BALCHEM CORP
Form 10-Q
November 02, 2012

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For The Quarterly Period Ended September 30, 2012

or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission File Number 1-13648

BALCHEM CORPORATION
(Exact name of registrant as specified in its charter)

Maryland (State or other jurisdiction of incorporation or organization)	13-2578432 (I.R.S. Employer Identification Number)
52 Sunrise Park Road, New Hampton, New York (Address of principal executive offices)	10958 (Zip Code)

845-326-5600
Registrant's telephone number, including area code:

Indicate by a check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

As of October 26, 2012 the registrant had 29,371,972 shares of its Common Stock, $.06 2/3 par value, outstanding.

Part I. Financial Information
Item 1. Financial Statements

BALCHEM CORPORATION
Condensed Consolidated Balance Sheets
(Dollars in thousands, except per share data)

Assets		September 30, 2012 (unaudited)	December 31, 2011
Current assets:			
Cash and cash equivalents	$	147,182	$114,781
Accounts receivable, net		36,931	34,433
Inventories		20,311	18,637
Prepaid expenses		1,869	2,793
Prepaid income taxes		-	4,142
Deferred income taxes		579	556
Other current assets		580	398
Total current assets		207,452	175,740
Property, plant and equipment, net		47,468	44,282
Goodwill		28,515	28,515
Intangible assets with finite lives, net		19,747	22,706
Other assets		474	474
Total assets	$	303,656	$271,717
Liabilities and Stockholders' Equity			
Current liabilities:			
Trade accounts payable	$	11,906	$11,526
Accrued expenses		11,218	8,435
Accrued compensation and other benefits		3,129	4,328
Dividends payable		-	5,237
Income taxes payable		2,081	-
Current portion of long-term debt		-	1,387
Total current liabilities		28,334	30,913
Deferred income taxes		4,853	5,984
Other long-term obligations		3,187	2,811
Total liabilities		36,374	39,708
Commitments and contingencies (note 12)			
Stockholders' equity:			
Preferred stock, $25 par value. Authorized 2,000,000 shares; none issued and outstanding		-	-
Common stock, $.0667 par value. Authorized 60,000,000 shares; 29,356,818 shares issued and outstanding at September 30, 2012 and 29,165,721 shares issued and outstanding at December 31, 2011		1,957	1,944

Additional paid-in capital		55,178		49,933
Retained earnings		211,184		181,070
Accumulated other comprehensive loss		(1,037	)	(938)
Total stockholders' equity		267,282		232,009
Total liabilities and stockholders' equity	$	303,656		$271,717

See accompanying notes to consolidated financial statements.

BALCHEM CORPORATION
Condensed Consolidated Statements of Earnings
(Dollars in thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net sales	$75,116	$74,439	$230,333	$222,134
Cost of sales	51,718	51,822	163,193	156,976
Gross margin	23,398	22,617	67,140	65,158
Operating expenses:				
Selling expenses	3,810	4,042	12,066	12,331
Research and development expenses	897	648	2,620	2,257
General and administrative expenses	2,451	2,752	7,714	8,038
	7,158	7,442	22,400	22,626
Earnings from operations	16,240	15,175	44,740	42,532
Other expenses (income):				
Interest income	(2)	(39)	(9)	(179)
Interest expense	3	32	8	72
Other, net	14	(56)	4	(327)
Earnings before income tax expense	16,225	15,238	44,737	42,966
Income tax expense	5,352	4,453	14,624	13,697
Net earnings	$10,873	$10,785	$30,113	$29,269
Net earnings per common share - basic	$0.37	$0.38	$1.04	$1.03
Net earnings per common share - diluted	$0.36	$0.36	$0.99	$0.97

See accompanying notes to consolidated financial statements.

BALCHEM CORPORATION
Condensed Consolidated Statements of Comprehensive Income
(Dollars in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Net earnings	$10,873	$10,785	$30,113	$29,269
Other comprehensive income (loss), net of tax:				
Net foreign currency translation adjustment	326	(675)	(84)	143
Net change in postretirement benefit plan, net of taxes of $1 and $1 for the three months ended September 30, 2012 and 2011, and $4 and $2 for the nine months ended September 30, 2012 and 2011	(4)	(2)	(15)	(5)
Other comprehensive income (loss)	322	(677)	(99)	138
Comprehensive income	$11,195	$10,108	$30,014	$29,407

See accompanying notes to consolidated financial statements.

