

BALCHEM CORP  
Form 10-Q  
August 02, 2013

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

For The Quarterly Period Ended June 30, 2013  
or

Transition Report Pursuant to Section 13 or  
o 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

13-2578432

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

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

Yes  No

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.

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

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

As of July 26, 2013 the registrant had 29,882,278 shares of its Common Stock, \$.06 2/3 par value, outstanding.

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Part I. Financial Information  
Item 1. Financial Statements

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

|  | June 30,<br>2013<br>(unaudited) | December<br>31, 2012 |
|--|---------------------------------|----------------------|
| <u>Assets</u>  |                                 |                      |
| Current assets:  |                                 |                      |
| Cash and cash equivalents  | \$ 171,220                      | \$ 144,737           |
| Accounts receivable, net   | 39,679                          | 41,999               |
| Inventories  | 24,714                          | 20,693               |
| Prepaid expenses   | 1,954                           | 3,048                |
| Prepaid income taxes   | -                               | 326                  |
| Deferred income taxes  | 801                             | 593                  |
| Other current assets   | 433                             | 513                  |
| Total current assets   | 238,801                         | 211,909              |
| Property, plant and equipment, net   | 54,512                          | 52,725               |
| Goodwill   | 28,515                          | 28,515               |
| Intangible assets with finite lives, net   | 17,084                          | 18,858               |
| Other assets   | 538                             | 538                  |
| Total assets   | \$ 339,450                      | \$ 312,545           |
| <u>Liabilities and Stockholders' Equity</u>  |                                 |                      |
| Current liabilities:   |                                 |                      |
| Trade accounts payable   | \$ 10,315                       | \$ 14,276            |
| Accrued expenses   | 11,460                          | 11,820               |
| Accrued compensation and other benefits  | 3,234                           | 4,138                |
| Income taxes payable   | 460                             | -                    |
| Total current liabilities  | 25,469                          | 30,234               |
| Deferred income taxes  | 5,282                           | 5,868                |
| Other long-term obligations  | 3,307                           | 3,431                |
| Total liabilities  | 34,058                          | 39,533               |
| 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; 29,852,278 shares issued and outstanding at June 30, 2013 and 29,454,171 shares issued and outstanding at December 31, 2012 | 1,990                           | 1,964                |
| Additional paid-in capital   | 67,349                          | 57,198               |
| Retained earnings  | 237,079                         | 214,609              |
| Accumulated other comprehensive loss   | (1,026 )                        | (759 )               |
| Total stockholders' equity   | 305,392                         | 273,012              |

|  |            |           |
|--|------------|-----------|
| Total liabilities and stockholders' equity | \$ 339,450 | \$312,545 |
|--|------------|-----------|

See accompanying notes to consolidated financial statements.

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

|   | Three Months |          | Six Months Ended |           |
|---|--------------|----------|------------------|-----------|
|   | Ended        |          | June 30,         |           |
|   | June 30,     | June 30, | 2013             | 2012      |
|   | 2013         | 2012     | 2013             | 2012      |
| Net sales                               | \$83,296     | \$79,014 | \$167,947        | \$155,217 |
| Cost of sales                           | 58,411       | 56,430   | 118,830          | 111,475   |
| Gross margin                            | 24,885       | 22,584   | 49,117           | 43,742    |
| Operating expenses:                     |              |          |                  |           |
| Selling expenses                        | 4,046        | 4,169    | 8,333            | 8,256     |
| Research and development expenses       | 947          | 947      | 1,785            | 1,723     |
| General and administrative expenses     | 3,276        | 2,643    | 6,518            | 5,263     |
|   | 8,269        | 7,759    | 16,636           | 15,242    |
| Earnings from operations                | 16,616       | 14,825   | 32,481           | 28,500    |
| Other expenses (income):                |              |          |                  |           |
| Interest income                         | (61 )        | (1 )     | (113 )           | (8 )      |
| Interest expense                        | 2            | 3        | 3                | 6         |
| Other, net                              | (7 )         | (1 )     | 46               | (10 )     |
| Earnings before income tax expense      | 16,682       | 14,824   | 32,545           | 28,512    |
| Income tax expense                      | 5,100        | 4,852    | 10,075           | 9,272     |
| Net earnings                            | \$11,582     | \$9,972  | \$22,470         | \$19,240  |
| Net earnings per common share - basic   | \$0.39       | \$0.34   | \$0.76           | \$0.66    |
| Net earnings per common share - diluted | \$0.38       | \$0.33   | \$0.73           | \$0.64    |

See accompanying notes to consolidated financial statements.

