as well as \$1,198 of preferred distributions. These proceeds are included in other income.

**Note 4—Accounts Receivable and Allowance for Doubtful Accounts**

Trade accounts receivable are recorded at the invoiced amount and generally do not bear interest. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable. We determine the allowance based on historical write-off experience by industry and regional economic data. Reserves for customers filing for bankruptcy protection are generally established at 75-100% of the amount owed at the filing date, dependent on the Company's evaluation of likely proceeds from the bankruptcy process. Large and/or financially distressed customers are generally reserved for on a specific review basis while a general reserve is established for other customers based on historical experience. We perform a formal review of our allowance for doubtful accounts quarterly. Account balances are charged off against the allowance when we feel it is probable the receivable will not be recovered. We do not have any off-balance-sheet credit exposure related to our customers. During 2005, the Company's five largest customers accounted for approximately 25% of its consolidated net sales with the largest customer (General Motors) accounting for approximately 9% of consolidated net sales.

At December 31, 2005 and 2004, the Company had gross trade accounts receivable totaling \$98,009 and \$95,022 with trade accounts receivable greater than 90 days past due of \$11,725 and \$10,938, respectively. Following are the changes in the allowance for doubtful accounts during the years ended December 31, 2005, 2004, and 2003.

	<u>Balance at Beginning of Period</u>	<u>Charged to Costs and Expenses</u>	<u>Write-Offs Charged to Allowance</u>	<u>Effect of Exchange Rate Changes</u>	<u>Balance at End of Period</u>
<b>ALLOWANCE FOR DOUBTFUL ACCOUNTS</b>					
Year ended December 31, 2005	\$ 6,773	\$ 1,216	\$ (3,828)	\$ (95)	\$4,066
Year ended December 31, 2004	\$ 6,763	\$ 500	\$ (512)	\$ 22	\$6,773
Year ended December 31, 2003	\$ 6,118	\$ 991	\$ (435)	\$ 89	\$6,763

**Note 5—Inventories**

Total inventories comprise:

	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
Raw materials and supplies	\$20,016	\$18,989
Work in process and finished goods	25,802	22,309
	<u>\$45,818</u>	<u>\$41,298</u>

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**Note 6—Property, Plant and Equipment**

Property, plant and equipment comprise:

	December 31,	
	2005	2004
Land	\$ 5,391	\$ 6,595
Building and improvements	38,110	41,340
Machinery and equipment	94,223	95,637
Construction in progress	3,179	3,328
	<u>140,903</u>	<u>146,900</u>
Less accumulated depreciation	<u>(84,006)</u>	<u>(84,012)</u>
	<u>\$ 56,897</u>	<u>\$ 62,888</u>

The Company leases certain equipment under capital leases in Europe and the U.S., including its manufacturing facility in Tradate, Italy. Gross property, plant, and equipment includes \$2,659 and \$3,130 of capital leases with \$345 and \$262 of accumulated depreciation at December 31, 2005 and 2004, respectively. The following is a schedule by years of future minimum lease payments:

For the year ended December 31,	
2006	\$ 427
2007	\$ 407
2008	\$ 373
2009	\$ 311
2010	\$ 312
2011 and beyond	\$ 176
Total net minimum lease payments	2,006
Less amount representing interest	(375)
Present value of net minimum lease payments	<u>\$1,631</u>

**Note 7—Asset Retirement Obligations**

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs. The Company adopted the standard as of January 1, 2003 and there was no material impact to the financial statements. In March 2005, the FASB issued its FASB Interpretation No. 47 ("FIN 47"), "Accounting for Conditional Asset Retirement Obligations," an interpretation of FASB Statement No. 143. The interpretation clarifies that the term conditional asset retirement obligation ("CARO") as used in SFAS 143, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. A liability is recorded when there is enough information regarding the timing of the CARO to perform a probability weighted discounted cash flow analysis.

During 2005, the Company reviewed its CARO's, which consist primarily of asbestos contained in certain manufacturing facilities and decommissioning costs related to its above-ground storage tanks. In the fourth quarter of 2005, due to a change in facts and circumstances at one of its manufacturing facilities, the Company determined enough information regarding the timing of cash flows was available to record a liability for \$250.

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**Note 8—Taxes on Income**

Taxes on income consist of the following:

	Year Ended December 31,		
	2005	2004	2003
<b>Current:</b>			
Federal	\$ (443)	\$ —	\$ 626
State	20	—	7
Foreign	8,235	7,371	6,453
	<u>7,812</u>	<u>7,371</u>	<u>7,086</u>
<b>Deferred:</b>			
Federal	(3,194)	(1,881)	626
Foreign	(1,282)	9	(224)
<b>Total</b>	<u>\$ 3,336</u>	<u>\$ 5,499</u>	<u>\$ 7,488</u>

The components of earnings before income taxes were as follows:

	2005	2004	2003
Domestic	\$(12,249)	\$ (7,242)	\$ (1,483)
Foreign	18,864	24,699	25,601
<b>Total</b>	<u>\$ 6,615</u>	<u>\$ 17,457</u>	<u>\$ 24,118</u>

Domestic earnings before income taxes do not include foreign earnings that are included in U.S. taxable income. During the fourth quarter of 2005, the Company elected to repatriate substantial accumulated foreign earnings and implemented other tax planning strategies, which enabled the Company to utilize all domestic operating loss carryforwards, and improved its global capital structure. This repatriation was the primary reason for the increase in the Company's effective tax rate and resulted in a net \$1,000 charge to tax expense. After repatriation of foreign earnings, the Company has substantial domestic taxable income for the year ended 2005 and for the cumulative three years ended 2005.

Total deferred tax assets and liabilities are composed of the following at December 31:

	2005		2004	
	Current	Non-current	Current	Non-current
Retirement benefits	\$1,116	\$ 7,948	\$1,331	\$ 6,092
Allowance for doubtful accounts	690	—	1,237	—
Insurance and litigation reserves	800	—	658	—
Postretirement benefits	—	2,744	—	2,947
Supplemental retirement benefits	—	1,347	—	1,252
Performance incentives	474	1,150	611	1,130
Alternative minimum tax carryforward	—	2,092	—	2,092
Restructuring charges	966	—	245	—
Vacation pay	393	—	291	—
Insurance settlement	—	5,253	—	—
Operating loss carryforward	—	3,527	—	4,856
Foreign tax credit	—	1,404	—	3,298
Deferred compensation	—	873	—	921
Other	—	48	—	94
	<u>4,439</u>	<u>26,386</u>	<u>4,373</u>	<u>22,682</u>
Valuation allowance	—	(2,001)	—	(3,857)
<b>Total deferred income tax assets, net</b>	<u>\$4,439</u>	<u>\$ 24,385</u>	<u>\$4,373</u>	<u>\$ 18,825</u>
Depreciation		\$ 1,203		\$ 2,207
Europe pension and other		3,405		3,381
<b>Total deferred income tax liabilities</b>		<u>\$ 4,608</u>		<u>\$ 5,588</u>

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The following is a reconciliation of income taxes at the Federal statutory rate with income taxes recorded by the Company for the years ended December 31:

	2005	2004	2003
Income tax provision at the Federal statutory tax rate	\$ 2,315	\$6,110	\$ 8,441
State income tax provisions, net	13	—	5
Non-deductible entertainment and business meal expense	151	176	179
Differences in tax rates on foreign earnings and remittances	3,777	(719)	(1,504)
Excess FTC utilization	(2,429)	—	—
Settlement of tax contingencies	(446)	—	—
Miscellaneous items, net	(45)	(68)	367
Taxes on income	<u>\$ 3,336</u>	<u>\$5,499</u>	<u>\$ 7,488</u>

At December 31, 2005, the Company domestically had a net deferred tax asset of \$15,322 inclusive of alternative minimum tax (AMT) credits of \$2,092. Additionally the Company has foreign tax credit carryovers of \$1,404 which have the following expiration dates: \$106 in 2012, \$763 in 2013 and \$535 in 2014. A full valuation allowance has been taken against these foreign tax credits. Finally, the Company has foreign tax loss carryforwards of \$10,429 which have no expiration dates. A partial valuation allowance, based on estimates of future taxable income in each jurisdiction in which the Company operates, has been established with respect to the tax benefit of these losses for \$597.

U.S. income taxes have not been provided on the undistributed earnings of non-U.S. subsidiaries because it is the Company's intention to continue to reinvest these earnings in those subsidiaries to support growth initiatives. U.S. and foreign income taxes that would be payable if such earnings were distributed may be lower than the amount computed at the U.S. statutory rate due to the availability of tax credits. The amount of such undistributed earnings at December 31, 2005 was approximately \$27,000. Any income tax liability which might result from ultimate remittance of these earnings is expected to be substantially offset by foreign tax credits.

**Note 9—Pension and Other Postretirement Benefits**

The Company maintains various noncontributory retirement plans, the largest of which is in the U.S., covering substantially all of its employees in the U.S. and certain other countries. The plans of the Company's subsidiaries in The Netherlands and in the United Kingdom are subject to the provisions of SFAS No. 87, "Employers' Accounting for Pensions." The plans of the remaining non-U.S. subsidiaries are, for the most part, either fully insured or integrated with the local governments' plans and are not subject to the provisions of SFAS No. 87. The Company's U.S. pension plan year ends on November 30, which serves as the measurement date. The measurement date for the Company's postretirement benefits is December 31.

In 2003, the Company adopted SFAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." This statement retains the disclosure requirement contained in the original standard and requires additional disclosures about the assets, obligations, cash flows and net periodic cost of defined benefit postretirement plans.

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As part of the Company's 2005 fourth quarter restructuring program, the Company implemented a freeze of its U.S. pension plan for non-union employees and offered a voluntary early retirement window with enhanced pension and other postretirement benefits. The freeze of the Company's U.S. pension plan resulted in a plan curtailment charge of \$2,668. The pension and other postretirement benefits enhancements resulted in special termination benefits charges of \$1,205 and \$430, respectively. See also Note 2 of Notes to Consolidated Financial Statements.

The following table shows the Company plans' funded status reconciled with amounts reported in the consolidated balance sheet as of December 31:

	Pension Benefits						Other Postretirement Benefits	
	2005			2004			2005	2004
	Foreign	Domestic	Total	Foreign	Domestic	Total	Domestic	Domestic
<b>Change in benefit obligation</b>								
Benefit obligation at beginning of year	\$44,709	\$ 60,967	\$105,676	\$33,994	\$ 57,182	\$ 91,176	\$ 10,671	\$ 10,786
Service cost	2,025	1,735	3,760	1,825	1,730	3,555	20	18
Interest cost	1,898	3,394	5,292	1,806	3,383	5,189	581	621
Curtailment (gain)/loss	—	(1,938)	(1,938)	—	—	—	—	—
Special termination benefits	—	1,205	1,205	—	—	—	430	—
Amendments	—	—	—	172	18	190	—	156
Translation difference	(5,736)	—	(5,736)	3,273	—	3,273	—	—
Actuarial (gain)/loss	2,646	4,755	7,401	4,626	2,283	6,909	359	165
Benefits paid	(1,105)	(3,831)	(4,936)	(987)	(3,548)	(4,535)	(1,159)	(1,075)
Other	27	(80)	(53)	—	(81)	(81)	—	—
Benefit obligation at end of year	<u>\$44,464</u>	<u>\$ 66,207</u>	<u>\$110,671</u>	<u>\$44,709</u>	<u>\$ 60,967</u>	<u>\$105,676</u>	<u>\$ 10,902</u>	<u>\$ 10,671</u>
<b>Change in plan assets</b>								
Fair value of plan assets at beginning of year	\$36,020	\$ 33,188	\$ 69,208	\$29,318	\$ 32,399	\$ 61,717	—	—
Actual return on plan assets	1,423	1,955	3,378	1,477	2,848	4,325	—	—
Employer contribution	2,751	6,561	9,312	3,586	1,489	5,075	1,159	1,075
Plan participants' contributions	102	—	102	79	—	79	—	—
Translation difference	(4,677)	—	(4,677)	2,547	—	2,547	—	—
Benefits paid	(1,105)	(3,831)	(4,936)	(987)	(3,548)	(4,535)	(1,159)	(1,075)
Fair value of plan assets at end of year	<u>\$34,514</u>	<u>\$ 37,873</u>	<u>\$ 72,387</u>	<u>\$36,020</u>	<u>\$ 33,188</u>	<u>\$ 69,208</u>	<u>—</u>	<u>—</u>
Funded status	<u>\$ (9,950)</u>	<u>\$ (28,334)</u>	<u>\$ (38,284)</u>	<u>\$ (8,689)</u>	<u>\$ (27,779)</u>	<u>\$ (36,468)</u>	<u>\$ (10,902)</u>	<u>\$ (10,671)</u>
Unrecognized transition asset	(593)	—	(593)	(835)	—	(835)	—	—
Unrecognized (gain)/loss	15,057	18,403	33,460	14,999	15,324	30,323	2,445	2,188
Unrecognized prior service cost	254	253	507	322	3,185	3,507	(226)	(292)
Adjustments for contributions in December	—	1,036	1,036	—	—	—	—	—
Net amount recognized	<u>\$ 4,768</u>	<u>\$ (8,642)</u>	<u>\$ (3,874)</u>	<u>\$ 5,797</u>	<u>\$ (9,270)</u>	<u>\$ (3,473)</u>	<u>\$ (8,683)</u>	<u>\$ (8,775)</u>
Amounts recognized in the balance sheet consist of:								
Prepaid benefit cost	\$ 7,403	—	\$ 7,403	\$ 8,430	—	\$ 8,430	—	—
Accrued benefit obligation	(4,713)	(27,131)	(31,844)	(5,227)	(24,875)	(30,102)	—	—
Intangible asset	74	253	327	113	3,185	3,298	—	—
Accumulated other comprehensive income	2,004	18,236	20,240	2,481	12,420	14,901	—	—
Net amount recognized	<u>\$ 4,768</u>	<u>\$ (8,642)</u>	<u>\$ (3,874)</u>	<u>\$ 5,797</u>	<u>\$ (9,270)</u>	<u>\$ (3,473)</u>	<u>\$ (8,683)</u>	<u>\$ (8,775)</u>

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At December, 31, 2005 and 2004, the accumulated benefit obligation for all defined benefit pension plans was \$103,247 (\$66,040 Domestic, \$37,207 Foreign) and \$95,634 (\$58,063 Domestic, \$37,571 Foreign).

