

BALCHEM CORP  
Form 10-Q  
August 09, 2007

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For The Quarterly Period Ended June 30, 2007  
or  
[ ] Transition Report Pursuant to Section 13 or 15(d) of  
the Securities Exchange Act of 1934

Commission File Number 1-13648

Maryland 13-2578432

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification Number)

P.O. Box 600 New Hampton, New York 10958

(Address of principal executive offices) (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 ☒ No ☐

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 Exchange Act).

Yes ☐ No ☒

As of August 3, 2007 the registrant had 17,877,870 shares of its Common Stock, \$.06 2/3 par value, outstanding.

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## Part 1 - Financial Information Item 1. Financial Statements

### BALCHEM CORPORATION Condensed Consolidated Balance Sheets (In thousands, except share and per share data) (unaudited)

	Assets -----	June 30, 2007 -----	December 31, -----
Current assets:			
Cash and cash equivalents		\$ 5,312	\$ 5,312
Accounts receivable		23,629	11,629
Inventories		16,639	9,639
Prepaid expenses and other		1,554	1,554
Deferred income taxes		463	463
Other current assets		2,605	2,605
		-----	-----
Total current assets		50,202	28,202
Property, plant and equipment, net		39,986	31,986
Goodwill		26,240	25,240
Intangible assets with finite lives, net		35,250	6,250
Other assets		62	62
		-----	-----
Total assets		\$ 151,740	\$ 92,740
		=====	=====
	Liabilities and Stockholders' Equity -----		
Current liabilities:			
Trade accounts payable		\$ 8,765	\$ 3,765
Accrued expenses		8,331	3,331
Customer deposits and other deferred revenue		482	1,482
Current portion of long-term debt		7,244	7,244
Revolver borrowings		2,695	2,695
Dividends payable		--	1,000
Short-term payable		966	966
Income tax payable		642	642
		-----	-----
Total current liabilities		29,125	9,125
Long-term debt		30,292	30,292
Deferred income taxes		6,510	6,510
Other long-term obligations		1,231	1,231
		-----	-----
Total liabilities		67,158	16,158
		-----	-----
Stockholders' equity:			
Preferred stock, \$25 par value. Authorized 2,000,000 shares; none issued and outstanding		--	--
Common stock, \$.0667 par value. Authorized 25,000,000 shares; 17,872,870 shares issued and outstanding at June 30, 2007 and 17,733,849 shares issued and outstanding at December 31, 2006		797	797
Additional paid-in capital		12,388	10,388
Retained earnings		71,203	63,203
Accumulated other comprehensive income		194	194

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Total stockholders' equity	84,582	75
Total liabilities and stockholders' equity	\$ 151,740	\$ 92

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net sales	\$ 44,371	\$ 25,100	\$ 71,970	\$ 49,697
Cost of sales	32,189	16,300	50,047	32,675
Gross profit	12,182	8,800	21,923	17,022
Operating expenses:				
Selling expenses	3,194	1,941	5,322	3,610
Research and development expenses	615	486	1,184	1,012
General and administrative expenses	1,584	1,503	3,286	3,061
	5,393	3,930	9,792	7,683
Earnings from operations	6,789	4,870	12,131	9,339
Other expenses (income):				
Interest (income)	(29)	(27)	(74)	(89)
Interest expense	527	84	611	170
Other, net	(76)	--	(87)	--
Earnings before income tax expense	6,367	4,813	11,681	9,258
Income tax expense	2,302	1,758	4,175	3,345
Net earnings	\$ 4,065	\$ 3,055	\$ 7,506	\$ 5,913
Net earnings per common share - basic	\$ 0.23	\$ 0.18	\$ 0.42	\$ 0.34
Net earnings per common share - diluted	\$ 0.22	\$ 0.17	\$ 0.41	\$ 0.32

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See accompanying notes to condensed consolidated financial statements.

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## BALCHEM CORPORATION Condensed Consolidated Statements of Cash Flows (In thousands) (unaudited)

	Six Months Ended June 30, 2007	2006
	-----	-----
Cash flows from operating activities:		
Net earnings	\$ 7,506	\$ 5,000
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	2,761	1,000
Shares issued under employee benefit plans	235	
Deferred income taxes	(164)	
Stock compensation expense	784	
Provision for doubtful accounts	--	
Gain on sale of equipment	(11)	
Other	10	
Changes in assets and liabilities net of effects of acquisitions:		
Accounts receivable	(10,174)	(1,000)
Inventories	(702)	(1,000)
Prepaid expenses and other current assets	218	
Income taxes	458	1,000
Customer deposits and other deferred revenue	(590)	(1,000)
Accounts payable and accrued expenses	1,475	(1,000)
Other long-term obligations	436	
	-----	-----
Net cash provided by operating activities	2,242	6,000
	-----	-----
Cash flows from investing activities:		
Capital expenditures	(1,807)	(1,000)
Proceeds from sale of property, plant & equipment	11	
Cash paid for intangible assets acquired	(84)	
Acquisition of assets	(40,672)	(17,000)
	-----	-----
Net cash used in investing activities	(42,552)	(17,000)
	-----	-----
Cash flows from financing activities:		
Proceeds from long-term borrowings	38,946	10,000
Proceeds from short-term obligations	3,554	
Principal payments on long-term debt	(1,450)	(8,000)
Proceeds from stock options exercised	485	
Excess tax benefits from stock compensation	500	
Dividends paid	(1,596)	(1,000)
Other	--	
	-----	-----

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Net cash provided by financing activities	40,439	-----	-----
Effect of exchange rate changes on cash	(6)		
Increase (decrease) in cash and cash equivalents	123		(10,
Cash and cash equivalents beginning of period	5,189	12,	
Cash and cash equivalents end of period	\$ 5,312	\$ 2,	
	=====	=====	=====

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30, 2007	June 30, 2006	Six Months Ended June 30, 2007
	-----	-----	-----
Net Earnings	\$ 4,065	\$ 3,055	7,50
Other comprehensive income, net of tax:			
Unfunded post retirement benefit plan - prior service cost and gain amortized during period	(3)	--	(
Equity adjustment from translation	8	--	
	-----	-----	-----
Comprehensive income	\$ 4,070	\$ 3,055	7,50
	=====	=====	=====

See accompanying notes to condensed consolidated financial statements.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

### NOTE 1 - CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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The condensed consolidated financial statements presented herein have been prepared by the Company in accordance with the accounting policies described in its December 31, 2006 consolidated financial statements, and should be read in conjunction with the consolidated financial statements and notes, which appear in our Annual Report on Form 10-K for the year ended December 31, 2006. References in this report to "the Company" mean Balchem and/or its subsidiaries,

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BCP Ingredients, Inc., Balchem Minerals Corporation, and Balchem B.V., 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 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. The results of operations for the six months ended June 30, 2007 are not necessarily indicative of the operating results expected for the full year or any interim period.