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

|   | Three Months<br>Ended<br>June 30, |          | Six Months Ended<br>June 30, |           |
|---|-----------------------------------|----------|------------------------------|-----------|
|   | 2013                              | 2012     | 2013                         | 2012      |
| Net earnings  | \$ 11,582                         | \$ 9,972 | \$ 22,470                    | \$ 19,240 |
| Other comprehensive income (loss), net of tax:  |                                   |          |                              |           |
| Net foreign currency translation adjustment   | 242                               | (792 )   | (265 )                       | (409 )    |
| Net change in postretirement benefit plan, net of taxes of \$-0- and \$1 for the three months ended June 30, 2013 and 2012, and \$1 and \$3 for the six months ended June 30, 2013 and 2012 | 3                                 | (4 )     | (2 )                         | (12 )     |
| Other comprehensive income (loss)   | 245                               | (796 )   | (267 )                       | (421 )    |
| Comprehensive income  | \$ 11,827                         | \$ 9,176 | \$ 22,203                    | \$ 18,819 |

See accompanying notes to consolidated financial statements.

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

|   | Six Months Ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2013                         | 2012      |
| Cash flows from operating activities:   |                              |           |
| Net earnings  | \$22,470                     | \$19,240  |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                              |           |
| Depreciation and amortization   | 5,231                        | 4,806     |
| Stock compensation expense  | 1,981                        | 1,946     |
| Shares issued under employee benefit plans  | -                            | 310       |
| Deferred income tax expense   | (783 )                       | (828 )    |
| Foreign currency transaction loss   | 63                           | 68        |
| Changes in assets and liabilities   |                              |           |
| Accounts receivable   | 2,144                        | (2,784 )  |
| Inventories   | (4,103 )                     | (1,537 )  |
| Prepaid expenses and other current assets   | 1,065                        | 515       |
| Accounts payable and accrued expenses   | (5,097 )                     | 2,632     |
| Income taxes  | 848                          | 6,753     |
| Other   | (35 )                        | 102       |
| Net cash provided by operating activities   | 23,784                       | 31,223    |
| Cash flows from investing activities:   |                              |           |
| Capital expenditures  | (5,171 )                     | (3,198 )  |
| Intangible assets acquired  | (216 )                       | (10 )     |
| Net cash used in investing activities   | (5,387 )                     | (3,208 )  |
| Cash flows from financing activities:   |                              |           |
| Proceeds from long-term debt  | -                            | 178       |
| Principal payments on long-term debt  | -                            | (695 )    |
| Repayments of short-term obligations  | (89 )                        | -         |
| Proceeds from stock options exercised   | 5,088                        | 877       |
| Excess tax benefits from stock compensation   | 3,164                        | 1,182     |
| Dividends paid  | -                            | (5,237 )  |
| Purchase of treasury stock  | (56 )                        | (964 )    |
| Net cash provided by (used in) financing activities                                 | 8,107                        | (4,659 )  |
| Effect of exchange rate changes on cash   | (21 )                        | (77 )     |
| Increase in cash and cash equivalents   | 26,483                       | 23,279    |
| Cash and cash equivalents beginning of period                                       | 144,737                      | 114,781   |
| Cash and cash equivalents end of period   | \$171,220                    | \$138,060 |

Supplemental Cash Flow Information - see Note 9





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, 2012 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, 2012. 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 six months ended June 30, 2013 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 six months ended June 30, 2013 and 2012 reflected the following stock-based compensation cost, and such compensation cost had the following effects on net earnings:

|                    | Increase/(Decrease)<br>for the<br>Three Months<br>Ended June 30, |        |
|--------------------|--|--------|
|                    | 2013   | 2012   |
| Cost of sales      | \$ 152   | \$ 145 |
| Operating expenses | 753  | 827    |
| Net earnings       | (573 )   | (620 ) |

|                    | Increase/(Decrease)<br>for the<br>Six Months Ended<br>June 30, |          |
|--------------------|--|----------|
|                    | 2013   | 2012     |
| Cost of sales      | \$ 304   | \$ 289   |
| Operating expenses | 1,677  | 1,657    |
| Net earnings       | (1,243 )   | (1,231 ) |