**Information for pension plans with accumulated benefit obligation in excess of plan assets:**

	2005			2004		
	Foreign	Domestic	Total	Foreign	Domestic	Total
Projected benefit obligation	\$ 12,992	\$ 66,207	\$ 79,199	\$ 12,688	\$ 60,967	\$ 73,655
Accumulated benefit obligation	10,508	66,040	76,548	10,320	58,063	68,383
Fair value of plan assets	5,795	37,873	43,668	5,093	33,188	38,281

**Components of Net Periodic Benefit Cost—Pension Plans**

	2005			2004		
	Foreign	Domestic	Total	Foreign	Domestic	Total
Service cost	\$ 2,025	\$ 1,735	\$ 3,760	\$ 1,825	\$ 1,730	\$ 3,555
Interest cost	1,898	3,394	5,292	1,806	3,383	5,189
Expected return on plan assets	(1,529)	(2,888)	(4,417)	(1,734)	(2,741)	(4,475)
Pension plan curtailment	—	2,668	2,668	—	—	—
Special termination benefits	—	1,205	1,205	—	—	—
Other, amortization, net	656	855	1,511	376	898	1,274
Net periodic benefit cost	<u>\$ 3,050</u>	<u>\$ 6,969</u>	<u>\$10,019</u>	<u>\$ 2,273</u>	<u>\$ 3,270</u>	<u>\$ 5,543</u>

	2003		
	Foreign	Domestic	Total
Service cost	\$ 1,710	\$ 1,449	\$ 3,159
Interest cost	1,546	3,408	4,954
Expected return on plan assets	(1,513)	(2,621)	(4,134)
Pension plan curtailment	—	—	—
Special termination benefits	—	—	—
Other, amortization, net	274	611	885
Net periodic benefit cost	<u>\$ 2,017</u>	<u>\$ 2,847</u>	<u>\$ 4,864</u>

**Components of Net Periodic Benefit Cost—Other Postretirement Plan**

	2005	2004	2003
Service Cost	\$ 20	\$ 18	\$ 39
Interest cost and other	616	637	626
Special termination benefits	430	—	—
Net periodic benefit cost	<u>\$1,066</u>	<u>\$655</u>	<u>\$665</u>



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**Additional Information**

	Pension Benefits					
	2005			2004		
	Foreign	Domestic	Total	Foreign	Domestic	Total
Increase (decrease) in minimum liability included in other comprehensive income	\$(477)	\$5,816	\$5,339	\$206	\$1,399	\$1,605

**Weighted-average assumptions used to determine benefit obligations at December 31:**

	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
	<b>U.S. Plans:</b>			
Discount rate	5.50%	5.75%	5.50%	5.75%
Rate of compensation increase	3.375%	3.375%	N/A	N/A
<b>Foreign Plans:</b>				
Discount rate	4.35%	4.46%	N/A	N/A
Rate of compensation increase	3.10%	3.10%	N/A	N/A

**Weighted-average assumptions used to determine net periodic benefit costs for years ended December 31:**

	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
	<b>U.S. Plans:</b>			
Discount rate	5.750%	6.000%	5.750%	6.00%
Expected long-term return on plan assets	8.500%	8.750%	N/A	N/A
Rate of compensation increase	3.375%	3.625%	N/A	N/A
<b>Foreign Plans:</b>				
Discount rate	4.64%	5.26%	N/A	N/A
Expected long-term return on plan assets	4.35%	5.46%	N/A	N/A
Rate of compensation increase	3.10%	3.11%	N/A	N/A

The long-term rates of return on assets were selected from within the reasonable range of rates determined by (a) historical real returns for the asset classes covered by the investment policy and (b) projections of inflation over the long-term period during which benefits are payable to plan participants.

**Assumed health care cost trend rates at December 31:**

	2005	2004
Health care cost trend rate for next year	9.0%	10.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2013	2013

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Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1% point Increase	1% point Decrease
Effect on total service and interest cost	27	(25)
Effect on postretirement benefit obligations	526	(475)

**Plan Assets**

The Company's pension plan strategic target asset allocation and the weighted-average asset allocations at December 31, 2005 and 2004, by asset category were as follows:

<i>Asset Category</i>	Plan Assets at December 31,		
	Target	2005	2004
<b>U.S. Plans</b>			
Equity securities	61%	58%	60%
Debt securities	32%	25%	27%
Other	7%	17%	13%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>
<b>Foreign Plans</b>			
Equity securities	10%	11%	9%
Debt securities	90%	89%	91%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The general principles guiding investment of U.S. pension assets are those embodied in the Employee Retirement Income Security Act of 1974 (ERISA). These principles include discharging the Company's investment responsibilities for the exclusive benefit of plan participants and in accordance with the "prudent expert" standard and other ERISA rules and regulations. The Company establishes strategic asset allocation percentage targets and appropriate benchmarks for significant asset classes with the aim of achieving a prudent balance between return and risk. The interaction between plan assets and benefit obligations is periodically studied to assist in establishing such strategic asset allocation targets. The Company's pension investment professionals have discretion to manage the assets within established asset allocation ranges approved by senior management of the Company.

The total value of plan assets for the Company's pension plans is \$72,387 and \$69,208 as of December 31, 2005 and 2004, respectively. U.S. pension assets include Company common stock in the amounts of \$179 (1% of total U.S. plan assets), and \$242 (1% of total U.S. plan assets) at December 31, 2005 and 2004, respectively. "Other" consists principally of hedge funds and cash and cash equivalents.

**Cash Flows**

**Contributions**

The Company expects to make minimum cash contributions of \$8,024 to its pension plans (\$5,539 Domestic, \$2,485 Foreign) and \$1,124 to its other postretirement benefit plan in 2006.

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**Estimated Future Benefit Payments**

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

	Pension Benefits			Other Postretirement Benefits
	Foreign	Domestic	Total	
2006	910	5,491	6,401	1,124
2007	935	4,181	5,116	1,124
2008	1,062	4,704	5,766	1,092
2009	1,200	4,435	5,635	1,034
2010	1,225	4,684	5,909	996
2011 and beyond	7,426	26,962	34,388	4,357

The Company maintains a plan under which supplemental retirement benefits are provided to certain officers. Benefits payable under the plan are based on a combination of years of service and existing postretirement benefits. Included in total pension costs are charges of \$725, \$827, and \$626 in 2005, 2004, and 2003, respectively, representing the annual accrued benefits under this plan.

**401(k) plan**

The Company has a 401(k) plan with an employer match covering substantially all domestic employees. The Company's 401(k) matching contributions were \$625, \$575, and \$546 for 2005, 2004, and 2003, respectively.

**Note 10—Debt**

Debt consisted of the following:

	December 31,	
	2005	2004
6.98% senior unsecured notes	\$ —	\$ 8,572
Industrial development authority monthly floating rate (3.15% at December 31, 2005) demand bonds maturing 2014	5,000	5,000
Credit facilities (4.42% weighted average borrowing rate at December 31, 2005)	63,766	57,124
Other debt obligations (including capital leases)	3,738	4,847
	72,504	75,543
Short-term debt	(4,364)	(57,124)
Current portion of long-term debt	(730)	(3,571)
	\$67,410	\$ 14,848

The long-term financing agreements require the maintenance of certain financial covenants with which the Company is in compliance. During the next five years, payments on the Company's debt, including capital lease maturities, are due as follows: \$5,094 in 2006, \$893 in 2007, \$935 in 2008, \$448 in 2009, and \$59,788 in 2010.

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**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

Throughout 2004, the Company maintained various short-term credit facilities with multiple banks. At December 31, 2004, the Company's short-term credit facilities totaled \$95,000, of which \$40,000 was committed and \$55,000 was uncommitted.

In September 2005, the Company repaid its senior unsecured notes due in 2007. The total amount of principal repaid was \$8,572. In October 2005, the Company entered into a new syndicated multi-currency credit agreement that provides for financing in the United States and the Netherlands. This facility enabled the Company to consolidate the majority of its short-term debt into a longer-term facility. The new facility terminates on September 30, 2010. The new facility allows for revolving credit borrowings in a principal amount of up to \$100,000, which can be increased to \$125,000 at the Company's option if lenders agree to increase their commitments and the Company satisfies certain conditions. In general, borrowings under the credit facility bear interest at either a base rate or LIBOR rate plus a margin based on the Company's consolidated leverage ratio.

The provisions of the agreements require that the Company maintain certain financial ratios and covenants, all of which the Company was in compliance with as of December 31, 2005 and 2004. Under its most restrictive covenants, the Company could have borrowed an additional \$32,874 at December 31, 2005. At December 31, 2005 and 2004, the Company had approximately \$63,766 and \$57,124 outstanding on these credit lines at a weighted average borrowing rate of 4.42% and 2.9%, respectively. As of December 31, 2005, the Company maintained a \$5,135 stand-by letter of credit which guarantees payment of the industrial development authority bonds. This letter of credit is renewed annually.

At December 31, 2005, the amounts at which the Company's debt are recorded are not materially different from their fair market value. The estimated fair value of the Company's senior unsecured notes, based on quoted market prices for similar issues of the same remaining maturities, was approximately \$8,972 at December 31, 2004.

**Note 11—Shareholders' Equity**

The Company has 30,000,000 shares of common stock authorized, with a par value of \$1, and 9,726,385 shares issued.

Holders of record of the Company's common stock for a period of less than 36 consecutive calendar months or less are entitled to 1 vote per share of common stock. Holders of record of the Company's common stock for a period greater than 36 consecutive calendar months are entitled to 10 votes per share of common stock.

The Company is authorized to issue 10,000,000 shares of preferred stock, \$1.00 par value, subject to approval by the Board of Directors. The Board of Directors may designate one or more series of preferred stock and the number of shares, rights, preferences, and limitations of each series. No preferred stock has been issued.

Under provisions of a stock purchase plan, which permits employees to purchase shares of stock at 85% of the market value, 17,440 shares, 13,084 shares, and 13,358 shares were issued in 2005, 2004, and 2003, respectively. The number of shares that may be purchased by an employee in any year is limited by factors dependent upon the market value of the stock and the employee's base salary. At December 31, 2005, 432,431 shares are available for purchase.

The Company has a long-term incentive program for key employees which provides for the granting of options to purchase stock at prices not less than market value on the date of the grant. Most options are

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
(Dollars in thousands except per share amounts)

exercisable between one and three years after the date of the grant for a period of time determined by the Company not to exceed seven years from the date of grant for options issued in 1999 or later and ten years for options issued in prior years. The program also provides for cash awards and commencing in 1999, common stock awards, the value of which is determined based on operating results over a three-year period for awards issued starting in 1999, and over a four-year period in prior years. The effect on operations of the change in the estimated value of incentive units during the year was \$(44), \$82, and \$(45) in 2005, 2004, and 2003, respectively.

The table below summarizes stock option transactions in the plan during 2005, 2004, and 2003:

	2005		2004		2003	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at January 1,	1,237,425	\$ 19.49	1,128,800	\$ 18.42	1,125,247	\$ 17.61
Options granted	158,360	21.97	181,575	25.99	273,800	20.36
Options exercised	(156,775)	17.97	(46,050)	18.03	(244,697)	16.58
Options expired	(55,525)	22.41	(26,900)	20.96	(25,550)	21.42
Options outstanding at December 31,	<u>1,183,485</u>	19.88	<u>1,237,425</u>	19.49	<u>1,128,800</u>	18.42
Options exercisable at December 31,	<u>1,066,274</u>	\$ 19.55	<u>876,825</u>	\$ 18.00	<u>672,625</u>	\$ 17.32

The fair value of each option grant is estimated on the date of the grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2005	2004	2003
Dividend yield	3.4%	3.3%	3.9%
Expected volatility	22.6%	22.8%	23.9%
Risk-free interest rate	3.9%	3.6%	3.0%
Expected life (years)	5	5	5

The following table summarizes information about stock options outstanding at December 31, 2005:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/05	Weighted Average Contractual Life	Weighted Average Exercise Price	Number Exercisable at 12/31/05	Weighted Average Exercise Price
\$13.30—\$15.96	206,850	1	\$ 14.23	206,850	\$ 14.23
15.97— 18.62	180,750	2	17.58	180,750	17.58
18.63— 21.28	417,725	3	20.14	364,650	20.13
21.29— 23.94	202,610	5	21.91	191,610	21.92
23.95— 26.60	175,550	5	25.99	122,414	26.03
	<u>1,183,485</u>	3	19.88	<u>1,066,274</u>	19.55

Options were exercised for cash, resulting in the net issuance of 27,640 shares in 2005 and 46,050 shares in 2004. Options to purchase 163,590 shares were available at December 31, 2005 for future grants.

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

Shareholders of record on February 20, 1990 received two stock purchase rights for each three shares of common stock outstanding. These rights expired on February 20, 2000. On March 6, 2000, the Company's Board of Directors approved a new Rights Plan and declared a dividend of one new right (the "Rights") for each outstanding share of common stock to shareholders of record on March 20, 2000.

The Rights become exercisable if a person or group acquires or announces a tender offer which would result in such person's acquisition of 20% or more of the Company's common stock.

Each Right, when exercisable, entitles the registered holder to purchase one one-hundredth of a share of a newly authorized Series B preferred stock at an exercise price of sixty-five dollars per share subject to certain anti-dilution adjustments. In addition, if a person or group acquires 20% or more of the outstanding shares of the Company's common stock, without first obtaining Board of Directors' approval, as required by the terms of the Rights Agreement, each Right will then entitle its holder (other than such person or members of any such group) to purchase, at the Right's then current exercise price, a number of one one-hundredth shares of Series B preferred stock having a total market value of twice the Right's exercise price.

In addition, at any time after a person acquires 20% of the outstanding shares of common stock and prior to the acquisition by such person of 50% or more of the outstanding shares of common stock, the Company may exchange the Rights (other than the Rights which have become null and void), in whole or in part, at an exchange ratio of one share of common stock or equivalent share of preferred stock, per Right.

The Board of Directors can redeem the Rights for \$.01 per Right at any time prior to the acquisition by a person or group of beneficial ownership of 20% or more of the Company's common stock. Until a Right is exercised, the holder thereof will have no rights as a shareholder of the Company, including without limitation, the right to vote or to receive dividends. Unless earlier redeemed or exchanged, the Rights will expire on March 20, 2010.

**Restricted stock bonus:** As part of the Company's 2001 Global Annual Incentive Plan ("Annual Plan"), approved by shareholders on May 9, 2001, a restricted stock bonus of 100,000 shares of the Company's stock was granted to an executive of the Company. The shares were issued in April 2001, in accordance with the terms of the Annual Plan, and registered in the executive's name. The shares vested over a five-year period, with the first installment vesting at the end of 2001 on achieving certain performance targets and the four remaining installments vesting annually in January thereafter, subject to the executive's continued employment by the Company. In 2005, 2004 and 2003, 20,000, 15,000 and 35,000 shares were earned and \$355, \$266 and \$624 was charged to selling, general, and administrative expenses, respectively.

**Note 12—Earnings Per Share**

The following table summarizes earnings per share ("EPS") calculations for the years ended December 31, 2005, 2004, and 2003:

	December 31,		
	2005	2004	2003
Numerator for basic EPS and diluted EPS—net income	\$1,688	\$8,974	\$14,833
Denominator for basic EPS—weighted average shares	9,679	9,606	9,381
Effect of dilutive securities, primarily employee stock options	137	363	380
Denominator for diluted EPS—weighted average shares and assumed conversions	9,816	9,969	9,761
Basic EPS	\$ 0.17	\$ 0.93	\$ 1.58
Diluted EPS	\$ 0.17	\$ 0.90	\$ 1.52

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

The following number of stock options are not included in dilutive earnings per share since in each case the exercise price is greater than the market price: 770, 177, and 0, in 2005, 2004, and 2003, respectively.

**Note 13—Business Segments**

The Company's reportable segments are as follows:

- (1) Metalworking process chemicals—industrial process fluids for various heavy industrial and manufacturing applications.
- (2) Coatings—temporary and permanent coatings for metal and concrete products and chemical milling maskants.
- (3) Other chemical products—other various chemical products.

Segment data includes direct segment costs as well as general operating costs, including depreciation, allocated to each segment based on net sales. Inter-segment transactions are immaterial.

The table below presents information about the reported segments for the years ended December 31:

	Metalworking Process Chemicals	Coatings	Other Chemical Products	Total
<b>2005</b>				
Net sales	\$ 393,762	\$26,486	\$ 3,785	\$424,033
Operating income	49,357	6,574	470	56,401
Depreciation	7,346	494	71	7,911
Segment assets	312,776	18,196	1,023	331,995
<b>2004</b>				
Net sales	\$ 370,716	\$24,529	\$ 5,450	\$400,695
Operating income	55,723	6,633	914	63,270
Depreciation	7,046	466	104	7,616
Segment assets	306,825	16,429	1,639	324,893
<b>2003</b>				
Net sales	\$ 313,299	\$22,732	\$ 4,161	\$340,192
Operating income	53,939	6,019	724	60,682
Depreciation	5,807	421	77	6,305
Segment Assets	273,663	14,977	827	289,467

Operating income comprises revenue less related costs and expenses. Nonoperating expenses primarily consist of general corporate expenses identified as not being a cost of operation, interest expense, interest income, and license fees from nonconsolidated associates.