### NOTE 2 - STOCKHOLDERS' EQUITY

#### STOCK-BASED COMPENSATION

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share Based Payment" ("SFAS 123R"), which requires all share-based payments, including grants of stock options, to be recognized in the statement of earnings as an operating expense, based on their fair values. SFAS 123R establishes the accounting for transactions in which an entity pays for employee services in share-based payment transactions. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method and 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 employee share options and similar instruments is estimated using option-pricing models that take into account the unique characteristics of those instruments. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. The Company adopted SFAS 123R effective January 1, 2006, using the modified prospective transition method. Under this method, compensation cost is recognized for awards granted and for awards modified, repurchased or cancelled in the period after adoption. Compensation cost is also recognized for the unvested portion of awards granted prior to adoption over the remaining requisite service period. The Company's results for the three and six months ended June 30, 2007 and 2006 reflected the following compensation cost as a result of adopting SFAS 123R and such compensation cost had the following effects on net earnings and basic and diluted earnings per share:

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	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Cost of sales	\$ 44	\$ 27
Operating expenses	348	235
Net earnings	(265)	(205)
Basic earnings per common share	(0.01)	(0.01)
Diluted earnings per common share	\$ (0.01)	\$ (0.01)

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	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
Cost of sales	\$ 87	\$ 54
Operating expenses	697	470
Net earnings	(534)	(459)
Basic earnings per common share	(0.03)	(0.03)
Diluted earnings per common share	\$ (0.03)	\$ (0.03)

As required by SFAS 123R, 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.

Additionally, since adoption of SFAS 123R, excess tax benefits related to stock compensation are presented as a cash inflow from financing activities. This change had the effect of decreasing cash flows from operating activities and increasing cash flows from financing activities by \$114 and \$500 for the three and six months ended June 30, 2007, respectively, and by \$67 and \$163 for the three and six months ended June 30, 2006, respectively.

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 shares to be issued upon exercise of the outstanding options have been approved, reserved and are adequate to cover all exercises. As of June 30, 2007, the plans had 727,033 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 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 six months ended June 30, 2007 and 2006 is summarized below:

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For the six months ended June 30, 2007	Shares (000s)	Weighted Average Exercise Price	Aggregate Intrinsic Value (\$000s)	Weighted Average Remaining Contractual Term
Outstanding as of December 31, 2006	2,170	\$ 10.13	\$ 15,168	
Granted	3	17.86		
Exercised	(125)	3.87		
Expired	--	--		
Forfeited	(13)	14.01		
Outstanding as of June 30, 2007	2,035	\$ 10.51	\$ 15,595	7.1
Exercisable as of June 30, 2007	1,206	\$ 7.91	\$ 12,380	6.2

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For the six months ended June 30, 2006	Shares (000s)	Weighted Average Exercise Price	Aggregate Intrinsic Value (\$000s)	Weighted Average Remaining Contractual Term
Outstanding as of December 31, 2005	2,153	\$ 8.38	\$ 10,479	
Granted	15	15.06		
Exercised	(57)	5.30		
Expired	--	--		
Forfeited	(19)	9.37		
Outstanding as of June 30, 2006	2,092	\$ 8.51	\$ 13,588	7.0
Exercisable as of June 30, 2006	1,142	\$ 6.24	\$ 10,011	5.6

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 0.3% and 0.4%; expected volatilities of 27% and 26%; risk-free interest rates of 4.1% and 3.8%; and expected lives of 3.7 and 4.5 for the six months ended June 30, 2007 and 2006, respectively.

For the six months ended June 30, 2007 and 2006, the Company used a projected expected life for each award granted based on historical experience of employees' exercise behavior. For the six months ended June 30, 2007 and 2006, expected volatility is based on the Company's historical volatility levels. For the six months ended June 30, 2007 and 2006, 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.

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Other information pertaining to option activity during the three and six months ended June 30, 2007 and 2006 was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Weighted-average fair value of options granted	\$ 6.47	\$ 3.59	\$ 6.47	\$ 3.50
Total intrinsic value of stock options exercised	\$ 312	\$ 187	\$ 1,513	\$ 524

Non-vested restricted stock activity for the six months ended June 30, 2007 and 2006 is summarized below:



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Six Months ended June 30, 2007	Shares (000s)	Weighted Average Grant Date Fair Value
Non-vested balance as of December 31, 2006	113	\$ 16.40
Granted	5	18.61
Vested	--	--
Forfeited	--	--
Non-vested balance as of June 30, 2007	118	\$ 16.49

Six Months ended June 30, 2006	Shares (000s)	Weighted Average Grant Date Fair Value
Non-vested balance as of December 31, 2005	34	\$ 13.22
Granted	--	--
Vested	--	--
Forfeited	--	--
Non-vested balance as of June 30, 2006	34	\$ 13.22

As of June 30, 2007 and 2006, there was \$3,299 and \$1,891, respectively, of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans. As of June 30, 2007, the unrecognized compensation cost is expected to be recognized over a weighted-average period of 2 years. We estimate that share-based compensation expense for the year ended December 31, 2007 will be approximately \$1,568.

## STOCK SPLITS AND REPURCHASE OF COMMON STOCK

On December 8, 2006, the Board of Directors of the Company approved a three-for-two split of the Company's common stock to be effected in the form of a stock dividend to shareholders of record on December 29, 2006. Such stock dividend was made on January 19, 2007. The stock split was recognized by reclassifying the par value of the additional shares resulting from the split, from additional paid-in capital to common stock.

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On December 15, 2005, the Board of Directors of the Company approved a three-for-two split of the Company's common stock to be effected in the form of a stock dividend to shareholders of record on December 30, 2005. Such stock dividend was made on January 20, 2006. The stock split was recognized by reclassifying the par value of the additional shares resulting from the split, from additional paid-in capital to common stock.

All references to number of common shares and per share amounts except shares authorized in the accompanying consolidated financial statements were retroactively adjusted to reflect the effect of the December 2006 and December 2005 stock splits.

In June 1999, the board of directors authorized the repurchase of shares of the Company's outstanding common stock over a two-year period commencing July 2, 1999. Under this program, which was subsequently extended, the Company had, as of December 31, 2004, repurchased a total 772,461 shares at an average cost of \$4.11 per share, none of which remained in treasury at December 31, 2004. In June 2005, the board of directors authorized another extension of the stock

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repurchase program for up to an additional 900,000 shares, over and above those 772,461 shares previously repurchased under the program. Under this extension, a total of 99,450 shares were purchased at an average cost of \$12.05 per share, none of which remained in treasury at June 30, 2007. During the six months ended June 30, 2007, no additional shares have been purchased. 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 - ACQUISITIONS

Effective April 30, 2007, pursuant to an asset purchase agreement dated March 30, 2007 (the "Akzo Nobel Asset Purchase Agreement"), the Company, through its European subsidiary, Balchem B.V., completed an acquisition of the methylamines and choline chloride business and manufacturing facilities of Akzo Nobel Chemicals S.p.A., located in Marano Ticino, Italy (the "Akzo Nobel Acquisition") for a provisional purchase price including acquisition costs of \$9,066, subject to adjustment based on actual working capital and other adjustments.