BALCHEM CORPORATION
Condensed Consolidated Statements of Cash Flows
(Dollars in thousands)
(unaudited)

	Nine Months Ended September 30, 2012	2011
Cash flows from operating activities:		
Net earnings	$30,113	$29,269
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	7,213	6,872
Stock compensation expense	2,933	2,840
Shares issued under employee benefit plans	310	398
Deferred income tax expense	(1,155)	(716)
Foreign currency transaction loss	74	180
Loss on impairment of assets	-	92
Changes in assets and liabilities		
Accounts receivable	(2,759)	(4,270)
Inventories	(1,712)	(2,652)
Prepaid expenses and other current assets	735	960
Accounts payable and accrued expenses	2,067	(800)
Income taxes	6,237	1,157
Other	305	750
Net cash provided by operating activities	44,361	34,080
Cash flows from investing activities:		
Capital expenditures	(7,493)	(4,851)
Proceeds from sale of property, plant and equipment	-	28
Intangible assets acquired	(11)	(23)
Net cash used in investing activities	(7,504)	(4,846)
Cash flows from financing activities:		
Proceeds from long-term debt	178	-
Principal payments on long-term debt	(1,377)	(1,182)
Proceeds from stock options exercised and restricted shares purchased	1,312	2,600
Excess tax benefits from stock compensation	1,668	1,392
Dividends paid	(5,237)	(4,310)
Purchase of treasury stock	(964)	(108)
Net cash used in financing activities	(4,420)	(1,608)
Effect of exchange rate changes on cash	(36)	(7)
Increase in cash and cash equivalents	32,401	27,619
Cash and cash equivalents beginning of period	114,781	77,253

Cash and cash equivalents end of period	$147,182	$104,872
Supplemental Cash Flow Information - see Note 9		

See accompanying notes to consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All dollar amounts in thousands, except share and per share data)

NOTE 1 - CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements presented herein have been prepared by the Company in accordance with the accounting policies described in its December 31, 2011 consolidated financial statements, and should be read in conjunction with the consolidated financial statements and notes, which appear in the Annual Report on Form 10-K for the year ended December 31, 2011. References in this report to the “Company” mean either Balchem Corporation or Balchem Corporation and its subsidiaries, including BCP Ingredients, Inc., Aberco, Inc., Balchem BV, Balchem Trading BV, and Balchem Italia Srl, on a consolidated basis, as the context requires.

In the opinion of management, the unaudited condensed consolidated financial statements furnished in this Form 10-Q include all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature. The condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP” or “GAAP”) governing interim financial statements and the instructions to Form 10-Q and Article 10 of Regulation S-X under the Securities Exchange Act of 1934 and therefore do not include some information and notes necessary to conform to annual reporting requirements. Certain prior year amounts have been reclassified to conform to current year presentation. The results of operations for the nine months ended September 30, 2012 are not necessarily indicative of the operating results expected for the full year or any interim period.

NOTE 2 - STOCKHOLDERS’ EQUITY

STOCK-BASED COMPENSATION

The Company records stock-based compensation in accordance with the provisions of ASC 718, “Compensation-Stock Compensation.” The Company’s results for the three and nine months ended September 30, 2012 and 2011 reflected the following stock-based compensation cost, and such compensation cost had the following effects on net earnings:

	Increase/(Decrease) for the Three Months Ended September 30,	
	2012	2011
Cost of sales	$ 144	$ 145
Operating expenses	843	761
Net earnings	(627)	(569)

	Increase/(Decrease) for the Nine Months Ended September 30,	
	2012	2011
Cost of sales	$ 433	$ 436
Operating expenses	2,500	2,404
Net earnings	(1,858)	(1,782)

As required by ASC 718, the Company has made an estimate of expected forfeitures based on its historical experience and is recognizing compensation cost only for those stock-based compensation awards expected to vest.