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
(Dollars in thousands except per share amounts)

A reconciliation of total segment operating income to total consolidated income before taxes for the years ended December 31, 2005, 2004, and 2003 is as follows:

	2005	2004	2003
Total operating income for reportable segments	\$ 56,401	\$ 63,270	\$ 60,682
Restructuring and related charges, net	(10,320)	(450)	(57)
Non-operating charges	(40,307)	(43,778)	(35,178)
Depreciation of corporate assets and amortization	(2,620)	(2,151)	(1,332)
Interest expense	(3,681)	(2,363)	(1,576)
Interest income	1,022	1,111	815
Other income, net	6,120	1,818	764
Consolidated income before taxes	<u>\$ 6,615</u>	<u>\$ 17,457</u>	<u>\$ 24,118</u>

The following sales and long-lived asset information is by geographic area as of and for the years ended December 31:

	2005	2004	2003
<b>Net sales</b>			
United States	\$ 190,735	\$ 189,179	\$ 152,360
Europe	130,080	132,491	120,180
Asia/Pacific	53,763	39,364	33,711
South America	43,939	34,404	28,105
South Africa	5,516	5,257	5,836
Consolidated	<u>\$ 424,033</u>	<u>\$ 400,695</u>	<u>\$ 340,192</u>

	2005	2004	2003
<b>Long-lived assets</b>			
United States	\$ 80,555	\$ 69,753	\$ 71,358
Europe	41,553	50,009	44,309
Asia/Pacific	5,283	5,119	6,332
South America	14,181	9,950	8,959
South Africa	45	50	19
Consolidated	<u>\$ 141,617</u>	<u>\$ 134,881</u>	<u>\$ 130,977</u>



**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
(Dollars in thousands except per share amounts)

**Note 14—Business Acquisitions and Divestitures**

In March 2005, the Company acquired the remaining 40% interest in its Brazilian joint venture for \$6,700. In addition, annual \$1,000 payments for four years will be paid subject to the former minority partners' compliance with the terms of the purchase agreement. In connection with the acquisition, the Company allocated \$1,475 to intangible assets, comprising customer lists of \$600 to be amortized over 20 years and non-compete agreements of \$875 to be amortized over five years. The Company also recorded \$610 of goodwill, which was assigned to the metalworking process chemicals segment. The following table shows the allocation of purchase price of assets and liabilities recorded for this acquisition. The pro forma results of operations have not been provided because the effects were not material:

	<b>December 31, 2005</b>
Current assets	\$ 4,199
Fixed assets	1,920
Intangibles	1,475
Goodwill	610
Other non-current assets	604
Total Assets	8,808
Liabilities	2,108
Cash paid	\$ 6,700

**Note 15—Goodwill and Other Intangible Assets**

The Company completed its annual impairment assessment as of the end of the third quarter of 2005 and no impairment charge was warranted. The changes in carrying amount of goodwill for the twelve months ended December 31, 2005 and 2004 are as follows:

	<b>Metalworking Process Chemicals</b>	<b>Coatings</b>	<b>Total</b>
Balance as of December 31, 2003	\$ 26,032	\$7,269	\$33,301
Goodwill additions	331	—	331
Currency translation adjustments	1,221	—	1,221
Balance as of December 31, 2004	\$ 27,584	\$7,269	\$34,853
Goodwill additions	786	—	786
Currency translation adjustments	(221)	—	(221)
Balance as of December 31, 2005	\$ 28,149	\$7,269	\$35,418

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

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

	Gross Carrying Amount		Accumulated Amortization	
	2005	2004	2005	2004
Amortized intangible assets				
Customer lists and rights to sell	\$ 6,703	\$ 6,292	\$ 2,095	\$ 1,481
Trademarks and patents	1,788	1,788	1,724	1,655
Formulations and product technology	3,278	3,278	1,240	838
Other	2,976	1,962	1,583	1,372
Total	<u>\$ 14,745</u>	<u>\$ 13,320</u>	<u>\$ 6,642</u>	<u>\$ 5,346</u>

The Company recorded \$1,368, \$1,157 and \$960 of amortization expense in 2005, 2004 and 2003 respectively. Estimated annual aggregate amortization expense for the subsequent five years is as follows:

For the year ended December 31, 2006	\$1,382
For the year ended December 31, 2007	\$ 961
For the year ended December 31, 2008	\$ 873
For the year ended December 31, 2009	\$ 865
For the year ended December 31, 2010	\$ 691

The Company has one indefinite-lived intangible asset of \$600 for trademarks.

**Note 16—Other Assets**

Other assets comprise:

	December 31	
	2005	2004
Restricted insurance settlement	\$ 15,008	\$ —
Pension assets	7,730	11,728
Deferred compensation assets	5,362	4,908
Supplemental retirement income program	2,543	1,897
Other	3,332	3,315
Total	<u>\$ 33,975</u>	<u>\$ 21,848</u>

In December 2005, an inactive subsidiary of the Company reached a settlement agreement and release with one of its insurance carriers for \$15,000. The proceeds of the settlement are restricted and can only be used to pay claims and costs of defense associated with this subsidiary's asbestos litigation. The subsidiary received \$7,500 in December 2005, which was deposited into an interest bearing account, and will receive an additional \$7,500 in December 2006 unless Federal asbestos legislation is adopted. Both the subsidiary and the insurance company acknowledge that as of the effective date of the settlement agreement and release it appears unlikely that Federal asbestos legislation will be enacted into law prior to the scheduled December 2006 payment. However, if the President of the United States signs into law the Federal asbestos legislation, the insurance

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

carrier's obligation to make the second payment will be cancelled. The first payment of \$7,500 earned \$8 of interest from the time of receipt until the end of 2005. The restrictions regarding the use of proceeds lapse after a period of 15 years. Due to the restricted nature of the proceeds, a corresponding deferred credit was established in Other non-current liabilities for an equal and offsetting amount, and will remain until the restrictions lapse or the funds are exhausted via payments of claims and costs of defense. See Notes 17 and 18 of Notes to Consolidated Financial Statements.

**Note 17—Other Non-Current Liabilities**

	December 31	
	2005	2004
Restricted insurance settlement	\$ 15,008	\$ —
Other (primarily deferred compensation agreements)	7,355	7,372
<b>Total</b>	<b>\$ 22,363</b>	<b>\$ 7,372</b>

See also Notes 16 and 18 of Notes to Consolidated Financial Statements.

**Note 18—Commitments and Contingencies**

The Company is involved in environmental clean-up activities and litigation in connection with an existing plant location and former waste disposal sites operated by unaffiliated third parties. In April of 1992, the Company identified certain soil and groundwater contamination at AC Products, Inc. ("ACP"), a wholly owned subsidiary. Voluntarily in coordination with the Santa Ana California Regional Water Quality Board, ACP is remediating the contamination. The Company believes that the remaining potential-known liabilities associated with these matters range from approximately \$1,200 to \$1,500, for which the Company has sufficient reserves. Notwithstanding the foregoing, the Company cannot be certain that liabilities in the form of remediation expenses and damages will not be incurred in excess of the amount reserved.

On or about December 18, 2004, the Orange County Water District ("OCWD") filed a civil complaint in Orange County Superior Court, California against ACP and other parties potentially responsible for groundwater contamination containing tetrachloroethylene and other compounds, including perchloroethylene ("PCE"). OCWD is seeking to recover compensatory and other damages related to the investigation and remediation of the contamination in the groundwater. AC Products seeks to defend this case vigorously on a number of bases including, most significantly, that it voluntarily investigated and remediated some or all of the PCE that appears to have originated at its facility. In cases such as these, parties often are allocated a percentage of responsibility for the damages awarded or agreed upon. At this point in the case, it is not possible to provide an estimate of the percentage of liability, if any, that AC Products ultimately may bear. Accordingly, it is not possible at this time to estimate the amount, if any, that ACP ultimately may be required to pay in settlement or to satisfy any adverse judgement as a result of the filing of this action or to assess whether the payment of such amount would be material to the Company.

Additionally, although there can be no assurance regarding the outcome of other environmental matters, the Company believes that it has made adequate accruals for costs associated with other environmental problems of which it is aware. Approximately \$134 and \$168 was accrued at December 31, 2005 and December 31, 2004, respectively, to provide for such anticipated future environmental assessments and remediation costs.

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**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
**(Dollars in thousands except per share amounts)**

An inactive subsidiary of the Company that was acquired in 1978 sold certain products containing asbestos, primarily on an installed basis, and is among the defendants in numerous lawsuits alleging injury due to exposure to asbestos. The subsidiary discontinued operations in 1991 and has no remaining assets other than its existing insurance policies and proceeds from an insurance settlement received in late 2005. To date, the overwhelming majority of these claims have been disposed of without payment and there have been no adverse judgements against the subsidiary. Based on a continued analysis of the existing and anticipated future claims against this subsidiary, it is currently projected that the subsidiary's total liability over the next 50 years for these claims is approximately \$10,100 (excluding costs of defense). Although the Company has also been named as a defendant in certain of these cases, no claims have been actively pursued against the Company and the Company has not contributed to the defense or settlement of any of these cases pursued against the subsidiary. These cases have been handled to date by the subsidiary's primary and excess insurers who agreed to pay all defense costs and be responsible for all damages assessed against the subsidiary arising out of existing and future asbestos claims up to the aggregate limits of the policies. A significant portion of this primary insurance coverage was provided by an insurer that is now insolvent, and the other primary insurers have asserted that the aggregate limits of their policies have been exhausted. The subsidiary is challenging the applicability of these limits to the claims being brought against the subsidiary. In response to this challenge, one of these carriers entered into a settlement and release agreement with the subsidiary for \$15,000. The proceeds of the settlement are restricted and can only be used to pay claims and costs of defense associated with the subsidiary's asbestos litigation. The subsidiary has additional coverage under its excess policies. The Company believes, however, that if the coverage issues under the primary policies with the other carriers are resolved adversely to the subsidiary, the subsidiary's insurance coverage will likely be exhausted. As a result, liabilities in respect of claims may exceed coverage available to the subsidiary. See also Notes 16 and 17 of Notes to Consolidated Financial Statements.

If the subsidiary's assets and insurance coverage were to be exhausted, claimants of the subsidiary may actively pursue claims against the Company because of the parent-subsubsidiary relationship. Although asbestos litigation is particularly difficult to predict, especially with respect to claims that are currently not being actively pursued against the Company, the Company does not believe that such claims would have merit or that the Company would be held to have liability for any unsatisfied obligations of the subsidiary as a result of such claims. After evaluating the nature of the claims filed against the subsidiary and the small number of such claims that have resulted in any payment, the potential availability of additional insurance coverage at the subsidiary level, the additional availability of the Company's own insurance and the Company's strong defenses to claims that it should be held responsible for the subsidiary's obligations because of the parent-subsubsidiary relationship, the Company believes it is not probable that the Company will incur any material losses.

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

The Company leases certain manufacturing and office facilities and equipment under non-cancelable operating leases with various terms from one to 25 years expiring in 2020. Rent expense for 2005, 2004, and 2003 was \$5,165, \$5,037, and \$4,771, respectively. The Company's minimum rental commitments under non-cancelable operating leases at December 31, 2005, were approximately \$4,358 in 2006, \$3,909 in 2007, \$3,203 in 2008, \$1,693 in 2009, \$1,357 in 2010, and \$7,153 thereafter.

**QUAKER CHEMICAL CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**  
(Dollars in thousands except per share amounts)

**Note 19—Quarterly Results (unaudited)**

	First	Second	Third	Fourth
<b>2005</b>				
Net sales	\$ 104,161	\$ 107,042	\$ 105,751	\$ 107,079
Gross profit	30,927	32,709	33,877	32,301
Operating income	1,478	3,589	3,940	(5,853)
Net income	3,126	1,795	2,212	(5,445)
Net income per share—basic	\$ 0.32	\$ 0.19	\$ 0.23	\$ (0.56)
Net income per share—diluted	\$ 0.32	\$ 0.18	\$ 0.23	\$ (0.56)
<b>2004</b>				
Net sales	\$ 98,131	\$ 98,683	\$ 99,667	\$ 104,214
Gross profit	32,455	32,544	31,691	34,187
Operating income	5,857	5,335	2,442	3,257
Net income	3,309	2,847	1,154	1,664
Net income per share—basic	\$ 0.35	\$ 0.30	\$ 0.12	\$ 0.17
Net income per share—diluted	\$ 0.33	\$ 0.29	\$ 0.12	\$ 0.17

**Item 9. *Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.***

None.

**Item 9A. *Controls and Procedures.***

**Conclusion regarding the Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “1934 Act”). Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

**Management’s Report on Internal Control over Financial Reporting**

The management of Quaker is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rule 13a-15(f) promulgated under the 1934 Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Our management, with the participation of our principal executive officer and principal financial officer, assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2005. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in *Internal Control-Integrated Framework*. Based on its assessment, Quaker’s management has concluded that as of December 31, 2005, the Company’s internal control over financial reporting is effective based on those criteria.

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PricewaterhouseCoopers LLP, the independent registered public accounting firm that audited the financial statements included in Item 8 of this Report, has included in its Report of Independent Registered Public Accounting Firm, included in Item 8, its attestation report on management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, which is incorporated herein by this reference.

**Changes in Internal Controls Over Financial Reporting**

The Company is in the process of implementing a global ERP system. At the end of 2005, subsidiaries representing more than 60% of consolidated revenue were operational on the global ERP system. Additional subsidiaries and CMS sites are planned to be implemented during 2006. The Company is taking the necessary steps to monitor and maintain the appropriate internal controls during this period of change.

**Item 9B. *Other Information.***

None.

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## PART III

### **Item 10. Directors and Executive Officers of the Registrant.**

Incorporated by reference is (i) the information beginning immediately following the caption “Proposal 1—Election of Directors and Nominee Biographies” in the Registrant’s definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held May 10, 2006 to be filed with the SEC no later than 120 days after the close of its fiscal year ended December 31, 2005 (the “2006 Proxy Statement”) to, but not including, the caption “Compensation of Directors,” (ii) the information in the 2006 Proxy Statement beginning immediately following the caption “Board Committees and Meeting Attendance” to, but not including, the caption “Proposal 2-Approval of the 2001 Global Annual Incentive Plan,” (iii) the information in the 2006 Proxy Statement beginning with and including the caption, “Section 16(a) Beneficial Ownership Reporting Compliance” to, but not including the caption “General,” and (iv) the information appearing in Item 4(a) of this Report.

In addition to the information incorporated by reference from the 2006 Proxy Statement, Mr. Robert P. Hauptfuhrer (Age 74), who has been a director of the Registrant since 1977, has reached the mandatory retirement age and therefore is not eligible for reelection as a director. Mr. Hauptfuhrer is the former Chairman of the Board and Chief Executive Officer of Oryx Energy Company.