The Akzo Nobel Acquisition has been accounted for using the purchase method of accounting and the purchase price of the acquisition has been assigned to the net assets acquired based on the fair value of such assets at the date of acquisition. The preliminary allocation of the total purchase price, including acquisition costs, was based on the estimated fair values as of April 30, 2007. Adjustments to these estimates will be included in the allocation of the purchase price of the Akzo Nobel Acquisition upon settlement of any working capital or other adjustments. The preliminary purchase price has been allocated as follows (in thousands):

	Fair Value Recorded in Purchase Accounting
Property plant & equipment	\$ 7,994
Short-term receivable	2,506
Inventories	4,323
Goodwill	965
Other	83
Accounts payable and accrued expenses	(8,258)
<b>Total</b>	<b>\$ 7,613</b>

On March 16, 2007, the Company, through its wholly-owned subsidiary BCP Ingredients, Inc. ("BCP"), entered into an asset purchase agreement (the "Asset Purchase Agreement") with Chinook Global Limited ("Chinook"), a privately held Ontario corporation, pursuant to which BCP acquired certain of Chinook's choline chloride business assets (the "Chinook Acquisition") for a purchase price of \$29,000, plus the value of certain product inventories estimated at approximately \$1,840. The acquisition closed effective the same date.

The Chinook Acquisition has been accounted for using the purchase method of accounting and the purchase price of the acquisition has been assigned to the net assets acquired based on the fair value of such assets at the date of acquisition. The preliminary allocation of the total purchase price, including acquisition costs, was based on the estimated fair values as of March 16, 2007. Adjustments to these estimates will be included in the allocation of the

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purchase price of the Chinook Acquisition upon settlement of any working capital or other adjustments. The preliminary purchase price has been allocated as follows (in thousands):

	Fair Value Recorded in Purchase Accounting
Customer list	\$ 29,261
Inventory	1,840
Short-term receivable	1,850
Short-term obligation	(870)
Other	73
<b>Total</b>	<b>\$ 32,154</b>

The short-term receivable is included in other current assets.

### Pro Forma Summary of Operations

The following unaudited pro forma information has been prepared as if the Chinook Acquisition had occurred on January 1, 2007 and does not include cost savings expected from the transaction. In addition to including the results of operations, the pro forma information gives effect primarily to changes in depreciation and amortization of tangible and intangible assets resulting from the acquisition.

The pro forma information presented does not purport to be indicative of the results that actually would have been attained if the Chinook acquisition had occurred at the beginning of the periods presented and is not intended to be a projection of future results.

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	Pro Forma Six Months Ended June 30, 2007
Net sales	\$ 80,957
Net earnings	7,978
Basic EPS	.45
Diluted EPS	.43

Effective August 24, 2006, pursuant to an asset purchase agreement of the same date, the Company, through its wholly owned subsidiaries BCP Ingredients and BCP St. Gabriel, acquired from BioAdditives, LLC, CMB Additives, LLC and CMB Realty of Louisiana (the "St. Gabriel Sellers") an animal feed grade aqueous choline chloride manufacturing facility and related assets located in St. Gabriel, Louisiana (the "St. Gabriel Acquisition"). The Company also acquired the St. Gabriel Sellers' remaining interest in a land lease (approximately 21 years) relating to the realty upon which the acquired facility and related assets are located. The acquisition was funded through the Company's cash reserves. In February 2007, the facility was placed in service.

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On February 8, 2006, the Company, through its wholly owned subsidiary Balchem Minerals Corporation ("BMC"), completed an acquisition (the "CMC Acquisition") of all of the outstanding capital stock of Chelated Minerals Corporation ("CMC"), a privately held Utah corporation, for a purchase price of \$17,350, subject to adjustment based upon CMC's actual working capital and other adjustments. On February 6, 2006, the Company and its principal bank entered into a Loan Agreement (the "Loan Agreement") providing for an unsecured term loan of \$10,000 (the "Term Loan"), the proceeds of which were used to fund the CMC Acquisition, in part. The remaining balance of the purchase price of the CMC Acquisition was funded through the Company's cash reserves. At December 31, 2006, the Term Loan had been repaid in full.

The CMC Acquisition has been accounted for using the purchase method of accounting and the purchase price of the acquisition has been assigned to the net assets acquired based on the fair value of such assets and liabilities at the date of acquisition. The allocation of the total purchase price, including acquisition costs, of CMC's net tangible and intangible assets was based on the estimated fair values as of February 8, 2006. Adjustments to these estimates have been included in the allocation of the purchase price of CMC upon settlement of any working capital or other adjustments. The excess of the purchase price over the identifiable intangible and net tangible assets was allocated to goodwill. The purchase price has been allocated as follows (in thousands):

	Fair Value Recorded in Purchase Accounting
Accounts receivable	\$ 884
Inventory	552
Property, plant and equipment	1,980
Current liabilities	(388)
Other long-term liabilities	(2,368)
Goodwill	11,925
Other intangible assets	5,334
Total	\$ 17,919

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### Pro Forma Summary of Operations

The following unaudited pro forma information has been prepared as if the CMC Acquisition had occurred on January 1, 2006 and does not include cost savings expected from the transaction. In addition to including the results of operations, the pro forma information gives effect primarily to changes in depreciation and amortization of tangible and intangible assets resulting from the acquisition.

The pro forma information presented does not purport to be indicative of the results that actually would have been attained if the CMC acquisition had occurred at the beginning of the periods presented and is not intended to be a projection of future results.

	Actual June 30, 2007	Pro Forma June 30, 2006
Net sales	\$ 71,970	\$ 50,431

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Net earnings	7,506	5,960
Basic EPS	.42	.34
Diluted EPS	.41	.33

### NOTE 4 - INVENTORIES

Inventories at June 30, 2007 and December 31, 2006 consisted of the following:

	June 30, 2007	December 31, 2006
Raw materials	\$ 5,512	\$ 4,264
Finished goods	11,127	5,654
Total inventories	\$ 16,639	\$ 9,918

### NOTE 5 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2007 and December 31, 2006 are summarized as follows:

	June 30, 2007	December 31, 2006
Land	\$ 1,201	\$ 650
Building	12,467	11,640
Equipment	44,806	38,545
Construction in progress	3,959	1,247
	62,433	52,082
Less: Accumulated depreciation	22,447	20,769
Net property, plant and equipment	\$ 39,986	\$ 31,313

### NOTE 6 - INTANGIBLE ASSETS

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. These standards require the use of the purchase method of accounting for a business

combination and define an intangible asset. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but are instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

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As of December 31, 2006, the Company performed an impairment test of its goodwill balance. As of such date, the Company's reporting units' fair values exceeded their carrying amounts, and therefore there was no indication that goodwill was impaired. Accordingly, the Company was not required to perform any further impairment tests. The Company will perform its impairment test next on December 31, 2007.