The Company's stock incentive plans allow for the granting of restricted stock awards and options to purchase common stock. Both incentive stock options and nonqualified stock options can be awarded under the plans. No option will be exercisable for longer than ten years after the date of grant. The Company has approved and reserved a number of shares to be issued upon exercise of the outstanding options that is adequate to cover all exercises. As of September 30, 2012, the plans had 4,509,524 shares available for future awards. Compensation expense for stock options and restricted stock awards is recognized on a straight-line basis over the vesting period, generally three years for stock options, four years for employee restricted stock awards, and four to seven years for non-employee director restricted stock awards. Certain awards provide for accelerated vesting if there is a change in control (as defined in the plans) or other qualifying events.

Option activity for the nine months ended September 30, 2012 and 2011 is summarized below:

For the nine months ended September 30, 2012	Shares (000s)	Weighted Average Exercise Price	Aggregate Intrinsic Value ($000s)	Weighted Average Remaining Contractual Term
Outstanding as of December 31, 2011	2,514	$14.68	$65,043	
Granted	226	29.14		
Exercised	(150)	8.73		
Forfeited	(5)	28.87		
Outstanding as of September 30, 2012	2,585	$16.26	$52,983	5.3
Exercisable as of September 30, 2012	2,010	$12.66	$48,402	4.3

For the nine months ended September 30, 2011	Shares (000s)	Weighted Average Exercise Price	Aggregate Intrinsic Value ($000s)	Weighted Average Remaining Contractual Term
Outstanding as of December 31, 2010	2,955	$14.21	$57,930	
Granted	15	40.59		
Exercised	(226)	11.52		
Forfeited	(50)	24.47		
Outstanding as of September 30, 2011	2,694	$14.39	$61,814	5.7
Exercisable as of September 30, 2011	2,006	$10.69	$53,394	4.7

ASC 718 requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. 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: dividend yields of 0.5% and 0.5%; expected volatilities of 41% and 36%; risk-free interest rates of 0.8% and 1.4%; and expected lives of 4.6 and 4.5 years, in each case for the nine months ended September 30, 2012 and 2011, respectively.

The Company used a projected expected life for each award granted based on historical experience of employees' exercise behavior. Expected volatility is based on the Company's historical volatility levels. Dividend yields are based on the Company's historical dividend yields. Risk-free interest rates are based on the implied yields currently available on U.S. Treasury zero coupon issues with a remaining term equal to the expected life.

Other information pertaining to option activity during the three and nine months ended September 30, 2012 and 2011 was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Weighted-average fair value of options granted	$11.50	$13.48	$9.76	$12.37
Total intrinsic value of stock options exercised ($000s)	$1,659	$952	$4,249	$6,081

Non-vested restricted stock activity for the nine months ended September 30, 2012 and 2011 is summarized below:

Nine months ended September 30, 2012	Shares (000s)	Weighted Average Grant Date Fair Value
Non-vested balance as of December 31, 2011	354	$ 18.77
Granted	54	30.60
Vested	(80)	13.72
Non-vested balance as of September 30, 2012	328	$ 21.96

Nine months ended September 30, 2011	Shares (000s)	Weighted Average Grant Date Fair Value
Non-vested balance as of December 31, 2010	363	$ 17.66
Granted	1	40.88
Vested	(7)	12.41
Forfeited	(17)	19.12
Non-vested balance as of September 30, 2011	340	$ 17.77

As of September 30, 2012 and 2011, there was $6,267 and $5,658 respectively, of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans. As of September 30, 2012, the unrecognized compensation cost is expected to be recognized over a weighted-average period of 1.6 years. The Company estimates that share-based compensation expense for the year ended December 31, 2012 will be approximately $3,900.

REPURCHASE OF COMMON STOCK

The Company has an approved stock repurchase program. The total authorization under this program is 3,763,038 shares. Since the inception of the program in June 1999, a total of 2,033,700 shares have been purchased, none of which remained in treasury at September 30, 2012 or 2011. During the nine months ended September 30, 2012, a total of 23,212 shares have been purchased at an average cost of $41.53 per share. The Company intends to acquire shares from time to time at prevailing market prices if and to the extent it deems it advisable to do so based on its assessment of corporate cash flow, market conditions and other factors.