The Company has a compliance program, the governing documents of which include a Code of Conduct (which is applicable to all of the Company’s directors, executive officers and employees) and a Financial Code of Ethics for Senior Financial Officers (which is applicable to the Chief Executive Officer, Chief Financial Officer, Global Controller, Controllers of each of the Company’s majority-owned affiliates, Assistant Global Controller, and other individuals performing similar functions designated by the Company’s Board of Directors). The Audit Committee oversees the administration of the program and is directly responsible for the disposition of all reported violations of the Financial Code of Ethics for Senior Financial Officers and complaints received regarding accounting, internal accounting controls, or audit matters. In addition, the Audit Committee approves any waivers to the Code of Conduct for directors and executive officers. The Code of Conduct, Financial Code of Ethics for Senior Financial Officers, Corporate Governance Guidelines and Audit, Compensation/Management Development and Governance Committee Charters have been posted on and are available free of charge by accessing the Investors—Corporate Governance section of our Web site at <http://www.quakerchem.com> or by written request addressed to Quaker Chemical Corporation, One Quaker Park, 901 Hector Street, Conshohocken, PA 19428 to the attention of Irene Kisleiko, Assistant Secretary of the Company.

The Board has affirmatively determined that three of the four members of the Audit Committee, including its current Chairman, William R. Cook, meet the criteria for an “audit committee financial expert” as defined in Item 401 of SEC Regulation S-K. Each member of the Audit Committee, including Mr. Cook, is “independent” as defined in the listing standards of the New York Stock Exchange.

### **Item 11. Executive Compensation.**

Incorporated by reference is the information in the 2006 Proxy Statement (i) beginning immediately following the caption “Compensation of Directors” to, but not including, the caption “Board Committees and Meeting Attendance,” (ii) beginning immediately following the caption “Executive Compensation” to, but not including, the caption “Report of the Compensation/Management Development Committee on Executive Compensation” and (iii) immediately following the caption “Compensation Committee Interlocks and Insider Participation” to, but not including, the caption “Report of the Audit Committee.”

**Item 12. Security Ownership of Certain Beneficial Owners, and Management and Related Stockholder Matters.**

Incorporated by reference is the information in the 2006 Proxy Statement beginning immediately following the caption "Stock Ownership of Certain Beneficial Owners and Management" to, but not including, the subcaption "Section 16(a) Beneficial Ownership Reporting Compliance."

The following table sets forth certain information relating to the Company's equity compensation plans as of December 31, 2005. Each number of securities reflected in the table is a reference to shares of Quaker common stock.

*Equity Compensation Plans*

<b>Equity Compensation Plan Information</b>			
<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u> (a)	<u>Weighted-average exercise price of outstanding options, warrants and rights</u> (b)	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u> (c)
Equity compensation plans approved by security holders	1,183,485	19.88	525,319(1)
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>1,183,485</b>	<b>19.88</b>	<b>525,319</b>

(1) As of December 31, 2005, 357,500 of these shares were available for issuance as restricted stock awards under the Company's 2001 Global Annual Incentive Plan, 109,128 shares were available for issuance upon the exercise of stock options and/or as restricted stock awards under the Company's 2001 Long-Term Performance Incentive Plan, and the other 58,691 shares were available for issuance under the 2003 Director Stock Ownership Plan.

**Item 13. Certain Relationships and Related Transactions.**

No information is required to be provided in response to this Item 13.

**Item 14. Principal Accountant Fees and Services.**

Incorporated by reference is the information in the 2006 Proxy Statement beginning with the subcaption "Audit Fees" to, but not including the statement recommending a vote for ratification of the Company's independent auditors.



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PART IV

**Item 15. Exhibits and Financial Statement Schedules.**

(a) Exhibits and Financial Statement Schedules

**1. Financial Statements and Supplementary Data.**

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Financial Statements:	
Report of Independent Registered Public Accounting Firm	29
Consolidated Statement of Income	31
Consolidated Balance Sheet	32
Consolidated Statement of Cash Flows	33
Consolidated Statement of Shareholders' Equity	34
Notes to Consolidated Financial Statements	35

**2. Financial Statement Schedules**

All schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

Financial statements of 50% or less owned companies have been omitted because none of the companies meets the criteria requiring inclusion of such statements.

**3. Exhibits (numbered in accordance with Item 601 of Regulation S-K)**

- 3(a) — Amended and Restated Articles of Incorporation dated July 16, 1990. Incorporated by reference to Exhibit 3(a) as filed by Registrant with Form 10-K for the year 1996.
- 3(b) — By-laws as amended through May 6, 1998. Incorporated by reference to Exhibit 3(b) as filed by Registrant with Form 10-K for the year 1998.
- 4 — Shareholder Rights Plan dated March 6, 2000. Incorporated by reference to Form 8-K as filed by the Registrant on March 7, 2000.
- 10(a) — Long-Term Performance Incentive Plan as approved May 5, 1993. Incorporated by reference to Exhibit 10(a) as filed by the Registrant with Form 10-K for the year 1993.\*
- 10(i) — Employment Agreement by and between the Registrant and Ronald J. Naples dated August 14, 1995. Incorporated by reference to Exhibit 10(i) as filed by Registrant with Form 10-Q for the quarter ended September 30, 1995.\*
- 10(j) — Amendment to the Stock Option Agreement dated October 2, 1995 by and between the Registrant and Ronald J. Naples. Incorporated by reference to Exhibit 10(j) as filed by Registrant with Form 10-Q for the quarter ended September 30, 1995.\*
- 10(k) — Employment Agreement by and between Registrant and José Luiz Bregolato dated June 14, 1993. Incorporated by reference to Exhibit 10(k) as filed by Registrant with Form 10-K for the year 1995.\*
- 10(o) — Amendment No. 1 to Employment Agreement dated January 1, 1997 by and between Registrant and Ronald J. Naples. Incorporated by reference to Exhibit 10(o) as filed by Registrant with Form 10-K for the year 1997.\*

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- 10(p) — Amendment No. 1 to 1995 Naples Restricted Stock Plan and Agreement dated January 21, 1998 by and between Registrant and Ronald J. Naples. Incorporated by reference to Exhibit 10(p) as filed by Registrant with Form 10-K for the year 1997.\*
- 10(t) — Employment Agreement by and between Registrant and Ronald J. Naples dated March 11, 1999. Incorporated by reference to Exhibit 10(t) as filed by Registrant with Form 10-K for the year 1998.\*
- 10(u) — Employment Agreement by and between Registrant and Michael F. Barry dated November 30, 1998. Incorporated by reference to Exhibit 10(u) as filed by Registrant with Form 10-K for the year 1998.\*
- 10(dd) — 1999 Long-Term Performance Incentive Plan as approved May 12, 1999, effective January 1, 1999. Incorporated by reference to Exhibit 10(dd) as filed by Registrant with Form 10-K for the year 1999.\*
- 10(ff) — Deferred Compensation Plan as adopted by the Registrant dated December 17, 1999, effective July 1, 1997. Incorporated by reference to Exhibit 10(ff) as filed by Registrant with Form 10-K for the year 1999.\*
- 10(gg) — Supplemental Retirement Income Program adopted by the Registrant on November 6, 1984, as amended November 8, 1989. Incorporated by reference to Exhibit 10(gg) as filed by Registrant with Form 10-K for the year 1999.\*
- 10(hh) — 2001 Global Annual Incentive Plan as approved May 9, 2001, effective January 1, 2001. Incorporated by reference to Exhibit 10(hh) as filed by Registrant with Form 10-K for the year 2001.\*
- 10(ii) — 2001 Long-Term Performance Incentive Plan as approved May 9, 2001, effective January 1, 2001. Incorporated by reference to Exhibit 10(ii) as filed by Registrant with Form 10-K for the year 2001.\*
- 10(jj) — Agreement of Lease between Quaker Park Associates, L.P. and Quaker Chemical Corporation dated December 19, 2000. Incorporated by reference to Exhibit 10(jj) as filed by Registrant with Form 10-K for the year 2001.\*
- 10(kk) — Asset Purchase Agreement between United Lubricants Corporation and ULC Acquisition Corp. dated January 23, 2002, as amended by Amendment to Purchase Asset Agreement dated February 28, 2002. Incorporated by reference to Exhibit 10(kk) as filed by Registrant with Form 10-K for the year 2001.\*
- 10(mm) — Credit Agreement between Registrant and ABN AMRO Bank N.V. in the amount of \$20,000,000, dated April 12, 2002. Incorporated by reference to Exhibit 10(mm) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2002.
- 10(nn) — Promissory Note in the amount of \$10,000,000 in favor of ABN AMRO Bank N.V., dated April 15, 2002. Incorporated by reference to Exhibit 10(nn) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2002.
- 10(oo) — Stock Purchase Agreement between Epmar Corporation and Quaker Chemical Corporation dated April 22, 2002. Incorporated by reference to Exhibit 10(oo) as filed by the Registrant with Form 10-K for the year 2002.

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- 10(pp) — First Amendment between Quaker Chemical Corporation and ABN Amro Bank N.V. dated March 25, 2003. Incorporated by reference to Exhibit 10(pp) as filed by the Registrant with Form 10-Q for the quarter ended March 31, 2003.
- 10(qq) — Credit Agreement between Registrant and PNC Bank, National Association in the amount of \$10,000,000, dated June 19, 2003. Incorporated by reference to Exhibit 10(qq) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2003.
- 10(rr) — Commercial Note between Registrant and National City Bank, National Association in the amount of \$10,000,000, dated June 19, 2003. Incorporated by reference to Exhibit 10(rr) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2003.
- 10(ss) — Employment Agreement by and between Registrant and Mark A. Harris, effective January 1, 2001. Incorporated by reference to Exhibit 10(ss) as filed by the Registrant with Form 10-K for the year 2003.\*
- 10(uu) — Employment Agreement by and between Registrant and L. Wilbert Platzer, effective January 1, 2001. Incorporated by reference to Exhibit 10(uu) as filed by the Registrant with Form 10-K for the year 2003.\*
- 10(ww) — 2003 Director Stock Ownership Plan as approved May 14, 2003. Incorporated by reference to Exhibit 10(ww) as filed by the Registrant with Form 10-K for the year 2003.\*
- 10(yy) — Change in Control Agreement by and between Registrant and D. Jeffry Benoliel dated June 10, 2004, effective May 14, 2004. Incorporated by reference to Exhibit 10(yy) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(zz) — Change in Control Agreement by and between Registrant and Mark Featherstone dated June 10, 2004, effective May 14, 2004. Incorporated by reference to Exhibit 10(zz) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(aaa) — Change in Control Agreement by and between Registrant and Jose Luiz Bregolato, dated June 23, 2004, effective May 14, 2004. Incorporated by reference to Exhibit 10(aaa) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(ccc) — Amendment No. 1 to Employment Agreement dated March 11, 1999 between Registrant and Ronald J. Naples, effective July 21, 2004. Incorporated by reference to Exhibit 10(ccc) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(ddd) — Employment Agreement by and between Registrant and Neal E. Murphy, effective July 22, 2004. Incorporated by reference to Exhibit 10(ddd) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(eee) — Change in Control Agreement by and between Registrant and Neal E. Murphy, effective July 22, 2004. Incorporated by reference to Exhibit 10(eee) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(fff) — 1995 Naples Supplemental Retirement Income Program and Agreement (as amended and restated effective May 14, 2004) between Registrant and Ronald J. Naples dated August 4, 2004. Incorporated by reference to Exhibit 10(fff) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(hhh) — Change in Control Agreement by and between Registrant and Michael F. Barry, effective May 14, 2004. Incorporated by reference to Exhibit 10(hhh) as filed by the Registrant with Form 10-Q for the quarter ended June 30, 2004.\*
- 10(iii) — Letter Agreement by and between Registrant and Joseph W. Bauer dated March 8, 2005. Incorporated by reference to Exhibit 10 as filed by the Registrant with Form 8-K dated March 10, 2005.\*

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- 10(jjj) — Credit Agreement between Registrant and Bank of America, N.A. and ABN AMRO Bank, N.V. and Banc of America Securities LLC, in the amount of \$100,000,000, dated October 14, 2005. Incorporated by reference to Exhibit 10(jjj) as filed by the Registrant with Form 10-Q for the quarter ended September 30, 2005.
  - 10(kkk) — Quaker Chemical Corporation Directors' Deferred Compensation Plan (Amended and Restated as of May 5, 2004).\*
  - 10(III) — Amendment One to Registrant's 2001 Long-Term Performance Incentive Plan, effective February 22, 2005. Incorporated by reference to Exhibit 10.1 as filed by Registrant with Form 8-K filed on March 15, 2005.\*
  - 10(mmm) — Form of Stock Option Agreement for associates under Registrant's 2001 Long-Term Performance Incentive Plan. Incorporated by reference to Exhibit 10.2 as filed by Registrant with Form 8-K filed on March 15, 2005.\*
  - 10(nnn) — Settlement Agreement and Release between Registrant, an inactive subsidiary of the Registrant, and Hartford Accident and Indemnity Company dated December 12, 2005.
  - 10(ooo) — Amendment to Registrant's Deferred Compensation Plan for key officers dated December 20, 2005. Incorporated by reference to Exhibit 10 as filed by Registrant with Form 8-K filed on December 22, 2005.\*
  - 10(ppp) — Form of Restricted Stock Award Agreement for executive officers and other employees under Registrant's 2001 Long-Term Performance Incentive Plan. Incorporated by reference to Exhibit 10 as filed by Registrant with Form 8-K filed on March 6, 2006.\*
    - 21 — Subsidiaries and Affiliates of the Registrant
    - 23 — Consent of Independent Registered Public Accounting Firm
    - 31.1 — Certification of Chief Executive Officer of the Company pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
    - 31.2 — Certification of Chief Financial Officer of the Company pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934.
    - 32.1 — Certification of Ronald J. Naples pursuant to 18 U.S.C. Section 1350.
    - 32.2 — Certification of Neal E. Murphy pursuant to 18 U.S.C. Section 1350.

\* This exhibit is a management contract or compensation plan or arrangement required to be filed as an exhibit to this Report.

(b) *Exhibits required by Regulation 601 S-K*

See (a) 3 of this Item 15

(c) *Financial Statement Schedules*

See (a) 2 of this Item 15



**QUAKER CHEMICAL CORPORATION**  
**DIRECTORS' DEFERRED COMPENSATION PLAN**  
**(Amended and Restated as of May 5, 2004)**

**Section 1 - Statement of Purpose**

This Plan is designed and implemented for the purpose of providing to the members of the Board who have made significant contributions to the Company's success, the opportunity to accumulate capital on a tax-deferred basis, thereby increasing the incentive for such Directors to remain on the Board and to make the Company more profitable. This goal is accomplished through a pre-tax deferral of Board compensation and the investment of those funds on a tax-deferred basis.

**Section 2 - Definitions**

2.1 "Account Balance" means the amount, as denominated in dollars, of a Participant's account as indicated in the records of the Plan Administrator.

2.2 "Administrator" means the person designated by the Company pursuant to Section 3.1 to administer the Plan on behalf of the Company.

2.3 "Beneficiary" means the person to whom the share of a deceased Participant's total account is payable, as designated by a Participant in writing on a form satisfactory to the Company. In the absence of any living designated Beneficiary, a deceased Participant's Beneficiary shall be the deceased Participant's then living spouse, if any, for his or her life; if none, or from and after such spouse's death, then the living children of the deceased Participant, if any, in equal shares, for each of their lives; and if none, or after the death of all such children, the estate of the deceased Participant.

2.4 "Board" means the Board of Directors of the Company, or any committee of such Board that is authorized to oversee, administer and amend the Plan.

2.5 "Company" means Quaker Chemical Corporation and any successors that shall maintain this Plan. The Company is a corporation, with principal offices in the Commonwealth of Pennsylvania.

2.6 "Compensation" with respect to Participants means all fees paid to Participants by reason of serving on the Board or on committees of the Board.