The Company had goodwill in the amount of \$26,240 and \$25,253 at June 30, 2007 and December 31, 2006, respectively, subject to the provisions of SFAS Nos. 141 and 142. At June 30, 2007, the increase in goodwill is primarily attributable to the cost in excess of net assets acquired of the Akzo Nobel Acquisition, as described in Note 3.

As of June 30, 2007 and December 31, 2006, the Company had identifiable intangible assets with finite lives with a gross carrying value of approximately \$37,221 and \$7,799, respectively, less accumulated amortization of \$1,971 and \$887, respectively. At June 30, 2007, the increase in the gross carrying amount is primarily attributable to the customer list acquired as part of the Chinook Acquisition, as described in Note 3.

Identifiable intangible assets with finite lives at June 30, 2007 and December 31, 2006 are summarized as follows:

	Amortization Period (in years)	Gross Carrying Amount at 6/30/07	Accumulated Amortization at 6/30/07	Gross Carrying Amount at 12/31/06
Customer lists	10	\$ 34,149	\$ 1,472	\$ 4,888
Regulatory re-registration costs	10	28	--	28
Patents & trade secrets	15-17	1,587	266	1,550
Trademarks & trade names	17	878	121	876
Other	5	579	112	457
		\$ 37,221	\$ 1,971	\$ 7,799

Amortization of identifiable intangible assets was \$1,084 for the first six months of 2007. Assuming no change in the gross carrying value of identifiable intangible assets, the estimated amortization expense for the remainder of 2007 is \$1,743, approximately \$3,473 in 2008, \$3,468 in 2009, \$3,463 per annum for 2010 and 2011 and \$3,450 in 2012. At June 30, 2007, there were no identifiable intangible assets with indefinite useful lives as defined by SFAS No. 142. 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 six months ended June 30, 2007.

### NOTE 7 - NET EARNINGS PER SHARE

The following presents a reconciliation of the net earnings and shares used in

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calculating basic and diluted net earnings per share:

Three months ended June 30, 2007	Net Earnings (Numerator)	Number of Shares (Denominator)
Basic EPS - Net earnings and weighted average common shares outstanding	\$ 4,065	17,752,226
Effect of dilutive securities - stock options and restricted stock		826,959
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	\$ 4,065	18,579,185
Three months ended June 30, 2006	Net Earnings (Numerator)	Number of Shares (Denominator)
Basic EPS - Net earnings and weighted average common shares outstanding	\$ 3,055	17,425,384
Effect of dilutive securities - stock options and restricted stock		816,670
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	\$ 3,055	18,242,054
Six months ended June 30, 2007	Net Earnings (Numerator)	Number of Shares (Denominator)
Basic EPS - Net earnings and weighted average common shares outstanding	\$ 7,506	17,724,581
Effect of dilutive securities - stock options and restricted stock		762,434
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	\$ 7,506	18,487,015

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Six months ended June 30, 2006	Net Earnings (Numerator)	Number of Shares (Denominator)
Basic EPS - Net earnings and weighted average common shares outstanding	\$ 5,913	17,409,662
Effect of dilutive securities - stock options and restricted stock		828,321
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	\$ 5,913	18,237,983

The Company had stock options covering 286,900 and 491,325 shares at June 30, 2007 and 2006, 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.

## NOTE 8 - INCOME TAXES

Effective January 1, 2007, the Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). This interpretation, among other things, creates a two-step approach for evaluating uncertain tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the amount of benefit that more-likely-than-not will be realized upon settlement. De-recognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for de-recognition of tax positions, and it has expanded disclosure requirements. The adoption of FIN 48 resulted in, as a cumulative effect, a non-cash charge, net of federal tax benefits, of \$291, recorded as a reduction to beginning retained earnings. The charge before federal tax benefits was \$411. 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 statement of operations. The total amount of accrued interest and penalties related to uncertain tax positions at January 1, 2007 was \$89 and is included in other long-term obligations. All of our unrecognized tax benefits, if recognized in future periods, would impact the Company's effective tax rate. The Company remains open for examination by the IRS for 2003 through 2006. For most of its other significant tax jurisdictions (U.S. states), the Company's income tax returns are also open for examination for 2003 through 2006. There was not a significant change in our liabilities for unrecognized tax benefits during the six months ended June 30, 2007.

## NOTE 9 - SEGMENT INFORMATION

The Company's reportable segments are strategic businesses that offer products



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and services to different markets. Presently, the Company has three segments: specialty products, encapsulated / nutritional products and BCP Ingredients, its unencapsulated feed supplements segment.

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### Business Segment Net Sales:

	Three Months Ended June 30,		Six Mo Ju
	2007	2006	2007
Specialty Products	\$ 8,367	\$ 8,009	\$ 16,428
Encapsulated/Nutritional Products	11,746	10,539	23,246
BCP Ingredients	24,258	6,552	32,296
Total	\$ 44,371	\$ 25,100	\$ 71,970

### Business Segment Earnings:

	Three Months Ended June 30,		Six Mo Ju
	2007	2006	2007
Specialty Products	\$ 3,053	\$ 2,764	\$ 5,956
Encapsulated/Nutritional Products	1,213	1,013	2,456
BCP Ingredients	2,523	1,093	3,719
Other expense	(422)	(57)	(450)
Earnings before income taxes	\$ 6,367	\$ 4,813	\$ 11,681

The following table summarizes domestic and foreign sales for the three and six months ended June 30, 2007 and June 30, 2006:

	Three Months Ended June 30,		Six Mo Ju
	2007	2006	2007
Domestic	\$ 31,348	\$ 22,816	\$ 55,475
Foreign	13,023	2,284	16,495
Total	\$ 44,371	\$ 25,100	\$ 71,970

### NOTE 10 - SUPPLEMENTAL CASH FLOW INFORMATION

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Cash paid during the six months ended June 30, 2007 and 2006 for income taxes and interest is as follows:

	Six months ended June 30,			
	2007		2006	
Income taxes	\$	3,295	\$	2,142
Interest	\$	458	\$	170

Other supplemental non-cash transactions resulting from acquisitions are described in Notes 3 and 11.