NOTE 3 - INVENTORIES

Inventories at September 30, 2012 and December 31, 2011 consisted of the following:

	September 30, 2012	December 31, 2011
Raw materials	$ 8,211	$ 7,456
Work in progress	1,672	1,344
Finished goods	10,428	9,837
Total inventories	$ 20,311	$ 18,637

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at September 30, 2012 and December 31, 2011 are summarized as follows:

	September 30, 2012	December 31, 2011
Land	$ 1,962	$ 1,971
Building	16,388	15,680
Equipment	68,473	66,584
Construction in progress	7,223	2,632
	94,046	86,867
Less: accumulated depreciation	46,578	42,585
Net property, plant and equipment	$ 47,468	$ 44,282

NOTE 5 – INTANGIBLE ASSETS

The Company had goodwill in the amount of $28,515 as of September 30, 2012 and December 31, 2011 subject to the provisions of ASC 350, “Intangibles-Goodwill and Other.”

Identifiable intangible assets with finite lives at September 30, 2012 and December 31, 2011 are summarized as follows:

	Amortization Period (in years)	Gross Carrying Amount at 9/30/12	Accumulated Amortization at 9/30/12	Gross Carrying Amount at 12/31/11	Accumulated Amortization at 12/31/11
Customer lists	10	$37,142	$ 20,003	$37,142	$ 17,272
Regulatory registration costs	10	1,302	317	1,302	220
Patents & trade secrets	15-17	1,580	744	1,571	681
Trademarks & trade names	17	909	395	907	356
Other	5-10	754	481	754	441
		$41,687	$ 21,940	$41,676	$ 18,970

Amortization of identifiable intangible assets was approximately $2,970 for the nine months ended September 30, 2012. Assuming no change in the gross carrying value of identifiable intangible assets, the estimated amortization expense for the remainder of 2012 is $989, approximately $4,000 per annum for 2013 through 2016 and $1,400 in 2017. At September 30, 2012, there were no identifiable intangible assets with indefinite useful lives as defined by ASC 350. Identifiable intangible assets are reflected in “Intangible assets with finite lives, net” in the Company’s condensed consolidated balance sheets. There were no changes to the useful lives of intangible assets subject to amortization during the nine months ended September 30, 2012.

NOTE 6 – NET EARNINGS PER SHARE

The following presents a reconciliation of the net earnings and shares used in calculating basic and diluted net earnings per share:

Three months ended September 30, 2012	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Share Amount
Basic EPS – Net earnings and weighted average common shares outstanding	$ 10,864	29,000,657	$ .37
Effect of dilutive securities – stock options and restricted stock		1,416,067	
Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	$ 10,864	30,416,724	$ .36

Three months ended September 30, 2011	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Share Amount
Basic EPS – Net earnings and weighted average common shares outstanding	$ 10,785	28,618,618	$ .38
Effect of dilutive securities – stock options and restricted stock		1,692,532	
Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	$ 10,785	30,311,150	$ .36

Nine months ended September 30, 2012	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Share Amount
Basic EPS – Net earnings and weighted average common shares outstanding	$ 30,104	28,960,802	$ 1.04
Effect of dilutive securities – stock options and restricted stock		1,379,180	
Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	$ 30,104	30,339,982	$ .99

Nine months ended September 30, 2011	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Share Amount
Basic EPS – Net earnings and weighted average common shares outstanding	$ 29,269	28,531,757	$ 1.03
Effect of dilutive securities – stock options and restricted stock		1,679,963	
Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	$ 29,269	30,211,720	$ .97

The Company had stock options covering 239,647 and 15,200 shares at September 30, 2012 and 2011, respectively, that could potentially dilute basic earnings per share in future periods that were not included in diluted earnings per share because their effect on the period presented was anti-dilutive.

The Company has some share-based payment awards that have non-forfeitable dividend rights. These awards are restricted shares and they participate on a one-for-one basis with holders of common stock. These awards have an immaterial impact as participating securities with regard to the calculation using the two-class method for determining earnings per share.

NOTE 7 – INCOME TAXES

The Company accounts for uncertainty in income taxes in accordance with ASC 740-10, “Accounting for Uncertainty in Income Taxes.” ASC 740-10 clarifies whether or not to recognize assets or liabilities for tax positions taken that may be challenged by a tax authority. All of the unrecognized tax benefits, if recognized in future periods, would impact the Company’s effective tax rate. The Company files income tax returns in the U.S. and in various states and foreign countries. As of September 30, 2012, in the major jurisdictions where the Company operates, it is generally no longer subject to income tax examinations by tax authorities for years before 2008. During the nine months ended September 30, 2012 and 2011, there was no significant change to the amount of unrecognized tax benefits. As of September 30, 2012 and December 31, 2011, the Company had approximately $2,128 and $2,021, respectively, of unrecognized tax benefits. The Company does not anticipate any material change in the total amount of unrecognized tax benefits to occur within the next twelve months. The Company includes interest expense or income as well as potential penalties on unrecognized tax positions as a component of income tax expense in the consolidated statements of earnings. The total amount of accrued interest and penalties related to uncertain tax positions at September 30, 2012 and December 31, 2011 was approximately $600 and $547, respectively, and is included in other long-term obligations.