2.7 "Director" means a member of the Board.

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2.8 "Participant" means any Director who participates in the Plan as provided in Section 4 and has not for any reason become ineligible to participate further in the Plan.

2.9 "Plan" means the Quaker Chemical Corporation Directors' Deferred Compensation Plan, as contained in this instrument, including all amendments thereto.

2.10 "Plan Participation Agreement" means the agreement signed by a Director authorizing the deferral of his or her Compensation to the Plan pursuant to Sections 4.2 and 5.1.

2.11 "Plan Year" means the Plan's accounting year. On and after May 5, 2004, the Plan Year shall be the period beginning on the date of the annual meeting of the Company's shareholders and ending on the date immediately preceding the next such annual meeting. The Plan Years prior to May 5, 2004, were as follows:

- (a) The six-month period beginning July 1, 2002, and ending December 31, 2002;
- (b) The calendar year beginning January 1, 2003, and ending December 31, 2003; and
- (c) The period beginning January 1, 2004, and ending May 4, 2004.

2.12 "Vested" means the nonforfeitable portion of any account maintained on behalf of a Participant.

### **Section 3 - Plan Administration**

3.1 **Powers and Duties of the Administrator.** The Company shall appoint the Administrator, who shall administer the Plan for the exclusive benefit of the Participants and their Beneficiaries, subject to the specific terms of the Plan. The Administrator shall administer the Plan in accordance with its terms and shall have the power and discretion to construe the terms of the Plan and to determine all questions arising in connection with the administration, interpretation, and application of the Plan. Any such determination by the Administrator shall be conclusive and binding upon all persons. The Administrator may establish procedures, correct any defect, supply any information, or reconcile any inconsistency in such manner and to such extent as shall be deemed necessary or advisable to carry out the purpose of the Plan; provided, however, that any procedure, discretionary act, interpretation or construction shall be done in a nondiscriminatory manner based upon uniform principles consistently applied. The Administrator shall have all powers necessary or appropriate to accomplish the duties under this Plan.

The Administrator shall be charged with the duties of the general administration of the Plan, including, but not limited to, the following:

- (a) The discretion to determine all questions relating to the eligibility of a Director to participate or remain a Participant hereunder and to receive benefits under the Plan;

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- (b) To compute and make determinations with respect to the amount of benefits to which any Participant shall be entitled hereunder;
  - (c) To authorize and make nondiscretionary or otherwise directed disbursements to Participants;
  - (d) To maintain all necessary records for the administration of the Plan;
  - (e) To interpret the provisions of the Plan and to make and publish such rules for the regulation of the Plan as are consistent with the terms hereof;
  - (f) To prepare and implement a procedure to notify Directors that they may elect to have a portion of Compensation deferred or paid to them in cash;
- and
- (g) To assist any Participant regarding his or her rights, benefits, or elections available under the Plan.

3.2 **Records and Reports.** The Administrator shall keep a record of all actions taken and shall keep all other books of account, records, and other data that may be necessary for proper administration of the Plan and shall be responsible for supplying all information and reports to the Company, Participants and Beneficiaries.

3.3 **Information from Company.** To enable the Administrator to perform the functions under the Plan, the Company shall supply full and timely information to the Administrator on all matters relating to the Compensation of all Participants, their retirement, death, disability, or termination of service as a member of the Board, and such other pertinent facts as the Administrator may require. The Administrator may rely upon such information as is supplied by the Company and shall have no duty or responsibility to verify such information.

3.4 **Claims Procedure.** Claims for benefits under the Plan may be filed with the Administrator on forms supplied by the Company. Written or electronic notice of the disposition of a claim shall be furnished to the claimant within 90 days after the application is filed. In the event the claim is denied, in whole or in part, the notice shall set forth in language calculated to be understood by the claimant (i) the specific reason or reasons for the denial, (ii) specific reference to pertinent Plan provisions on which the denial is based, (iii) a description of any additional material or information necessary for the claimant to perfect the claim and an explanation of why such material or information is necessary, and (iv) a description of the Plan's review procedures and the time limits applicable to such procedures, including a statement of the claimant's right, if any, to bring a civil action under section 502(a) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), following an adverse benefit determination on review.

3.5 **Claims Review Procedure.** Any Director, former Director, or Beneficiary who has been denied a benefit by a decision of the Administrator pursuant to Section 3.4, or his or her authorized representative (the "claimant"), shall be entitled to request the Administrator to give further consideration to his or her claim by filing with the Administrator a request for a hearing. Such request, together with a written statement of the reasons why the claimant believes his or



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her claim should be allowed, shall be filed with the Administrator no later than 60 days after receipt of the notification provided for in Section 3.4. The claimant shall be provided, upon request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claimant's claim for benefits. The Administrator shall then conduct a hearing within the next 60 days, at which the claimant shall have an opportunity to submit comments, documents, records, and other information relating to the claim without regard to whether such information was submitted or considered in the initial benefit determination. The Administrator shall make a final decision as to the allowance of the claim within 60 days of receipt of the appeal, unless special circumstances require an extension of time, in which case notice of the extension and circumstances shall be provided to the claimant prior to the termination of the initial 60-day period and a decision shall be rendered as soon as possible but not later than 120 days after receipt of the request for review; provided, however, in the event the claimant fails to submit information necessary to make a benefit determination on review, such period shall be tolled from the date on which the extension notice is sent to the claimant until the date on which the claimant responds to the request for additional information. The decision on review shall be written or electronic and, in the case of an adverse determination, shall include specific reasons for the decision, in a manner calculated to be understood by the claimant, and specific references to the pertinent Plan provisions on which the decision is based. The decision on review shall also include (i) a statement that the claimant is entitled to receive, upon request and free of charge, reasonable access to, and copies of, all documents, records, or other information relevant to the claimant's claim for benefits, and (ii) a statement describing any voluntary appeal procedures offered by the Plan, and a statement of the claimant's right, if any, to bring an action under section 502(a) of ERISA.

#### **Section 4 - Eligibility**

4.1 **Eligibility.** The Company shall identify and notify those Directors who are serving on the Board on June 30, 2002. A Director whose service on the Board commences after June 30, 2002 shall be identified and notified of the Plan at that time. Participation in the Plan shall be voluntary.

4.2 **Participation.** A Director becomes a Participant in the Plan upon the execution and delivery by him or her and the Company of a Plan Participation Agreement. Elections by Participants with respect to a Plan Year shall be made before the beginning of the Plan Year. In the first year in which a Director becomes eligible to participate in the Plan, the Director may make an election, within 30 days after the date the Director becomes eligible to Participate, with respect to Compensation for services to be performed subsequent to the election during that Plan Year. Elections made with respect to any Plan Year are irrevocable once the Plan Year has begun.

4.3 **Effective Date of Participation.** A Director shall become a Participant effective as of the first day of the Plan Year for which a Plan Participation Agreement under Section 4.2 is in effect, provided that the Director is still serving on such date. A new Director shall become a Participant as of the first day for which his or her election to defer is effective.

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4.4 **Election Not to Participate.** Any Director may elect not to participate in the Plan. A Director who fails to execute and deliver a Plan Participation Agreement in accordance with Section 4.2 shall be deemed to have elected not to participate in the Plan.

#### **Section 5 - Contributions to the Plan**

5.1 **Participant's Compensation Deferral.** A Participant may elect to defer up to 100% of his or her Compensation each Plan Year. The total amount of Compensation that is deferred shall be considered as the Participant's contribution to the Plan for that year. Deferral elections shall continue in effect from year to year unless changed or revoked by the Participant. Any change or revocation shall not be effective prior to the first day of the Plan Year beginning after the date on which such change or revocation is filed with the Company.

5.2 **Vesting of Contributions.** Participant contributions shall be Vested at all times.

#### **Section 6 - Participants' Accounts**

6.1 **Maintenance of Participants' Accounts.** The Administrator shall maintain a separate account for each Participant, to which shall be credited Participants' contributions. Accounts shall be credited for contributions as of the date the relevant amounts would otherwise have been payable to the Participant in cash. Each Participant's account also shall be credited with any increases in value determined under Section 6.2. Each Participant's account shall be charged with any withdrawals, distributions, or transfers permitted under the Plan. These Participant accounts shall be for recordkeeping purposes only and no actual funds will be deposited or set aside for any individual Participant or for the group of Participants as a whole.

#### **6.2 Earnings or Losses Credited to Participant Accounts.**

(a) Each Participant may from time to time designate the investment vehicle or vehicles which shall be used to determine the earnings and losses of his or her account from among available investment vehicles designated by the Administrator in its sole discretion. Any such designation shall be made at the time and in the manner prescribed by the Administrator. Each Participant's Account Balance shall be adjusted on a daily basis to reflect the earnings and losses of the designated investment vehicle or vehicles. In the event that no designation is in effect under this Section 6.2(a) for any period, the Participant shall be deemed to have designated such default investment vehicle as may be designated by the Administrator.

(b) Notwithstanding Section 6.2(a), a Participant's Account Balance as of any date shall not be less than the amount determined (i) by crediting his account with interest on a daily basis at the prime lending rate charged by the Company's principal banking institution on January 1 of the calendar year for which such interest credit is made (or July 1, 2002, with regard to interest credits made during 2002); (ii) without regard to any contributions made on or after May 5, 2004; and (iii) without regard to any adjustments under Section 6.2(a).

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6.3 **Statements of Participants' Accounts.** The Administrator shall prepare or have prepared each quarter a statement for each Participant of his or her Account Balance and shall send such statement to the Participant.

#### **Section 7 - Distributions**

7.1 **Distributions from the Plan.** A Participant will be entitled to payment from the Company of an amount equal to his or her Account Balance upon the Participant's termination of service as a member of the Board. All payments shall be made or commence as soon as administratively possible following the date of termination.

7.2 **Form of Payment.** Distribution shall be made in a single-sum payment equal to the Participant's Account Balance; provided, however, that the Company may, in its sole and absolute discretion, approve a Participant's request for an alternate form of distribution of the Account Balance, in which case such distribution or distributions shall be in the amount of the Actuarial Equivalent of the benefit otherwise distributable hereunder. Any such request for an alternate form of distribution must be made not later than the last day of the calendar year preceding the Participant's termination of service as a member of the Board.

7.3 **Loans.** Loans from the Plan are not permitted.

7.4 **Distribution for Minor Beneficiary.** In the event a distribution is to be made to a minor, then the Administrator may direct that such distribution be paid to the legal guardian, or if none, to a parent of such Beneficiary, or to the custodian of such Beneficiary under the Uniform Gifts to Minors Act or a similar statute, if such is permitted by the laws of the state in which said Beneficiary resides. Such a payment to the legal guardian, custodian or parent of a minor Beneficiary shall fully discharge the Company and the Plan from further liability on account thereof.

#### **Section 8 - Amendment and Termination**

8.1 **Amendment.** The Company shall have the right at any time to amend this Plan. However, no amendment shall be effective so as to reduce the amount of any Participant's Account Balance, to reduce future interest credits (with respect to the Participant's Account Balance attributable to contributions made prior to May 5, 2004) below the amount provided under Section 6.2(b) (as in effect prior to the amendment), to adversely affect the Participant's right to adjustments for earnings or losses under Section 6.2(a), or to delay the payment of any amount to a Participant beyond the time that such amount would be payable without regard to such amendment.

8.2 **Termination.** The Company shall have the right at any time to notify the Participants of the termination of the Plan by delivering to the Directors and Administrator written notice of such termination. Upon any such notice of termination, beginning with the following Plan Year no additional amounts may be deferred and credited to Participants' accounts; however, Participants' accounts shall continue to be credited with any increases or decreases in value pursuant to Section 6.2. In the event of termination, at the Company's election, each Participant's

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Account Balance may be paid to the Participant in full, or any payment may be made to each Participant in accordance with the terms of the Plan.

**Section 9 - Company-Owned Life Insurance**

9.1 **Company Owns All Rights.** In the event that, in its discretion, the Company purchases a life insurance policy or policies insuring the life of any Participant to allow the Company to informally finance and/or recover, in whole or in part, the cost of providing the benefits hereunder, neither the Participant nor any Beneficiary shall have any rights whatsoever therein. The Company shall be the sole owner and beneficiary of any such policy or policies and shall possess and may exercise all incidents of ownership therein.

9.2 **Participant Cooperation.** If the Company decides to purchase a life insurance policy or policies on any Participant, the Company will so notify such Participant. Each Participant shall consent to being insured for the benefit of the Company and shall take whatever actions may be necessary to enable the Company to timely apply for and acquire such life insurance and to fulfill the requirements of the insurance carrier relative to the issuance thereof as a condition of eligibility to participate in the Plan.

9.3 **Participant Misrepresentation.** If (a) any Participant is required by this Plan to submit information to any insurance carrier; and (b) the Participant makes a material misrepresentation in any application for such insurance; and (c) as a result of that material misrepresentation the insurance carrier is not required to pay all or any part of the proceeds provided under that insurance, then the Participant's (or the Participant's Beneficiary's) rights to any benefits under this Plan may be, in the sole discretion of the Board, reduced to the extent of any reduction of proceeds that is paid by the insurance carrier because of such material misrepresentation.

9.4 **Suicide.** Notwithstanding any other terms or provision of the Plan or the Plan Participation Agreement, if a Participant dies by reason of suicide and if the Company's receipt of insurance proceeds is as a result reduced, then the Participant's (or the Participant's Beneficiary's) rights to any benefits under this Plan may be, in the sole discretion of the Board, reduced to the extent of any reduction of proceeds that is paid by the insurance carrier.

**Section 10 - Resignation and Removal of the Administrator**

10.1 **Resignation.** The Administrator may resign at any time by written notice to the Board, which shall be effective 30 days after receipt of such notice unless the Administrator and the Board agree otherwise.

10.2 **Removal.** The Administrator may be removed by the Board on 30 days notice or upon shorter notice accepted by the Administrator.

10.3 **Appointment of Successor.** If the Administrator resigns or is removed, a successor shall be appointed, in accordance with Section 11, by the effective date of resignation or removal under this Section 10. If no such appointment has been made, the Administrator may apply to a court of competent jurisdiction for appointment of a successor or for instructions. All expenses

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of the Administrator in connection with the proceeding shall be allowed as administrative expenses of the Plan.

**Section 11 - Appointment of Successor Administrator**

11.1 **Successor Administrator.** If the Administrator resigns or is removed in accordance with Section 10.1 or 10.2, the Board shall appoint a successor Administrator. The appointment shall be effective when accepted in writing by the new Administrator. The new Administrator shall have all of the rights and powers of the former Administrator.

**Section 12 - The Administrator's Consultant**

12.1 **Consultant.** The Company agrees to the designation by the Administrator of NYLEX Benefits LLC ("NYLEX"), headquartered in Stamford, Connecticut, as the Administrator's consultant (the "Administrator's Consultant") under this Plan. The Administrator shall have no responsibility for the performance of the duties of the Administrator's Consultant.

12.2 **Independent Consultant.** It is recognized that NYLEX also acts as an independent consultant for the Administrator with respect to the Administrator's obligations under the Plan.

12.3 **Resignation or Removal of Consultant.** The Administrator's Consultant may resign at any time by delivery of written notice of resignation to the Administrator. The Administrator's Consultant may be removed by the Administrator at any time by delivery of written notice of such removal to the Administrator's Consultant. Any such resignation or removal shall take effect as of a future date specified in the notice, which date shall not be earlier than 30 days after such notice is delivered, or such earlier date as may be agreed to by the Administrator's Consultant and the Administrator. As soon as practicable after the Administrator's Consultant has resigned or has been removed hereunder, it shall deliver to the successor Administrator's Consultant or to the Administrator all reports, records, documents, and other written information in its possession regarding the Plan, the Participants and Beneficiaries, and thereupon shall be paid all unpaid fees, compensation and reimbursements to which it is entitled and shall be relieved of all responsibilities and duties under the Plan.