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### NOTE 11 - LONG-TERM DEBT AND CREDIT AGREEMENTS

On April 30, 2007, the Company, and its principal bank entered into a Loan Agreement (the "European Loan Agreement") providing for an unsecured term loan of \$10,244 (the "European Term Loan"), the proceeds of which were used to fund the Akzo Nobel Acquisition (the "Akzo Nobel Acquisition"), as described in Note 3. The European Term Loan is 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. The European Term Loan has a maturity date of May 1, 2010 and is subject to a monthly interest rate equal to EURIBOR plus 1%. At June 30, 2007, this interest rate was 5.12%. The European Loan Agreement also provides for a short-term revolving credit facility of \$2,732 (the "European Revolving Facility"). The European Revolving Facility is subject to a monthly interest rate equal to EURIBOR plus 1.25%, and accrued interest is payable monthly. The Company has drawn down the European Revolving Facility as of June 30, 2007. The European Revolving Facility has a maturity date of May 1, 2008. Management believes that such facility will be renewed in the normal course of business.

On March 16, 2007, the Company and its principal bank entered into a new Loan Agreement (the "New Loan Agreement") providing for an unsecured term loan of \$29,000 (the "New Term Loan"), the proceeds of which were used to fund the Chinook acquisition (the "Chinook Acquisition"), as described in Note 3. The New Term Loan is payable in equal monthly installments of principal, each equal to 1/60th of the principal of the New Term Loan, together with accrued interest, with remaining principal and interest payable at maturity. The New Term Loan has a maturity date of March 16, 2010 and is subject to a monthly interest rate equal to LIBOR plus 1%. At June 30, 2007, this interest rate was 6.32%. The New Loan Agreement also provides for a short-term revolving credit facility of \$6,000 (the "New Revolving Facility"). The New Revolving Facility is subject to a monthly interest rate equal to LIBOR plus 1%, and accrued interest is payable monthly. No amounts have been drawn on the New Revolving Facility as of the date hereof. The New Revolving Facility has a maturity date of May 31, 2009. Management believes that such facility will be renewed in the normal course of business.

### NOTE 12 - EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) savings and profit sharing plan for eligible employees. The plan allows participants to make pretax contributions and the Company matches certain percentages of those pretax contributions with shares of

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the Company's common stock. The profit sharing portion of the plan is discretionary and non-contributory. All amounts contributed to the plan are deposited into a trust fund administered by independent trustees.

The Company also currently provides postretirement benefits in the form of an unfunded 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 six months ended June 30, 2007 and June 30, 2006 was as follows:

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	2007	2006
Service Cost	\$ 15	\$ 14
Interest Cost	20	19
Expected return on plan assets	--	--
Amortization of transition obligation	--	--
Amortization of prior service cost	(9)	(9)
Amortization of (gain) or loss	(2)	(1)
Net periodic benefit cost	\$ 24	\$ 23

The plan is unfunded and approved claims are paid from Company funds. Historical cash payments made under such plan approximated \$50 per year.

### NOTE 13 - NEW ACCOUNTING PRONOUNCEMENTS

In February, 2007 the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities", including an amendment of FASB Statement No. 115. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This statement is expected to expand the use of fair market value measurement, which is consistent with long-term measurement objectives for accounting for financial instruments. This statement is effective beginning in January 2008. The Company does not expect the adoption of this statement to be significant to its consolidated financial statements.

In September 2006, the FASB issued SFAS 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective beginning in January 2008. The Company is evaluating whether adoption of this statement will result in a change to its fair value measurements.

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Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations (All dollar amounts in thousands)

This Report contains forward-looking statements, within the meaning of Section

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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 1 of our Annual Report on Form 10-K for the year ended December 31, 2006 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

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We develop, manufacture, distribute and market specialty performance ingredients and products for the food, nutritional, pharmaceutical, animal health and medical device sterilization industries. Our reportable segments are strategic businesses that offer products and services to different markets. We presently have three reportable segments: specialty products; encapsulated / nutritional products; and BCP Ingredients.

### Specialty Products

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Our specialty products segment operates 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. Our 100% ethylene oxide product is distributed in uniquely designed, recyclable double-walled stainless steel drums to assure compliance with safety, quality and environmental standards as outlined by the U.S. Environmental Protection Agency (the "EPA") and the U.S. Department of Transportation. Our inventory of these specially built drums, along with our two filling facilities, represents a significant capital investment. 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 two other products, propylene oxide and methyl chloride, principally to customers seeking smaller (as opposed to bulk) quantities and whose requirements include timely delivery and safe handling. Propylene oxide is used for fumigation in spice treatment, various chemical synthesis applications, to make paints more durable, and for manufacturing specialty starches and textile coatings. Methyl chloride is used as a raw material in specialty herbicides, fertilizers, pharmaceuticals, malt and wine preservers.

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### Encapsulated / Nutritional Products

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The encapsulated / nutritional products segment provides microencapsulation, granulation and agglomeration solutions to a variety of applications in food, pharmaceutical and nutritional ingredients to enhance performance of nutritional fortification, processing, mixing, packaging applications and shelf-life. Major product applications are baked goods, refrigerated and frozen dough systems, processed meats, seasoning blends, confections, nutritional supplements and

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animal nutrition. 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. Our portfolio of granulated calcium carbonate products are primarily used in, or in conjunction with, novel over-the-counter and prescription pharmaceuticals for the treatment of osteoporosis, gastric disorders and calcium deficiencies in the United States.

In the animal health industry, we market REASHURE(R) Choline, an encapsulated choline product that boosts health and milk production in transition and early lactation cows. Commercial sales are currently derived from the dairy industry where REASHURE(R) delivers nutrient supplements that survive the rumen and are biologically available, providing required nutritional levels during certain weeks preceding and following calving, commonly referred to as the "transition period" of the animal. Also, in animal health, we market NITROSHURETM, an encapsulated urea supplement for lactating dairy cows that is designed to create a slow-release nitrogen source for the rumen, allowing for greater flexibility in feed rations for dairy nutritionists and producers, and NIASHURETM, our microencapsulated niacin product for dairy cows. In addition, CMC manufactures, sells and distributes chelated mineral supplements for use in animal feed throughout the world. CMC's proprietary chelation technology provides enhanced nutrient absorption for various species of domestic and companion animals.

### BCP Ingredients

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This segment manufactures and supplies raw choline chloride, an essential nutrient for animal health, predominantly to the poultry and swine industries. Choline plays a vital role in the metabolism of fat and the building and maintaining of cell structures. Choline deficiency can result in, among other symptoms, reduced growth and perosis in poultry, and fatty liver, kidney necrosis and general poor health condition in swine. In addition, certain derivatives of choline chloride are also manufactured and sold into industrial applications. Choline chloride is manufactured and sold in both an aqueous and dry form.

We sell products for all three segments through our own sales force, independent distributors, and sales agents.