NOTE 8 - SEGMENT INFORMATION

The Company's reportable segments are strategic businesses that offer products and services to different markets. Presently, the Company has three segments: Specialty Products; Food, Pharma & Nutrition; and Animal Nutrition & Health.

Business Segment Net Sales:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Specialty Products	$ 12,318	$ 12,197	$ 37,032	$ 35,516
Food, Pharma & Nutrition	10,893	10,993	33,406	32,920
Animal Nutrition & Health	51,905	51,249	159,895	153,698
Total	$ 75,116	$ 74,439	$ 230,333	$ 222,134

Business Segment Earnings Before Income Taxes:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Specialty Products	$5,245	$4,677	$14,823	$13,595
Food, Pharma & Nutrition	2,898	3,151	8,996	8,495
Animal Nutrition & Health	8,097	7,347	20,921	20,442
Interest and other income (expense)	(15)	63	(3)	434
Total	$16,225	$15,238	$44,737	$42,966

The following table summarizes domestic (U.S.) and foreign sales for the three and nine months ended September 30, 2012 and September 30, 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Domestic	$50,673	$48,685	$154,426	$145,144
Foreign	24,443	25,754	75,907	76,990
Total	$75,116	$74,439	$230,333	$222,134

NOTE 9 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the nine months ended September 30, 2012 and 2011 for income taxes and interest is as follows:

	Nine Months Ended September 30,	
	2012	2011
Income taxes	$ 9,259	$ 11,445
Interest	$ 7	$ 68

NOTE 10 – LONG-TERM DEBT AND CREDIT AGREEMENTS

The Company and a bank had a Loan Agreement (the “European Loan Agreement”) which provided for an unsecured term loan of €7,500 (the “European Term Loan”). The European Term Loan was payable in equal monthly installments of principal, each equal to 1/84th of the principal of the European Term Loan, together with accrued interest, with remaining principal and interest payable at maturity. Effective April 30, 2010, the European Term Loan was renewed with a new maturity date of May 1, 2014, and was subject to a monthly interest rate equal to EURIBOR plus 1%. As of September 30, 2012, the Company has paid the European Term Loan in full. The European Loan Agreement also provided for a short-term revolving credit facility of €3,000 (the "European Revolving Facility"). The European Revolving Facility was subject to a monthly interest rate equal to EURIBOR plus 1.45%, and accrued interest was payable monthly. The European Revolving Facility matured on May 31, 2012, and the Company did not renew this facility.

The Company and a bank had a Loan Agreement (the “Loan Agreement”), which provided for a short-term revolving credit facility of $6,000 (the "Revolving Facility"). The Revolving Facility was subject to a monthly interest rate equal to LIBOR plus 1%, and accrued interest was payable monthly. The Revolving Facility matured on May 31, 2012, and the Company did not renew this facility.

NOTE 11 - EMPLOYEE BENEFIT PLAN

The Company currently provides postretirement benefits in the form of a retirement medical plan under a collective bargaining agreement covering eligible retired employees of its Verona, Missouri facility.

Net periodic benefit cost for such retirement medical plan for the nine months ended September 30, 2012 and September 30, 2011 was as follows:

	2012	2011
Service cost	$ 40	$ 47
Interest cost	31	49
Amortization of prior service cost	(14)	(14)
Amortization of loss	3	10
Net periodic benefit cost	$ 60	$ 92

The amount recorded on the Company’s balance sheet as of September 30, 2012 for this obligation is $1,152, and it is included in other long-term obligations. The plan is unfunded and approved claims are paid from Company funds. Historical cash payments made under such plan have typically been less than $100 per year.