12.4 **Records to be Maintained.** The Administrator's Consultant shall maintain or cause to be maintained all of the records contemplated by the current agreement between the Administrator and the Administrator's Consultant. The Administrator's Consultant shall also perform such other duties and responsibilities under this Plan as agreed in writing between the Administrator's Consultant and the Administrator.

12.5 **Furnishing of Information.** The Administrator shall furnish to the Administrator's Consultant all the information necessary to determine the benefits payable to or with respect to each Participant and Beneficiary, and the name, address and Social Security number of each Participant and Beneficiary. The Administrator shall regularly, at least annually, or promptly at the request of the Administrator's Consultant, furnish to the Administrator's Consultant revised and updated information, including copies of any amendments or supplements to the Plan or the Administrator's obligations. Based on the foregoing information, the Administrator's Consultant

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shall prepare annual statements for each Participant and Beneficiary and shall furnish a copy of same to the Administrator. In the event the Administrator refuses or neglects to provide updated information, as contemplated herein, the Administrator's Consultant shall be entitled to rely upon the most recent information furnished to it by the Administrator. The Administrator's Consultant has no responsibility to verify information provided to it by the Administrator.

12.6 **Annual Valuation.** The Administrator's Consultant shall assist the Administrator in providing all required Plan information to the Company. The Administrator's Consultant shall also perform an annual actuarial valuation of the obligations under the Plan and the funding requirements therefore, based solely on the most recent information furnished to it by the Administrator.

### **Section 13 - Miscellaneous**

13.1 **Unsecured Company Liability.** The obligation of the Company to make payments hereunder to a Participant shall constitute an unsecured liability of the Company. Such payments shall be made from the general funds of the Company, and the Company shall not be required to establish or maintain any special or separate fund, to purchase or acquire life insurance on a Participant's life, or otherwise to segregate assets to assure that such payments shall be made. Neither a Participant nor any other person shall have any interest in any particular asset of the Company by reason of its obligations hereunder, and the right of any of them to receive payments under this Plan shall be no greater than the right of any other unsecured general creditor of the Company. Nothing contained in the Plan shall create or be construed as creating a trust of any kind or any other fiduciary relationship between the Company and a Participant or any other person.

13.2 **No Contract of Employment.** This Plan shall not be deemed to constitute a contract between the Company and any Participant or to be a consideration or an inducement for the service as a Director of any Participant. Nothing contained in this Plan shall be deemed to give any Participant the right to be retained as a Director regardless of the effect which any such cessation of service shall have upon him or her as a Participant in this Plan.

13.3 **Nonalienation of Benefits.** No benefit which shall be payable by this Plan to any person (including a Participant or his or her Beneficiary) shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, or charge, and any attempt to anticipate, alienate, sell, transfer, assign, pledge, encumber, or charge the same shall be void; and no such benefit shall in any manner be liable for, or subject to, the debts, contracts, liabilities, engagements, or torts of any such person, nor shall it be subject to attachment or legal process for or against such person, and the same shall not be recognized by the Administrator or Company, except to such extent as may be required by law.

13.4 **Designation of Beneficiary.** Each Participant shall file with the Company a notice in writing, in a form acceptable to the Board, designating one or more Beneficiaries to whom payments becoming due by reason of or after his or her death shall be made. Participants shall have the right to change the Beneficiary or Beneficiaries so designated from time to time;

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provided, however, that no such change shall become effective until received in writing and acknowledged by the Company.

13.5 **Payment to Incompetents.** The Company shall make the payments provided herein directly to the Participant or Beneficiary entitled thereto or, if such Participant or Beneficiary has been determined by a court of competent jurisdiction to be mentally or physically incompetent, then payment shall be made to the duly appointed guardian, committee or other authorized representative of such Participant or Beneficiary. The Company shall have the right to make payment directly to a Participant or Beneficiary until it has received actual notice of the physical or mental incapacity of such Participant or Beneficiary and actual notice of the appointment of a duly authorized representative of his or her estate. Any payment to or for the benefit of a Participant or Beneficiary shall be a complete discharge of all liability of the Company therefore.

13.6 **Authority to Establish a Trust.** The Company shall have the right at any time to establish a trust to which the Company may transfer from time to time certain assets to be used by the trustee of such trust to satisfy some or all of the Company's obligations and liabilities under the Plan. All assets held by such trust shall be subject to the claims of the Company's creditors in the event of the Company's Insolvency (as defined herein). The Company shall be considered Insolvent for purposes of said trust if: (a) the Company is unable to pay its debts as they become due; or (b) the Company is subject to a pending proceeding as a debtor under the United States Bankruptcy Act.

13.7 **Binding Effect.** Obligations incurred by the Company pursuant to this Plan shall be binding upon and inure to the benefit of the Company, its successors and assigns, and the Participant, his or her Beneficiaries, personal representatives, heirs, and legatees.

13.8 **Entire Plan.** This document and any amendments hereto contain all the terms and provisions of the Plan and shall constitute the entire Plan, any other alleged terms or provisions being of no effect.

13.9 **Merger, Consolidation or Acquisition.** In the event of a merger or consolidation of the Company with another corporation or entity, or the sale or lease of all or substantially all of the Company's assets to another corporation or entity, or the acquiring of another corporation or entity of a right to elect at least 30% of the Board, then and in such event the obligation and responsibilities of the Company under this Plan shall be assumed by any such successor or acquiring corporation or entity, and all of the rights, privileges and benefits of the Participants hereunder shall continue.

#### **Section 14 - Construction**

14.1 **Construction of this Plan.** This Plan shall be construed and enforced according to the laws of the Commonwealth of Pennsylvania, other than its laws respecting choice of law.

14.2 **Enforceability.** If any term or condition of this Plan shall be invalid or unenforceable to any extent or in any application, then the remainder of the Plan, and such term or condition except to such extent or in such application, shall not be affected thereby, and each and every

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term and condition of the Plan shall be valid and enforced to the fullest extent and in the broadest application permitted by law.

14.3 **Number.** Wherever any words are used herein in the singular or plural form, they shall be construed as though they were also used in the other form in all cases where they would so apply.

14.4 **Headings.** The headings and subheadings of this Plan have been inserted for convenience of reference and are to be ignored in any construction of the provisions hereof.

14.5 **Uniformity.** All provisions of this Plan shall be interpreted and applied in a uniform, nondiscriminatory manner. In the event of any conflict between the terms of this Plan and any summaries or other descriptions of this Plan, the Plan provisions shall control.



**SETTLEMENT AGREEMENT AND RELEASE**

This Settlement Agreement and Release (“Agreement”) is made between Quaker Chemical Corporation and SB Decking, Inc. on the one hand, and Hartford Accident & Indemnity Company (“Hartford A&I”) on the other hand. Collectively, Quaker Chemical Corporation, SB Decking, Inc. and Hartford A&I are referred to as the “Parties”.

**RECITALS**

WHEREAS, Hartford A&I issued or is alleged to have issued certain insurance policies to SB Decking, Inc. (the “Policies,” as more fully defined below); and

WHEREAS, SB Decking, Inc. has been named as a defendant in numerous actions involving Asbestos Claims (as defined below), and it anticipates that it will be named in additional Asbestos Claims in the future; and

WHEREAS, SB Decking, Inc. has made certain requests to Hartford A&I for insurance coverage in connection with Asbestos Claims under the Policies; and

WHEREAS, for many years, under a reservation of rights, Hartford A&I has provided a defense and paid indemnity under the Policies for Asbestos Claims; and

WHEREAS, SB Decking, Inc. and Hartford A&I disagree over the extent to which the Policies afford coverage for Asbestos Claims (the “Coverage Disputes”); and

WHEREAS, the Parties, without admitting in any way the validity of the positions or arguments advanced by the other side, now find it in their respective best interests to settle, resolve and compromise their Coverage Disputes and other coverage disputes amicably and to provide for the releases contained herein; and

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WHEREAS, this Agreement represents a good faith compromise of the Parties' Coverage Disputes and not an agreement as to the merits of their respective claims, defenses, and positions, all of which they maintain; and

WHEREAS, the Parties have each received the advice of counsel in the preparation, drafting, and execution of this Agreement, which was negotiated at arms' length; and

WHEREAS, the Settlement Payments (as defined below) represent fair value for the release of the Policies and are a good faith estimate of the total amount that Hartford A&I could otherwise become obligated to pay on behalf of SB Decking (as defined below) and/or Quaker (as defined below) for any and all Claims (as defined below), including without limitation Asbestos Claims, under the Policies;

NOW, THEREFORE, in consideration of the mutual covenants and promises contained herein, the sufficiency of which is hereby acknowledged, and intending to be legally bound, the Parties agree as follows:

**AGREEMENT**

**1. Definitions.** For purposes of this Agreement only, the following defined terms shall have the following meanings. The singular shall include the plural and vice-versa.

**1.1 "Asbestos Claim"** means any Claim alleging personal injury, bodily injury, mental injury, mental anguish, shock, sickness, disease, disability, or death or the

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fear or apprehension thereof, property damage, loss of use, financial loss, loss of consortium, or seeking compensation for the cost of medical monitoring or screening, or seeking relief of any kind for any other injury, damage or condition of any kind or sort whatsoever, arising out of, caused by or related to, in whole or in part, directly or indirectly, the manufacture, sale, handling, distribution, installation, repair, removal or use of asbestos or asbestos-containing products or material, or any conduct that results or is alleged to result in the exposure to asbestos or asbestos-containing material, alone or in combination with any other dust, mineral, fiber, substance or material, including without limitation any Claim arising out of actual, threatened or alleged exposure to asbestos (alone or in combination with any other dust, mineral, fiber, substance or material), any Claim seeking the removal, repair, abatement or replacement of asbestos or asbestos-containing material, any Claim arising out of the alleged failure to produce an asbestos-free product, and any Claim based on or arising out of any theory of liability or basis of recovery based upon, growing out of or related to asbestos or any asbestos-containing product, whether the injury associated with such Claim falls within or outside of the definitions of Products Hazard or Completed Operations Hazard, or their equivalents, contained in the Policies.

**1.2 “Claim”** means any past, present, or future claim, demand, action, cause of action, suit or liability of any kind or nature whatsoever, whether at law or in equity, known or unknown, asserted or unasserted, anticipated or unanticipated, accrued or unaccrued, fixed or contingent, which has been or may be asserted by or on behalf of any Person, whether seeking damages (including compensatory, punitive or exemplary damages) or equitable, mandatory, injunctive, or any other type of relief, including cross-claims, counterclaims, third-party claims, suits, lawsuits, administrative proceedings, notices of liability or potential liability, arbitrations, actions, rights, requests, causes of action or orders, and including without limitation

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Asbestos Claims and any "Claim" as that term is defined in United States Bankruptcy Code, 11 U.S.C. § 101(5) and "future demands" as that term is defined in United States Bankruptcy Code, 11 U.S.C. § 524(g)(5).

**1.3 "Claims Account"** means an account owned by SB Decking and established by SB Decking at a financial institution in Philadelphia, Pennsylvania that is acceptable to all Parties.

**1.4 "Effective Date"** means the date the last signature of the Parties is placed hereon, and this Agreement shall be effective as of such date.

**1.5 "Hartford"** means Hartford A&I, The Hartford Financial Services Group, Inc., and all of their respective past or present corporate parents, subsidiaries, affiliates and divisions, and all of their respective past, present, and future directors, officers, principals, employees, agents, representatives, attorneys, joint ventures, predecessors, successors, beneficiaries, grantees, vendees, transferees and assigns, and all other Persons acting on their behalf with respect to the events, transactions, or occurrences that are the subject of this Agreement. The corporate Persons currently within the definition of "Hartford" are listed on Exhibit 1.

**1.6 "Indemnified Claim"** means any Claim, whether based in tort, contract or any other theory of recovery, seeking any type of damages or relief, made by any Person against Hartford seeking amounts that are allegedly owed under the Policies in addition to the Settlement Amount and amounts that have previously been paid by Hartford under the Policies, except that an Indemnified Claim shall not include Claims for coverage that has been preserved under Section 4.3 of this Agreement.

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**1.7 “Non-Insurance Assets”** means all of the assets of SB Decking except the proceeds of any insurance policies that provide insurance coverage to SB Decking, including the payments required by Section 2.1 of this Agreement, or the proceeds of any loan from Quaker to SB Decking.

**1.8 “Person”** means any individual, group of individuals, corporation, partnership, association, trust or estate (or beneficiary thereof), government agency or other organization or entity, and any successor in interest, heir, guardian, executor, administrator, trustee, trustee in bankruptcy, or receiver of any person or entity.

**1.9 “Policies”** means all general liability, umbrella liability or excess liability, or any other insurance policies, known or unknown, issued or alleged to have been issued prior to the Effective Date by Hartford to SB Decking and/or Quaker or under which SB Decking and/or Quaker is insured or may claim to be insured or entitled to benefits, including without limitation, the policies listed on Exhibit 2.

**1.10 “Retained Counsel”** means counsel selected to defend an Indemnified Claim pursuant to Section 5.2 of this Agreement.

**1.11 “Settlement Amount”** means the sum total of the payments identified to be made by Hartford A&I pursuant to Section 2.1 of this Agreement.

**1.12 “SB Decking”** means SB Decking, Inc., formerly known as Selby Battersby & Co., and all of its past or present corporate parents, subsidiaries, affiliates and divisions, and all of its respective past, present, and future directors, officers, principals, employees, agents, representatives, attorneys, joint ventures, predecessors, successors, beneficiaries, grantees, vendees, transferees and assigns, and all other Persons acting on its behalf with respect to the events, transactions, or occurrences that are the subject of this Agreement.

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**1.13 “Quaker”** means Quaker Chemical Corporation and all of its past or present corporate parents, subsidiaries, affiliates and divisions, and all of its respective past, present, and future directors, officers, principals, employees, agents, representatives, attorneys, joint ventures, predecessors, successors, beneficiaries, grantees, vendees, transferees and assigns, and all other Persons acting on its behalf with respect to the events, transactions, or occurrences that are the subject of this Agreement.

**2. Payments to SB Decking, Inc.**

**2.1** Hartford A&I shall make payments to SB Decking, Inc, totaling Fifteen Million Dollars (\$15,000,000) (the “Settlement Amount”) in the following amounts at the following times:

a. Within fifteen days after the Effective Date, the sum of Seven Million, Five Hundred Thousand Dollars (\$7,500,000) (the “First Settlement Payment”); and

b. Subject to the provisions of Section 8, within three hundred and eighty (380) days after the Effective Date, the sum of Seven Million, Five Hundred Thousand Dollars (\$7,500,000) (the “Second Settlement Payment”).

**2.2** The Parties agree, subject to Section 4.3, that: (a) the Settlement Amount is the total amount that Hartford ever will be obligated to pay to Quaker, SB Decking, or any other Person under or arising out of the Policies in connection with any Claim, including without limitation Asbestos Claims; (b) Hartford is not acting as a volunteer in paying the Settlement Amount pursuant to this Agreement; and (c) the Settlement Amount is based on a compromise reached through arms-length negotiations and represents fair value for the releases provided for in Section 4 of this Agreement.