The following tables summarize consolidated net sales by segment and business segment earnings for the six months ended June 30, 2007 and June 30, 2006 (in thousands):

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### Business Segment Net Sales:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Specialty Products	\$ 8,367	\$ 8,009	\$ 16,428	\$ 15,960
Encap/Nutritional Products	11,746	10,539	23,246	20,328
BCP Ingredients	24,258	6,552	32,296	13,409
Total	\$ 44,371	\$ 25,100	\$ 71,970	\$ 49,697

### Business Segment Earnings:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Specialty Products	\$ 3,053	\$ 2,764	\$ 5,956	\$ 5,536
Encap/Nutritional Products	1,213	1,013	2,456	2,052
BCP Ingredients	2,523	1,093	3,719	1,751
Other expense	(422)	(57)	(450)	(81)
Earnings bef. income taxes	\$ 6,367	\$ 4,813	\$ 11,681	\$ 9,258

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### RESULTS OF OPERATIONS

Three months ended June 30, 2007 compared to three months ended June 30, 2006

#### Net Sales

Net sales for the three months ended June 30, 2007 were \$44,371 compared with \$25,100 for the three months ended June 30, 2006, an increase of \$19,271 or 76.8%. Net sales for the specialty products segment were \$8,367 for the three months ended June 30, 2007 compared with \$8,009 for the three months ended June 30, 2006, an increase of \$358 or 4.5%. This increase was principally due to an increase in sales volume, along with modest price increases for our ethylene oxide products for medical device sterilization. Net sales for the encapsulated / nutritional products segment were \$11,746 for the three months ended June 30, 2007 compared with \$10,539 for the three months ended June 30, 2006, an increase of \$1,207 or 11.5%. This result was driven principally by increased global sales of human nutritional and choline products, and includes \$300 from the Akzo Nobel Acquisition, as described in Note 3. Sales of REASHURE(R) and Niashure, our specialty animal nutrition and health products targeted for ruminant animals, and increases in the companion animal market also contributed to this growth. Net sales of \$24,258 were realized for the three months ended June 30, 2007 for the BCP Ingredients (unencapsulated feed supplements) segment, as compared with \$6,552 for the three months ended June 30, 2006, an increase of \$17,706 or 270.2%. This result reflects sales from the customer list acquisition of Chinook Group Limited ("Chinook"), as described in Note 3, as well as sales from the Akzo Nobel Acquisition. The Chinook and Akzo Nobel acquisitions contributed approximately \$9,500 and \$6,700 of the revenue increase in this segment, respectively. The remaining increase was due to increased volumes sold in the core dry choline, aqueous choline, and specialty industrial product lines.

#### Gross Margin

Gross margin for the three months ended June 30, 2007 increased to \$12,182 compared to \$8,800 for the three months ended June 30, 2006, an increase of \$3,382 or 38.4%, due largely to the above-noted increase in sales. Gross margin percentage for the three months ended June 30, 2007 was 27.5% compared to 35.1% for the three months ended June 30, 2006. This decrease in gross margin percentage reflects the initial impact of the acquisitions in the animal grade choline business, which carry lower gross margins and was also a result of higher raw material and fuel costs. Gross margin dollars for the specialty products segment increased 9.7% as increases in sales volume and modest sales price increases were partially offset by higher raw material prices. Gross

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margin dollars in the encapsulated / nutritional products segment increased 10% as margins were favorably affected by increased volumes sold in the human choline markets and specialty animal nutrition and health products. Gross margin dollars for BCP Ingredients increased 219% and was favorably affected by increased sales volumes and improved productivity.

### Operating Expenses

Operating expenses for the three months ended June 30, 2007 were \$5,393 compared to \$3,930 for the three months ended June 30, 2006, an increase of \$1,463 or 37.2%. This \$1,463 increase was due primarily to \$732 of additional amortization expense, plus sales and technical personnel expense associated with the Chinook and Akzo Nobel

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acquisitions. We also incurred approximately \$200 of commercial development expenses toward our pharmaceutical market initiatives in the quarter. With these increases, operating expenses were 12.2% of sales or 3.5 percentage points less than the operating expenses as a percent of sales incurred in last year's comparable quarter. During the three months ended June 30, 2007 and 2006, the Company spent \$615 and \$486, respectively, on research and development programs, substantially all of which pertained to the Company's encapsulated / nutritional products segment for both human and animal health.

### Earnings From Operations

Primarily as a result of the above-noted increase in sales, earnings from operations for the three months ended June 30, 2007 were \$6,789 as compared to \$4,870 for the three months ended June 30, 2006.

### Other expenses (income)

Interest income for the three months ended June 30, 2007 totaled \$29 as compared to \$27 for the three months ended June 30, 2006. Interest expense was \$527 for the three months ended June 30, 2007 compared to \$84 for the three months ended June 30, 2006. This increase is attributable to the increase in average current and long-term debt resulting from the aforementioned Chinook and Akzo Nobel acquisitions. Other income of \$76 for the three months ended June 30, 2007 is the result of favorable fluctuations in foreign currency exchange rates between the U.S. dollar (the functional reporting currency) and the Canadian dollar.

### Income Tax Expense

The Company's effective tax rate for the three months ended June 30, 2007 and 2006 was 36.2% and 36.5%, respectively. This decrease in the effective tax rate is primarily attributable to a domestic manufacturer's deduction, partially offset by proportionately higher earnings in jurisdictions with higher tax rates.

### Net earnings

Primarily as a result of the above-noted increase in sales, net earnings were \$4,065 for the three months ended June 30, 2007 as compared with \$3,055 for the three months ended June 30, 2006, an increase of 33.1%.

Six months ended June 30, 2007 compared to six months ended June 30, 2006

Net Sales

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Net sales for the six months ended June 30, 2007 were \$71,970 compared with \$49,697 for the six months ended June 30, 2006, an increase of \$22,273 or 44.8%. Net sales for the specialty products segment were \$16,428 for the six months ended June 30, 2007 compared with \$15,960 for the six months ended June 30, 2006, an increase of \$468 or 2.9%. This increase was principally due to an increase in sales volume along with modest price increases for our ethylene oxide products for medical device sterilization partially offset by a decline in sales of propylene oxide for starch processing. Net sales for the encapsulated / nutritional products segment were \$23,246 for the six months ended June 30, 2007 compared with \$20,328 for the six months ended June 30, 2006, an increase of \$2,918 or 14.4%. This increase was due principally to increased volumes sold in the human choline markets partially offset by slowness in sales of calcium products into the over-the-counter pharmaceutical markets. Sales of REASHURE(R), Niashure and Chelated Minerals, our specialty animal nutrition and health products targeted for ruminant animals, and increases in the companion animal market also contributed to this growth. Net sales of \$32,296 were realized for the six months ended June 30, 2007 for the BCP Ingredients (unencapsulated feed supplements) segment, as compared with \$13,409 for the six months ended June 30, 2006, an increase of \$18,887 or 140.9%. This result reflects sales from the customer list acquisition of Chinook as well as sales from the Akzo Nobel Acquisition. This increase was also due to increased volumes sold in dry and aqueous choline, and choline derivatives, along with modest price increases in all product lines.