NOTE 12 – COMMITMENTS AND CONTINGENCIES

In 2002, the Company entered into a ten (10) year lease for approximately 20,000 square feet of office space. In 2012, the Company renewed this lease for six (6) years with an option to extend the lease for an additional five (5) years. The office space serves as the Company’s general offices and as a laboratory facility. The Company leases most of its

vehicles and office equipment under non-cancelable operating leases, which primarily expire at various times through 2022.

Rent expense charged to operations under such lease agreements for the nine months ended September 30, 2012 and 2011 aggregated approximately $708 and $821, respectively. Aggregate future minimum rental payments required under all non-cancelable operating leases at September 30, 2012 are as follows:

Year		
October 1, 2012 to December 31, 2012	$	232
2013		801
2014		625
2015		567
2016		494
2017		476
Thereafter		365
Total minimum lease payments	$	3,560

In 1982, the Company discovered and thereafter removed a number of buried drums containing unidentified waste material from the Company's site in Slate Hill, New York. The Company thereafter entered into a Consent Decree to evaluate the drum site with the New York Department of Environmental Conservation ("NYDEC") and performed a Remedial Investigation/Feasibility Study that was approved by NYDEC in February 1994. Based on NYDEC requirements, the Company cleaned the area and removed additional soil from the drum burial site, which was completed in 1996. The Company continues to be involved in discussions with NYDEC to evaluate test results and determine what, if any, additional actions will be required on the part of the Company to close out the remediation of this site. Additional actions, if any, would likely require the Company to continue monitoring the site. The cost of such monitoring has been less than $5 per year for the period 2004 to date.

The Company's Verona, Missouri facility, while held by a prior owner, was designated by the EPA as a Superfund site and placed on the National Priorities List in 1983, because of dioxin contamination on portions of the site. Remediation conducted by the prior owner under the oversight of the EPA and the Missouri Department of Natural Resources ("MDNR") included removal of dioxin contaminated soil and equipment, capping of areas of residual contamination in four relatively small areas of the site separate from the manufacturing facilities, and the installation of wells to monitor groundwater and surface water contamination by organic chemicals. No ground water or surface water treatment was required. The Company believes that remediation of the site is complete. In 1998, the EPA certified the work on the contaminated soils to be complete. In February 2000, after the conclusion of two years of monitoring groundwater and surface water, the former owner submitted a draft third party risk assessment report to the EPA and MDNR recommending no further action. The prior owner is awaiting the response of the EPA and MDNR to the draft risk assessment.

While the Company must maintain the integrity of the capped areas in the remediation areas on the site, the prior owner is responsible for completion of any further Superfund remedy. The Company is indemnified by the sellers under its May 2001 asset purchase

agreement covering its acquisition of the Verona, Missouri facility for potential liabilities associated with the Superfund site and one of the sellers, in turn, has the benefit of certain contractual indemnification by the prior owner that is implementing the above-described Superfund remedy.

From time to time, the Company is a party to various litigation, claims and assessments. Management believes that the ultimate outcome of such matters will not have a material effect on the Company's consolidated financial position, results of operations, or liquidity.

NOTE 13 – NEW ACCOUNTING PRONOUNCEMENTS

In July 2012, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2012-02, "Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment" ("ASU 2012-02"). This ASU states that an entity has the option first to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount in accordance with Codification Subtopic 350-30, Intangibles-Goodwill and Other, General Intangibles Other than Goodwill. Under the guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The Company is evaluating the impact of this ASU and does not expect its adoption to have a significant impact on the Company's consolidated financial statements.

ItemManagement's Discussion and Analysis of Financial Condition and Results of Operations(All dollar amounts
2. in thousands)

This Report contains forward-looking statements, within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, which reflect our expectation or belief concerning future events that involve risks and uncertainties. Our actions and performance could differ materially from what is contemplated by the forward-looking statements contained in this Report. Factors that might cause differences from the forward-looking statements include those referred to or identified in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011 and other factors that may be identified elsewhere in this Report. Reference should be made to such factors and all forward-looking statements are qualified in their entirety by the above cautionary statements.

Overview

We develop, manufacture, distribute and market specialty performance ingredients and products for the food, nutritional, pharmaceutical, animal health and medical device sterilization industries. Our three reportable segments are strategic businesses that offer products and services to different markets: Specialty Products; Food, Pharma & Nutrition; and Animal Nutrition & Health.

Specialty Products

Our Specialty Products segment operates in industry as ARC Specialty Products.