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### **3. The Claims Account**

**3.1** The Settlement Payments shall be made by check, on or before the due date, to the Claims Account. The Claims Account shall be a conservative, high quality interest-bearing investment account and, except as set forth in Sections 3.2 and 3.4 below, shall be used solely to pay defense and indemnity costs incurred by or on behalf of SB Decking or Quaker in connection with Asbestos Claims arising out of the business of SB Decking.

**3.2** If it ever becomes clear that, while funds remain in the Claims Account, neither SB Decking nor Quaker will have any future obligation to pay defense or indemnity costs in connection with Asbestos Claims (a circumstance that the Parties agree is very unlikely to occur), the funds then remaining in the Claims Account may be used to reimburse Quaker or SB Decking for any amounts expended by them that would have been eligible for insurance coverage under the Policies.

**3.3** The Claims Account shall be closed upon the exhaustion of the account or the expiration of 15 years from the Effective Date, whichever occurs first.

**3.4** The Parties agree that the Settlement Amount represents a good faith estimate of the total amount that Hartford could otherwise become obligated to pay under the Policies in connection with Asbestos Claims. If it appears at the time the Claims Account is closed that any sums remaining in the account may be needed to pay defense or indemnity costs in connection with Asbestos Claims or other Claims that would have been eligible for coverage under the Policies, then SB Decking shall use the remaining sums for such purposes. If, however,

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there are sums remaining in the Claims Account at the time that it is closed, and it should at any time thereafter become clear that there is only a remote possibility that such sums will ever be needed to pay defense or indemnity costs in connection with Asbestos Claims or other Claims that would have been eligible for coverage under the Policies (a contingency that the Parties to this Agreement believe is very unlikely to occur), such sums may then be used by SB Decking for any purpose.

**4. Releases.**

4.1 SB Decking, Quaker and Hartford each separately, fully, finally and completely, to the full extent that the Parties have the right, power or authority to do so, releases, remises, acquits and forever discharges each other from, and covenants not to sue each other regarding, any and all past, present and future Claims of any kind, whether actual or alleged, known or unknown, accrued or unaccrued, existing or potential, or suspected or unsuspected, in connection with, relating to, or arising out of, in any manner or fashion, the Policies, including without limitation,:

- a. Claims related to Asbestos Claims,
- b. Claims for breach of contract,
- c. Claims for indemnity, contribution, subrogation, equitable allocation, apportionment, or reimbursement that SB Decking and Quaker may have, either in their own right or by acquisition from another insurer, and



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- d. Claims for bad faith, extra-contractual damages, violation of an alleged duty of good faith and fair dealing, or comparable statutory Claim relating to Policies, including (1) any such Claim arising out of or relating to Hartford's handling of SB Decking's or Quaker's requests for insurance coverage for any Claims, including without limitation any Asbestos Claims or (2) the conduct of the Parties with regard to the negotiation of this Agreement,

whether such Claims seek compensatory damages, punitive damages, exemplary damages, statutorily multiplied damages, attorneys' fees, interest, costs or any other type of relief.

**4.2** The Parties understand that Claims that have been made or may be asserted against SB Decking and/or Quaker may increase or decrease in amount or severity over time, that Claims asserted against SB Decking and/or Quaker may include progressive, cumulative, unknown and/or unforeseen elements, and that there may be hidden, unknown and unknowable damages, defense expenses or other costs related to such Claims. Nonetheless, the Parties, and SB Decking, Quaker, and Hartford, to the full extent that the Parties have the right, power or authority to bind them, irrevocably and knowingly agree that the releases contained in this Section 4 include a full, complete and irrevocable release and discharge from all known or unknown rights or Claims under the Policies. In furtherance of this express intent, the Parties, and SB Decking, Quaker, and Hartford, to the full extent that the Parties have the right, power or authority to bind them, expressly waive any and all rights they may have under any contract, statute, code, regulation, ordinance or the common law that may limit or restrict the effect of a general release of Claims not known or suspected to exist in its favor at the time of the execution of the Agreement. The Parties, and SB Decking, Quaker, and Hartford, to the full extent that the Parties have the right, power or authority to bind them, expressly assume the risk that acts, omissions, matters, causes or things may have occurred or will occur that it does not know and does not suspect to exist.

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**4.3** Notwithstanding any provision of this Agreement to the contrary, the coverage provided by Insuring Agreement I.A of Worker's Compensation and Employer's Liability policies that Hartford issued to SB Decking (or the substantially equivalent provision, however titled, providing compensation and other benefits required of the insured by worker's compensation law) shall not be impaired by this Agreement.

**4.4** Subject to the provisions of Sections 6 and 7 of this Agreement, each Party expressly reserves any and all rights, positions and defenses it may have against any Person not a Party to this Agreement with respect to the matters addressed in this Agreement. Nothing in this Agreement is intended to release any reinsurance claim that Hartford has made or may make in the future.

**4.5** The release set forth in Section 4 is not intended to, and shall not, extend to or otherwise release or discharge any rights, privileges, benefits, duties, or obligations of any of the Parties arising under this Agreement.

**4.6** The Parties acknowledge, warrant, and represent that they are aware of and familiar with section 1542 of the California Civil Code, which provides as follows:

"A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR."

The Parties further acknowledge, warrant, and represent that the effect and import of California Civil Code section 1542 has been fully explained to them by their

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attorneys, and that, after consultation with their attorneys, they herein expressly waive and relinquish all rights and benefits which they may have under California Civil Code section 1542 or the law of any other state or jurisdiction, or common law principle to the same or similar effect.

**5. Indemnification.**

**5.1** SB Decking, Inc. (which, for purposes of this section 5 only shall include any successor to SB Decking, Inc.), to the extent of its Non-Insurance Assets, shall defend, indemnify, protect, save, and hold harmless Hartford from and against any Indemnified Claim.

**5.2** In connection with any Indemnified Claim, Hartford, upon consultation with SB Decking Inc. and subject to SB Decking Inc.'s consent, which shall not be unreasonably withheld, shall have the right to choose Retained Counsel. SB Decking, Inc. shall acknowledge its responsibility to indemnify for the Indemnified Claim to the extent of its Non-Insurance Assets, and it shall have the right, following consultation with and consideration of the views of Hartford, to direct and control the defense and determine defense strategy, subject to the following limitations: (a) SB Decking, Inc. may not take any position with respect to insurance coverage in Hartford's name without Hartford's written consent in advance, and SB Decking, Inc. shall provide copies of all pleadings and briefs filed on behalf of Hartford in advance of filing; (b) SB Decking, Inc. shall indicate that all pleadings, briefs, discovery responses and other filings are filed by SB Decking, Inc. as indemnitor of Hartford, and that the positions taken are those of SB Decking, Inc. not Hartford; and (c) SB Decking, Inc. shall not agree to provide any information or documents from Hartford, nor produce any Hartford witness for testimony or deposition, without Hartford's written consent in advance, which consent shall not be

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unreasonably withheld. SB Decking, Inc. shall have the right to settle or compromise any Indemnified Claim for which it is paying the entire settlement amount, subject to input from and consideration of the views of Hartford, and provided that such settlement does not adopt or signify acquiescence in any insurance policy interpretations or coverage theories. Nothing in this paragraph shall constitute a waiver of Hartford's attorney-client privilege.

**5.3** SB Decking, Inc. shall, to the extent of its Non-Insurance Assets, pay all defense costs incurred by Retained Counsel in connection with any Claim indemnified under Section 5.1 of this Agreement and shall pay all settlement and judgments entered in connection with such Claims.

**5.4** Sections 5.2 and 5.3 shall not apply if SB Decking Inc. does not have Non-Insurance Assets with which to defend, indemnify, protect, save, and hold harmless Hartford from and against any Indemnified Claim. Moreover, notwithstanding any other provision of this Section 5 to the contrary, Hartford shall have the right to assume at its own expense its defense in any Indemnified Claim. In that event, Hartford shall control its defense and the settlement or compromise of the Indemnified Claim (except that if Hartford settles or compromises an Indemnified Claim without the consent of SB Decking, Inc., which may not unreasonably be withheld, SB Decking, Inc. shall have no obligation to indemnify Hartford for such settlement or compromise). Subject to the foregoing, Hartford's assumption of its defense shall not act as a waiver or release of SB Decking Inc.'s obligations with respect to any Indemnified Claim.

**5.5** Quaker Chemical Corporation (and any successor to Quaker Chemical Corporation) shall indemnify and hold Hartford harmless from Claims by any Person that are the result of the actual (i.e., in fact, as opposed to alleged) use of the Claims Account in a manner inconsistent with Section 3 of this Agreement.

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**5.6** Quaker Chemical Corporation's (or its successor's) obligation to indemnify and hold Hartford harmless under Section 5.5 of this Agreement shall arise only upon a final judgment or award that is not subject to further appeal by a court or arbitrator(s), in a proceeding to which Quaker Chemical Corporation or its successor is a party, of Hartford's liability to a Person(s) that is the result of the actual use of the Claims Account in a manner inconsistent with Section 3 of this Agreement. Upon the entry of such a final judgment or award, Quaker Chemical Corporation (or its successor) shall indemnify and hold Hartford harmless against: (1) all of Hartford's reasonable costs, including but not limited to attorney's fees, of defending against liability that is the result of the actual use of the Claims Account in a manner inconsistent with Section 3 of this Agreement; and, (2) the judgment or award entered against Hartford, or reasonable settlement made by Hartford, for liability that is the result of the actual use of the Claims Account in a manner inconsistent with Section 3 of this Agreement.

**6. Contribution Claims By Other Insurers and Judgment Reduction.**

6.1 In the event that SB Decking and/or Quaker seek coverage for any Claim from another insurer and such insurer claims a right of contribution or indemnity from Hartford under the Policies, Hartford, SB Decking and Quaker will take the position that the releases set forth in this Agreement extinguish any such right of contribution or indemnity against Hartford. Hartford will also not oppose the position that such other insurer, at most, is entitled only to credit against obligations that it would otherwise owe to SB Decking and/or Quaker for amounts that would otherwise have been owed by Hartford under the Policies only to the extent that such amounts remain available from the proceeds of this Settlement. In the event

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that it is finally established by a final judgment from which no further appeal is possible that another insurer is entitled to obtain contribution or indemnification from Hartford under the Hartford Policies for some portion of amounts that such other insurer has become obligated under its insurance policies to pay to SB Decking or Quaker, SB Decking and/or Quaker will reduce the amount of any judgment obtained against such other insurer to the extent of any amount Hartford has been adjudged liable to pay to such other insurer by way of contribution or indemnity. To ensure that such a reduction is accomplished, Hartford shall be entitled to assert this Section 6 as an additional defense to any action that may be brought against it by other insurers and to request that the court or appropriate tribunal issue such orders as are appropriate to protect Hartford's rights under this Agreement and applicable law.

**7. Contribution/Indemnification Claims.**

**7.1** SB Decking and Quaker agree that they will use their best efforts to obtain an agreement from any insurers with which either of them in the future may enter into any settlement agreement regarding Asbestos Claims against SB Decking and/or Quaker that such settling insurer will not seek indemnification, contribution, subrogation or similar relief from Hartford.

**7.2 Contribution Claims By Hartford:** Hartford agrees that it will not seek contribution or indemnification from any other insurer (other than a Hartford reinsurer) for any amounts that it has paid for Asbestos Claims against SB Decking and/or Quaker in the past or pursuant to this Settlement unless such other insurer asserts claims for contribution or indemnity against Hartford with respect to amounts that such other insurer has paid under its insurance policies for Asbestos Claims against SB Decking and/or Quaker, and then only to that extent. Quaker and SB Decking agree to seek a similar commitment from any of their other insurers with which they make a future settlement.

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**8. Condition Subsequent:** The Parties acknowledge that the United States Congress is currently considering legislation (hereinafter the “Federal Asbestos Legislation”) that, if enacted, would impact the Asbestos Lawsuits and that would require Hartford to make certain payments into a trust established for the benefit of asbestos-related bodily injury claimants that Hartford would not be entitled to reduce by reason of the Seven Million Five Hundred Thousand Dollars (\$7,500,000) payment that Hartford is scheduled to make 380 days after the Effective Date of this Agreement (hereinafter the “Second Payment”). The Parties acknowledge that at the present time it appears unlikely that the Federal Asbestos Legislation will be enacted into law prior to 380 days after the Effective Date of this Agreement. Nonetheless, if the President of the United States signs the Federal Asbestos Legislation into law prior to that date:

- (i) Hartford’s obligation to make the Second Payment will be cancelled; and
- (ii) the Parties expressly agree that all other terms and conditions of this Agreement, including, without limitation, the releases set forth in Section 3 shall not be affected by such Federal Asbestos Legislation or any amendment thereto.

**9. Confidentiality.**

**9.1** This Agreement and all of its terms, and all documents, discussions and negotiations leading or related to it shall be and remain confidential and shall not be disclosed to any non-Party, except that such disclosures may be made by:

- a. Hartford in connection with reinsurance Claims and obligations in connection with the subject matter of this Agreement;

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b. Quaker and SB Decking in connection with Claims against, or settlement negotiations with, other insurers relating to insurance coverage for Asbestos Claims; provided, however, that disclosure shall be made only upon such insurer executing an agreement or becoming subject to a court order requiring such insurer to maintain the disclosed information as confidential;

c. Any Party to their respective auditors, regulators and lenders as deemed reasonably necessary;

d. Any Party as required by law, including but not limited to the securities laws of the United States or any state thereof, or as ordered by a court of competent jurisdiction;

e. Any Party with the written consent of the other;

f. Any Party, in an action to enforce the terms of this Agreement against another Party, provided that a protective order or confidentiality agreement is entered in advance to limit disclosure of the terms of the Agreement.

**9.2** Any Party making a disclosure pursuant to Section 9.1.c shall notify the Person receiving the information that the information is confidential and, to the extent reasonably practicable, shall obtain a commitment from that Person to maintain its confidentiality.

**9.3** In the event any Party believes disclosure is or may be required by law under Section 9.1.d., it shall give the other Party at least thirty (30) days written notice before disclosing the information, unless the Party is required by law or court order to provide earlier disclosure, in which case notice shall be provided as soon as possible.



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9.4 This confidentiality provision is a material term of this Agreement and is a significant inducement to the Parties to enter the Agreement.

**10. Representations and Warranties.**

10.1 Each Party represents and warrants that it has full power and authority to enter into and deliver this Agreement; that each individual signing this Agreement on behalf of the Party is fully authorized to do so; that it has not sold, assigned, transferred, conveyed, or otherwise disposed of any claim, demand or right surrendered by virtue of this Agreement; and that this Agreement is enforceable in accordance with its terms.

10.2 Each Party further represents and warrants on its own behalf that:

- a. It is a corporation duly organized and validly existing in good standing under the laws of one of the states of the United States of America;
- b. It has taken all necessary corporate and internal legal actions to duly approve the making and performance of this Agreement and that no further corporate or other internal approval is necessary;
- c. The making and performance of this Agreement will not violate any provision of law, or its articles of incorporation, charter or by-laws; and
- d. It has read this entire Agreement and (i) knows and understands the contents thereof, (ii) knows that the terms are contractual and not merely recitals, (iii) has signed this Agreement of its own free will, and (iv) has obtained and relied on advice of legal counsel.

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**10.3** Quaker represents and warrants that it knows of no entity entitled or which claims to be entitled to coverage under the Policies except those entities that have released Hartford under Section 4 of this Agreement.

**10.4** Quaker and SB Decking represent and warrant that they shall use the Claims Account solely to pay defense and indemnity costs incurred by or on behalf of SB Decking or Quaker in connection with Asbestos Claims arising out of the business of SB Decking, or as is otherwise permitted by Section 3 of this Agreement.