Gross Margin

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Gross margin for the six months ended June 30, 2007 increased to \$21,923 compared to \$17,022 for the six months ended June 30, 2006, an increase of \$4,901 or 28.8%, due largely to the above-noted increase in sales. Gross margin percentage for the six months ended June 30, 2007 was 30.5% compared to 34.3% for the six months ended June 30, 2006. This decrease in gross margin percentage reflects the initial impact of the acquisitions in the animal grade choline business, which carry lower gross margins and was also a result of higher raw material and fuel costs. Gross margin dollars for the specialty products segment increased 8.0% due to improved productivity, resulting from increases in sales volume, and modest increases in average selling price. These increases were partially offset by higher raw material prices. Gross margin dollars in the encapsulated / nutritional products segment increased 14.2% as margins were favorably affected by increased volumes sold in the human choline markets and specialty animal nutrition and health products, as described above. Gross margin dollars for BCP Ingredients increased 165.3% and was favorably affected by increased sales volumes and improved productivity.

Operating Expenses

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Operating expenses for the six months ended June 30, 2007 were \$9,792 compared to \$7,683 for the six months ended June 30, 2006, an increase of \$2,109 or 27.5%. This \$2,109 dollar increase was due primarily to additional amortization expense, plus sales and technical personnel expense associated with the Chinook and Akzo Nobel



acquisitions. With these increases, operating expenses were 13.6% of sales or 1.9 percentage points less than the operating expenses as a percent of sales incurred in last year's comparable period. During the six months ended June 30, 2007 and 2006, the Company spent \$1,184 and \$1,012, respectively, on research and development programs, substantially all of which pertained to the Company's encapsulated / nutritional products segment for both human and animal health.

#### Earnings From Operations

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Primarily as a result of the above-noted increase in sales, earnings from operations for the six months ended June 30, 2007 were \$12,131 as compared to \$9,339 for the six months ended June 30, 2006.

#### Other expenses (income)

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Interest income for the six months ended June 30, 2007 totaled \$74 as compared to \$89 for the six months ended June 30, 2006. This decrease is attributable to the decrease in the average total cash balance. Interest expense was \$611 for the six months ended June 30, 2007 compared to \$170 for the six months ended June 30, 2006. This increase is attributable to the increase in average current and long-term debt resulting from the aforementioned Chinook and Akzo Nobel acquisitions. Other income of \$76 for the six months ended June 30, 2007 is the result of favorable fluctuations in foreign currency exchange rates between the U.S. dollar (the functional reporting currency) and the Canadian dollar.

#### Income Tax Expense

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The Company's effective tax rate for the six months ended June 30, 2007 and 2006 was 35.7% and 36.1%, respectively. This decrease in the effective tax rate is primarily attributable to a domestic manufacturer's deduction, partially offset by proportionately higher earnings in jurisdictions with higher tax rates.

#### Net earnings

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Primarily as a result of the above-noted increase in sales, net earnings were \$7,506 for the six months ended June 30, 2007 as compared with \$5,913 for the six months ended June 30, 2006, an increase of 26.9%.

### FINANCIAL CONDITION

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#### LIQUIDITY AND CAPITAL RESOURCES

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#### Contractual Obligations

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As part of the June 30, 2005 acquisition of certain assets relating to the encapsulation, agglomeration and granulation business of Loders Croklaan USA, LLC, the asset purchase agreement provides for the contingent payment by the Company of additional consideration based upon the volume of sales associated

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with one particular product acquired by the Company during the three year period following the acquisition. Such contingent consideration will be recorded as an additional cost of the acquired product lines. No such contingent consideration has been earned and paid in 2007.

The Company's other contractual obligations and commitments principally include obligations associated with future minimum non-cancelable operating lease obligations (including for the headquarters office space entered into in 2002).

As a result of the adoption of FIN 48 on January 1, 2007, we have a liability for uncertain tax positions of \$291. We are unable to reasonably estimate the amount or timing of payments for this liability, if any. Other than the adoption of FIN 48, there have been no significant changes to the Contractual Obligations table, which was included in our Annual Report on Form 10-K for the year ended December 31, 2006.

The Company knows of no current or pending demands on, or commitments for, its liquid assets that will materially affect its liquidity.

The Company expects its operations to continue generating sufficient cash flow to fund working capital requirements and necessary capital investments. The Company is actively pursuing additional acquisition candidates. The Company could seek additional bank loans or access to financial markets to fund such acquisitions, its operations, working capital, necessary capital investments or other cash requirements should it deem it necessary to do so.

### Cash

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Cash and cash equivalents increased to \$5,312 at June 30, 2007 from \$5,189 at December 31, 2006. Working capital amounted to \$21,077 at June 30, 2007 as compared to \$19,295 at December 31, 2006, an increase of \$1,782.

### Operating Activities

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Cash flows from operating activities provided \$2,242 for the six months ended June 30, 2007 compared to \$6,612 for the six months ended June 30, 2006. The decrease in cash flows from operating activities was primarily due to increases in accounts receivable and inventories, a result of our reflecting approximately two months' activity from our recently acquired Akzo Nobel Methylamines and Choline business, which contributed approximately \$6,700 of revenue in the second quarter, and it also reflects a full quarter of the Chinook customer list acquisition, which was completed in March 2007 which

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contributed \$9,500 in the second quarter. This decrease was partially offset by an increase in net earnings, depreciation and amortization expense.

### Investing Activities

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Capital expenditures were \$1,807 for the six months ended June 30, 2007 compared to \$598 for the six months ended June 30, 2006. Cash paid for the acquisition of certain business assets of Chinook Global Limited and the Akzo Nobel Methylamines and Choline business was \$40,672.

### Financing Activities

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In June 1999, the board of directors authorized the repurchase of shares of the Company's outstanding common stock over a two-year period commencing July 2, 1999. Under this program, which was subsequently extended, the Company had, as of December 31, 2004, repurchased a total 772,461 shares at an average cost of \$4.11 per share, none of which remained in treasury at December 31, 2004. In June 2005, the board of directors authorized another extension of the stock repurchase program for up to an additional 900,000 shares, over and above those 772,461 shares previously repurchased under the program. Under this extension, a total of 99,450 shares were purchased at an average cost of \$12.05 per share, none of which remained in treasury at June 30, 2007. During the six months ended June 30, 2007, no additional shares have been purchased. 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.