Ethylene oxide, at the 100% level, is sold as a sterilant gas, primarily for use in the health care industry. It is used to sterilize a wide range of medical devices because of its versatility and effectiveness in treating hard or soft surfaces, composites, metals, tubing and different types of plastics without negatively impacting the performance of the device being sterilized. Contract sterilizers, medical device manufacturers, and medical gas distributors are our principal customers for this product. In addition, we also sell single use canisters with 100% ethylene oxide for use in medical device sterilization. As a fumigant, ethylene oxide blends are highly effective in killing bacteria, fungi, and insects in spices and other seasoning materials.

We sell propylene oxide as a fumigant: to aid in the control of insects and microbiological spoilage; and to reduce bacterial and mold contamination in certain shell and processed nut meats, processed spices, cacao beans, cocoa powder, raisins, figs and prunes. We also sell propylene oxide to customers seeking smaller (as opposed to bulk) quantities and whose requirements include utilization in various chemical synthesis applications, by example to make paints more durable, manufacturing specialty starches and textile coatings.

Food, Pharma & Nutrition

The Food, Pharma & Nutrition (“FPN”) segment provides microencapsulation solutions to a variety of applications in food, pharmaceutical and nutritional ingredients to enhance performance of nutritional fortification, processing, mixing, and packaging applications and shelf-life. Major product applications are baked goods, refrigerated and frozen dough

systems, processed meats, seasoning blends, confections, and nutritional supplements. We also market human grade choline nutrient products through this segment for wellness applications. Choline is recognized to play a key role in the development and structural integrity of brain cell membranes in infants, processing dietary fat, reproductive development and neural functions, such as memory and muscle function. The FPN portfolio also includes a novel smooth dissolve excipient technology, primarily used in chewable tablets or stick-pack dosage forms for nutritional and pharmaceutical products.

Animal Nutrition & Health

Our Animal Nutrition & Health ("ANH") segment provides the animal nutrition market with nutritional products derived from our microencapsulation and chelation technologies in addition to basic choline chloride. Commercial sales of REASHURE® Choline, an encapsulated choline product, NITROSHURETM, an encapsulated urea supplement, and NIASHURETM, our encapsulated niacin product for dairy cows, boosts health and milk production in transition and lactating dairy cows, delivering nutrient supplements that survive the rumen and are biologically available, providing enhanced nutritional levels. We also produce and market chelated mineral supplements for animal feed rations, as our proprietary chelation technology provides trace mineral absorption for various species of production and companion animals. In October 2008, we introduced the first proven rumen-protected lysine for use in dairy rations, AMINOSHURE®-L, which gives nutritionists and dairy producers a precise and consistent source of rumen-protected lysine. ANH also manufactures and supplies basic choline chloride, an essential nutrient for animal health, predominantly to the poultry and swine industries. Choline, which is manufactured and sold in both dry and aqueous forms, plays a vital role in the metabolism of fat. Choline deficiency can result in reduced growth and perosis in poultry; fatty liver, kidney necrosis and general poor health condition in swine. Certain derivatives of choline chloride are also manufactured and sold into industrial applications predominately as a component for hydraulic fracturing of shale natural gas wells. The ANH segment also includes the manufacture and sale of methylamines. Methylamines are a primary building block for the manufacture of choline products and are also used in a wide range of industrial applications.

The Company sells products for all three segments through its own sales force, independent distributors, and sales agents.

The following tables summarize consolidated net sales by segment and business segment earnings from operations for the three and nine months ended September 30, 2012 and September 30, 2011:

Business Segment Net Sales:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Specialty Products	$12,318	$12,197	$37,032	$35,516
Food, Pharma & Nutrition	10,893	10,993	33,406	32,920
Animal Nutrition & Health	51,905	51,249	159,895	153,698
Total	$75,116	$74,439	$230,333	$222,134

Business Segment Earnings From Operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Specialty Products	$5,245	$4,677	$14,823	$13,595
Food, Pharma & Nutrition	2,898	3,151	8,996	8,495
Animal Nutrition & Health	8,097	7,347	20,921	20,442
Total	$16,240	$15,175	$44,740	$42,532

RESULTS OF OPERATIONS

Three months ended September 30, 2012 compared to three months ended September 30, 2011.

Net Sales