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**11. Reliance on Representations.** Each of the Parties acknowledges that, but for the provision of each of the warranties, representations, and acknowledgments set forth herein, neither of the Parties would enter into this Agreement.

**12. Binding Effect.** This Agreement shall be binding upon and inure to the benefit of the Parties and, subject to any provisions restricting assignment, to their successors and assigns.

**13. No Admission.** This Agreement is intended to be and is a commercial accommodation among the Parties. Nothing in this Agreement, nor in the payment or receipt of the Settlement Amount under this Agreement, shall be construed as an admission by any Party of liability or of any duties, rights or obligations under the Policies. Nothing in this Agreement shall be construed as signifying acquiescence in, admission of or acceptance by any Party of another Party's claims, defenses, arguments, positions, or interpretations.

**14. Agreement Inadmissible.** Any evidence of the terms, negotiations or discussions associated with this Agreement shall be inadmissible in any action or proceeding for purposes of establishing any rights, duties, or obligations of the Parties, except in (i) an action or proceeding to enforce the terms of this Agreement, or (ii) any possible action or proceeding between Hartford and any of its reinsurers. This Agreement shall not be used, as evidence or in any other manner, in any court or dispute resolution proceeding to create, prove or interpret Hartford obligations under any insurance policy issued to SB Decking or to any other Person.

**15. No Precedential Value.** The compromise reflected in this Agreement shall be without precedential value and is not intended to be, nor shall it be, construed as an interpretation of any insurance policy.

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**16. Entire And Integrated Agreement.** This Agreement, together with any exhibits hereto, is intended by the Parties as a final expression of their agreement and is intended to be a complete and exclusive statement of the agreement and understanding of the Parties with respect to the subject matters contained herein.

**17. Headings.** The section titles, captions, and headings contained in this Agreement are inserted only as a matter of convenience and for reference, and shall in no way be construed to define, limit, or extend the scope of this Agreement or the effect of any of its provisions.

**18. Amendments.** Neither this Agreement nor any term set forth herein may be changed, waived, discharged, or terminated orally or in writing, except by a writing signed by all of the Parties, and the observance of any such term may be waived (either generally or in a particular instance either retroactively or prospectively) by a writing signed by the Parties against whom such waiver is to be asserted.

**19. Severability.** If any provisions of this Agreement, or the application thereof, shall for any reason or to any extent be construed by a court of competent jurisdiction to be invalid or unenforceable, the remainder of this Agreement, and application of such provisions to other circumstances, shall remain in effect and be interpreted so as best to reasonably effect the intent of the Parties. Notwithstanding the foregoing, if the releases set forth in Section 4, or the indemnification obligations set forth in Section 5 are found to be unenforceable or invalid by a court of competent jurisdiction, then it shall be the intent of the Parties that such invalidity or unenforceability shall be cause for rescission of the entire Agreement at the election of the Party whose interests are injured by the finding of invalidity or unenforceability.

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**20. No Waiver.** Neither the waiver by a Party of a breach of or a default under any of the provisions of this Agreement, nor the failure of a Party, on one or more occasion, to enforce any of the provisions of this Agreement or to exercise any right or privilege hereunder shall thereafter be construed as a waiver of any subsequent breach or default of a similar nature, or as a waiver of any such provisions, rights, or privileges hereunder.

**21. Attorneys' Fees, Costs and Expenses.** Each of the Parties shall bear its own costs, attorneys' fees, and expenses in connection with the matters set forth in this Agreement, including the negotiation and preparation of this Agreement.

**22. Assignment.** This Agreement shall not be assignable by any Party hereto without the prior written consent of the other Parties hereto, which consent shall not be unreasonably withheld; provided, however, that this provision shall not require such prior written consent for an assignment by a Party hereto by merger, consolidation, or operation of law.

**23. No Benefits to Third Parties.** This Agreement is intended to confer rights and benefits only on SB Decking, Quaker and Hartford. No other Person shall have any legally enforceable rights or benefits under this Agreement, except for the Parties' respective successors and assigns as permitted hereunder, and except to the extent the releases set forth in this Agreement inure to the benefit of Persons not signatories hereto.

**24. Third-Party Challenge to Agreement.** In the event that any action or proceeding of any type whatsoever is commenced or prosecuted by any Person not a Party hereto to invalidate, interpret, or prevent the validation, enforcement, or carrying out of all or any of the provisions of this Agreement, the Parties mutually agree, represent, warrant, and covenant to cooperate fully in opposing such action or proceeding.

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**25. Additional Necessary Documents.** The Parties agree to execute such additional documents as may be reasonably required in order to carry out the purpose and intent of this Agreement, or to evidence anything contained herein.

**26. Written Notice.** All notices, demands, or other communications to be provided pursuant to this Agreement shall be in writing and sent by facsimile, overnight mail or United States first-class mail, postage prepaid, to the other Party at the addresses set forth below, or to such other person or address as either SB Decking, Quaker or Hartford may designate in writing from time to time:

Hartford:

John Kinney  
Vice President  
Complex Claim Group  
The Hartford  
Hartford Plaza  
690 Asylum Avenue  
Hartford, CT 06115

and

Lee H. Ogburn  
Kramon & Graham, P.A.  
One South Street, Suite 2600  
Baltimore, MD 21202

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Quaker:

Jeffrey Benoliel, Esquire  
General Counsel  
Quaker Chemical Corp.  
One Quaker Park  
901 Hector Street  
Conshohocken, PA 19428

William P. Skinner, Esquire  
Covington & Burling  
1201 Pennsylvania Avenue, N.W.  
Washington, DC 20004

SB Decking:

Ms. Florence Larcamp  
SB Decking  
c/o Quaker Chemical Corp.  
One Quaker Park  
901 Hector Street  
Conshohocken, PA 19428

William P. Skinner, Esquire  
Covington & Burling  
1201 Pennsylvania Avenue, N.W.  
Washington, DC 20004

**27. Execution In Counterparts.** This Agreement may be signed by the Parties and counterparts of the signature pages may be combined to create a document binding on all of the Parties hereto and together shall constitute one and the same instrument.

**28. Construction.** This Agreement is not a contract of insurance and shall not be interpreted as such. Each of the Parties hereto participated in the drafting of this Agreement after consulting with counsel. Accordingly, the language of this Agreement shall not be presumptively construed either in favor of or against any of the Parties hereto.

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IN WITNESS WHEREOF, the Parties hereto have executed this Agreement as of the date set forth opposite the respective signatures below.

**On Behalf of Hartford Accident & Indemnity Company**

**By:** /s/ John Kinney  
**Name:** John Kinney  
**Title:** Vice President  
**Date:** 12/12/05  
**Witness:** /s/ Tracy Chartoonrean



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**On Behalf of Quaker Chemical Corporation**

**By:** /s/ D. Jeffry Benoiel  
**Name:** D. Jeffry Benoiel  
**Title:** Vice President-Corporate Secretary, General Council  
**Date:** 12/12/05  
**Witness:** /s/ Robert T. Traub

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**On Behalf of SB Decking, Inc.**

**By:** /s/ Florence J. Larcamp  
**Name:** Florence J. Larcamp  
**Title:** Treasurer  
**Date:** 12/12/05  
**Witness:** /s/ Robert T. Traub

**EXHIBIT 1**

Citizens Insurance Company of Missouri  
Citizens Insurance Company of New Jersey  
English and Scottish Reinsurance Company, Ltd.  
Ercos  
Excess Insurance Company Limited  
Fencourt Reinsurance Company, Ltd.  
First State Insurance Company  
First State Management Group, Inc.  
First State Management Group Insurance Services of Massachusetts, LLC  
First State Management Group Insurance Services of Texas, LLC  
First State Underwriters Agency of New England Reinsurance Corp.  
Hart Re Group, L.L.C.  
Hartford Accident and Indemnity Company  
Hartford Casualty Insurance Company  
Hartford Financial Services, LLC  
Hartford Fire Insurance Company  
Hartford Fire International (Germany) GMBH  
Hartford Fire International, Ltd.  
Hartford Insurance Company of Alabama  
Hartford Insurance Company of Connecticut  
Hartford Insurance Company of Illinois  
Hartford Insurance Company of the Midwest  
Hartford Insurance Company of the Southeast  
Hartford Insurance, Ltd.  
Hartford International Management Services Company, L.L.C.  
Hartford Lloyds Corp.  
Hartford Lloyds Insurance Company  
Hartford Management, Ltd.  
Hartford Management Services, Ltd.  
Hartford of Florida, L.L.C.  
Hartford RE Company  
Hartford Specialty Company  
Hartford Specialty Insurance Services of Texas LLC  
Hartford Underwriters Insurance Company  
HartRe Company, L.L.C.  
Heritage Holdings, Inc.  
Heritage Reinsurance Company, Ltd.  
Horizon Management Group, L.L.C.  
ITT Hartford Insurance Company  
ITT New England Management Company, Inc.

London-Canada Insurance Company  
London & Edinburgh General Insurance Company, Ltd.  
London & Edinburgh Insurance Company, Ltd.  
London-Canada Insurance Company  
New England Insurance Company  
New England Reinsurance Corporation  
New Ocean Insurance Co., Ltd.  
New York Underwriters Insurance Company  
Nutmeg Insurance Company  
Omni Indemnity Company  
Omni Insurance Company  
Omni Insurance Group, Inc.  
Pacific Insurance Company, Limited  
Property & Casualty Insurance Company of Hartford  
Royal Indemnity Company or other Royal insurance writing companies that issued policies with the following policy number prefixes: "REB", "REC",  
"RED", "REE", "REF", "REH" and "REK"  
Sentinel Insurance Company, Ltd.  
Specialty Risk Services, Inc.  
The Confluence Group, Inc.  
The Hartford Fidelity & Bonding Company  
The Hartford Financial Services Group, Inc.  
The Hartford International Financial Services Group, L.L.C.  
The Hartford International Financial Services Group Compania de Seguros e Reaseguros S.A.  
Trumbull Associates. L.L.C.  
Trumbull Insurance Company  
Trumbull Recovery Services, Inc.  
Twin City Fire Insurance Company  
Zwolsche Algemeene B.V.  
Zwolsche Algemeene Beleggingen B.V.  
Zwolsche Algemeene Beleggingen II B.V.  
Zwolsche Algemeene Beleggingen III B.V.  
Zwolsche Algemeene Europa B.V.  
Zwolsche Algemeene Herverzekering B.V.  
Zwolsche Algemeene Hypotheken, N.V.  
Zwolsche Algemeene Levens Verzekering N.V.  
Zwolsche Algemeene N.V.  
Zwolsche Algemeene Schadeverzekering N.V.  
Zwolsche Algemeene Verzekering N.V.

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**Exhibit 2**

<u>Writing Company</u>	<u>Policy Number</u>	<u>Effective Dates</u>
Hartford A&I	39 C 845326	4/30/77 – 4/30/78
Hartford A&I	39 C 847123	4/30/78 – 4/30/79
Hartford A&I	39 C 848601	4/30/79 – 4/30/80
Hartford A&I	39 HU 491325	4/30/77 – 4/30/78
*Hartford A&I	39 HU 491426	10/26/79 – 10/26/80
Hartford A&I	14 WZ 203756	4/30/80 – 4/30/81
Hartford A&I	14 WZ 203756	4/30/81 – 4/30/82

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\* Alleged coverage to Selby Battersby; Policy issued to Pilot School, Inc.

## SUBSIDIARIES AND AFFILIATES OF THE REGISTRANT

Name	Jurisdiction of Incorporation	Percentage of voting securities owned directly or indirectly by Quaker
*Quaker Chemical Corporation	Delaware, U.S.A.	100%
+*Quaker Chemical Management Inc.	Delaware, U.S.A.	100%
+SB Decking, Inc. (formerly Selby, Battersby & Co.)	Delaware, U.S.A.	100%
*AC Products, Inc.	California, U.S.A.	100%
*Epmar Corporation	California, U.S.A.	100%
+*Quaker QP, Inc.	Pennsylvania, U.S.A.	100%
*Quaker Automotive Italia, S.r.l.	Italy	100%
*Quaker Chemical Europe B.V.	Holland	100%
*Quaker Chemical B.V.	Holland	100%
*Quaker Chemical (China) Co. Ltd.	China	100%
*Quaker China Holdings B.V.	Holland	100%
*Quaker Chemical Canada Limited	Ontario, Canada	100%
*Quaker Chemical Hungary Ltd.	Hungary	100%
*Quaker Chemical Limited	United Kingdom	100%
*Quaker Chemical S.A.	France	100%
*Quaker Chemical, S.A.	Spain	100%
+*Quaker Denmark ApS	Denmark	100%
*Quaker Chemical S.A.	Argentina	100%
+*Quaker Chemical Participacoes, Ltda.	Brazil	100%
*Quaker Chemical Limited	Hong Kong	100%
*Quaker Chemical Holdings South Africa (Pty) Limited	Republic of South Africa	100%
*Quaker Italia, S.r.l.	Italy	100%
*Quaker Australia Holdings Pty. Limited	Victoria, Australia	100%
*Quaker Shanghai Trading Company Limited	China	100%
*Q2 Technologies, LLC	Nevada, U.S.A.	70%
*Quaker Chemical Industria e Comercio Ltda.	Brazil	100%
*Quaker Chemical Operacoes, Ltda.	Brazil	100%
*Wuxi Quaker Chemical Co., Ltd.	China	60%
*Quaker Chemical India Limited	India	55%
*Quaker Chemical (Australasia) Pty. Limited	New South Wales, Australia	51%
*Quaker Chemical South Africa (Pty.) Ltd.	Republic of South Africa	51%
**Quaker Park Associates, LP	Pennsylvania, U.S.A.	50%
**Nippon Quaker Chemical, Ltd.	Japan	50%
**Kelco Quaker Chemical, S.A.	Venezuela	50%
**Tecniquimia Mexicana S.A. de C.V.	Mexico	40%

+ A non-operating company.

\* Included in the consolidated financial statements.

\*\* Accounted for in the consolidated financial statements under the equity method.

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (Registration No. 333-19957) and Form S-8 (Registration Nos. 002-57924, 033-54158, 033-51655, 333-26793, 333-88229, 333-48130, 333-58676, 333-65400, 333-104354 and 333-115713) of Quaker Chemical Corporation of our report dated March 10, 2006 relating to the financial statements, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP

Philadelphia, PA  
March 13, 2006

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER OF THE COMPANY PURSUANT TO RULE 13A-14(A) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

I, Ronald J. Naples, certify that:

1. I have reviewed this annual report on Form 10-K of Quaker Chemical Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2006

/s/ RONALD J. NAPLES  
\_\_\_\_\_  
Ronald J. Naples  
Chief Executive Officer



**CERTIFICATION OF CHIEF FINANCIAL OFFICER OF THE COMPANY PURSUANT TO RULE 13A-14(A) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

I, Neal E. Murphy, certify that:

1. I have reviewed this annual report on Form 10-K of Quaker Chemical Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2006

/s/ NEAL E. MURPHY  
\_\_\_\_\_  
Neal E. Murphy  
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350**

The undersigned hereby certifies that the Form 10-K Annual Report of Quaker Chemical Corporation (the "Company") for the annual period ended December 31, 2005 filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 13, 2006

/s/ RONALD J. NAPLES

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**Ronald J. Naples**  
Chief Executive Officer of Quaker Chemical Corporation

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350**

The undersigned hereby certifies that the Form 10-K Annual Report of Quaker Chemical Corporation (the "Company") for the annual period ended December 31, 2005 filed with the Securities and Exchange Commission (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: March 13, 2006

/s/ NEAL E. MURPHY

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Neal E. Murphy  
Chief Financial Officer of Quaker Chemical Corporation