On April 30, 2007, the Company, and its principal bank entered into a Loan Agreement (the "European Loan Agreement") providing for an unsecured term loan of \$10,244 (the "European Term Loan"), the proceeds of which were used to fund the Akzo Nobel Acquisition (the "Akzo Nobel Acquisition"), as described in Note 3. The European Term Loan is 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. The European Term Loan has a maturity date of May 1, 2010 and is subject to a monthly interest rate equal to EURIBOR plus 1%. At June 30, 2007, this interest rate was 5.12%. The European Loan Agreement also provides for a short-term revolving credit facility of \$2,732 (the "European Revolving Facility"). The European Revolving Facility is subject to a monthly interest rate equal to EURIBOR plus 1.25%, and accrued interest is payable monthly. The Company has drawn down the European Revolving Facility as of June 30, 2007. The European Revolving Facility has a maturity date of May 1, 2008. Management believes that such facility will be renewed in the normal course of business.

On March 16, 2007, the Company and its principal bank entered into a new Loan Agreement (the "New Loan Agreement") providing for an unsecured term loan of \$29,000 (the "New Term Loan"), the proceeds of which were used to fund the Chinook acquisition (the "Chinook Acquisition"), as described in Note 3. The New Term Loan is payable in equal monthly installments of principal, each equal to 1/60th of the principal of the New Term Loan, together with accrued interest, with remaining principal and interest payable at maturity. The New Term Loan has a maturity date of March 16, 2010 and is subject to a monthly interest rate equal to LIBOR plus 1%. At June 30, 2007, this interest rate was 6.32%. The New Loan Agreement also provides for a short-term

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revolving credit facility of \$6,000 (the "New Revolving Facility"). The New Revolving Facility is subject to a monthly interest rate equal to LIBOR plus 1%, and accrued interest is payable monthly. No amounts have been drawn on the New Revolving Facility as of the date hereof. The New Revolving Facility has a maturity date of May 31, 2009. Management believes that such facility will be renewed in the normal course of business.

On February 6, 2006, the Company and its principal bank entered into a Loan Agreement (the "Loan Agreement") providing for an unsecured term loan of \$10,000 (the "Term Loan"), the proceeds of which were used to fund the CMC acquisition (the "CMC Acquisition"), as described in Note 3, in part. The remaining balance of the purchase price of the CMC Acquisition was funded through Balchem's cash on hand. The Company repaid in full the \$10,000 of principal under the Term Loan in 2006.

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Proceeds from stock options exercised totaled \$485 and \$301 for the six months ended June 30, 2007 and 2006, respectively. Dividend payments were \$1,596 and \$1,045 for the six months ended June 30, 2007 and 2006, respectively.

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### Other Matters Impacting Liquidity

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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. The amount recorded on the Company's balance sheet as of June 30, 2007 for this obligation is \$762. The postretirement plan is not funded. Historical cash payments made under such plan have approximated \$50 per year.

### Critical Accounting Policies

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#### Accounting for Uncertainty in Income Taxes

As discussed above, effective January 1 2007, the Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"). This interpretation, among other things, creates a two-step approach for evaluating uncertain tax positions. Recognition (step one) occurs when an enterprise concludes that a tax position, based solely on its technical merits, is more-likely-than-not to be sustained upon examination. Measurement (step two) determines the amount of benefit that more-likely-than-not will be realized upon settlement. De-recognition of a tax position that was previously recognized would occur when a company subsequently determines that a tax position no longer meets the more-likely-than-not threshold of being sustained. FIN 48 specifically prohibits the use of a valuation allowance as a substitute for de-recognition of tax positions, and it has expanded disclosure requirements. The adoption of FIN 48 resulted in a non-cash transition charge of \$291, recorded as a reduction to beginning retained earnings.

Other than the aforementioned adoption of FIN 48, there were no changes to the Company's Critical Accounting Policies, as described in its December 31, 2006 Annual Report on Form 10-K, during the six months ended June 30, 2007.

### Related Party Transactions

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The Company was not engaged in related party transactions during the six months ended June 30, 2007 and all transactions of the Company during such period were at arms length.

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### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Cash and cash equivalents are invested primarily in money market accounts. Accordingly, we believe we have limited exposure to market risk for changes in interest rates. The Company has no derivative financial instruments or derivative commodity instruments, nor does the Company have any financial instruments entered into for trading or hedging purposes. As of June 30, 2007, the Company's borrowings were under a bank term loan bearing interest at LIBOR

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plus 1.00%, a second bank term loan bearing interest at EURIBOR plus 1.00%, and a revolving line of credit bearing interest at EURIBOR plus 1.25%. A 100 basis point increase or decrease in interest rates, applied to the Company's borrowings at June 30, 2007, would result in an increase or decrease in annual interest expense and a corresponding reduction or increase in cash flow of approximately \$402. The Company believes that its business operations are not exposed in any material respect to market risk relating to foreign currency exchange risk or commodity price risk.

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### Item 4. Controls and Procedures

#### (a) Evaluation of Disclosure Controls and Procedures

Pursuant to the requirements of the Sarbanes-Oxley Act of 2002, the Company's management, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated, as of the end of the period covered by this Quarterly Report on Form 10-Q, the effectiveness of the Company's disclosure controls and procedures (including its internal controls and procedures).

Based upon management's evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures were effective in identifying the information required to be disclosed in the Company's periodic reports filed with the Securities and Exchange Commission ("SEC"), including this Quarterly Report on Form 10-Q, and ensuring that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

#### (b) Changes in Internal Controls

During the most recent fiscal quarter, there has been no significant change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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### Part II. Other Information

#### Item 1A. Risk Factors

There have been no material changes in the Risk Factors identified in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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

On June 15, 2007, the Company held its Annual Meeting of stockholders. The following actions were voted upon at the meeting:

1. The following individuals were elected Class 1 directors to serve until the annual meeting of stockholders in 2010 and until the election and qualification of their respective successors. A total of 16,281,534 shares were represented in person or by proxy at the Annual Meeting. The number of shares that were voted for, and that were withheld from, each of the director nominees is as follows:

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Director	For	Votes Withheld
Dino A. Rossi	15,874,422	407,112
Dr. Elaine R. Wedral	16,041,922	239,612

The terms of our other directors, Mr. Hoyt Ammidon, Jr., Mr. Edward L. McMillan, Dr. John Y. Televantos and Mr. Kenneth P. Mitchell continued after the annual meeting.

2. The shareholders approved the appointment of McGladrey & Pullen, LLP as the Company's independent registered public accounting firm for the 2007 fiscal year by a vote of 16,200,910 in favor, and 12,419 against, and 68,205 stockholders abstained.

### Item 6. Exhibits

Exhibit 31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a).
Exhibit 31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
Exhibit 32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
Exhibit 32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.

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### SIGNATURES

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

BALCHEM CORPORATION  
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By: /s/ Dino A. Rossi  
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Dino A. Rossi, President and  
Chief Executive Officer

Date: August 9, 2007

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Exhibit Index

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Exhibit No. -----	Description -----
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Exhibit 31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) .
Exhibit 32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.
Exhibit 32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code.