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 June 30, 2013, the plans had 4,295,152 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, ninety days to 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 six months ended June 30, 2013 and 2012 is summarized below:

| For the six months ended<br>June 30, 2013 | Shares<br>(000s) | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value<br>(\$000s) | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|---|------------------|--|---|---|
| Outstanding as of December 31, 2012       | 2,543            | \$ 16.87                                 | \$ 49,845                                   |   |
| Granted                                   | 172              | 38.35                                    |   |   |
| Exercised                                 | (402 )           | 12.65                                    |   |   |
| Forfeited                                 | (31 )            | 33.88                                    |   |   |
| Outstanding as of June 30, 2013           | 2,282            | \$ 19.01                                 | \$ 58,749                                   | 5.2   |
| Exercisable as of June 30, 2013           | 1,802            | \$ 15.11                                 | \$ 53,425                                   | 4.2   |

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| For the six months ended<br>June 30, 2012 | Shares<br>(000s) | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value<br>(\$000s) | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|---|------------------|--|---|---|
| Outstanding as of December 31, 2011       | 2,514            | \$ 14.68                                 | \$ 65,043                                   |   |
| Granted                                   | 225              | 29.11                                    |   |   |
| Exercised                                 | (92 )            | 9.52                                     |   |   |
| Forfeited                                 | (5 )             | 28.87                                    |   |   |
| Outstanding as of June 30, 2012           | 2,642            | \$ 16.06                                 | \$ 43,855                                   | 5.4   |
| Exercisable as of June 30, 2012           | 2,068            | \$ 12.51                                 | \$ 41,588                                   | 4.5   |

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 39% and 41%; risk-free interest rates of 1.0% and 0.8%; and expected lives of 5.0 and 4.6 years, in each case for the six months ended June 30, 2013 and 2012, 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 six months ended June 30, 2013 and 2012 was as follows:

|   | Three Months<br>Ended<br>June 30, |         | Six Months<br>Ended<br>June 30, |         |
|---|-----------------------------------|---------|---------------------------------|---------|
|   | 2013                              | 2012    | 2013                            | 2012    |
| Weighted-average fair value of options granted            | \$15.58                           | \$10.37 | \$12.94                         | \$9.75  |
| Total intrinsic value of stock options exercised (\$000s) | \$6,887                           | \$411   | \$11,984                        | \$2,590 |

Non-vested restricted stock activity for the six months ended June 30, 2013 and 2012 is summarized below:

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|  | Shares | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|--|--------|--|
| Six months ended June 30, 2013             | (000s) |  |
| Non-vested balance as of December 31, 2012 | 258    | \$ 26.88   |
| Granted                                    | 21     | 38.10  |
| Vested                                     | (3 )   | 35.79  |
| Forfeited                                  | (24 )  | 31.97  |
| Non-vested balance as of June 30, 2013     | 252    | \$ 27.18   |

|  | Shares | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|--|--------|--|
| Six months ended June 30, 2012             | (000s) |  |
| Non-vested balance as of December 31, 2011 | 354    | \$ 18.77   |
| Granted                                    | 44     | 29.06  |
| Vested                                     | (80 )  | 13.72  |
| Non-vested balance as of June 30, 2012     | 318    | \$ 21.48   |

As of June 30, 2013 and 2012, there was \$7,047 and \$6,883 respectively, of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans. As of June 30, 2013, 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, 2013 will be approximately \$3,800.

#### 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 2,055,434 shares have been purchased, none of which remained in treasury at June 30, 2013. During the six months ended June 30, 2013, a total of 1,266 shares have been purchased at an average cost of \$44.13 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 June 30, 2013 and December 31, 2012 consisted of the following:

|                   | June 30,<br>2013 | December<br>31,<br>2012 |
|-------------------|------------------|-------------------------|
| Raw materials     | \$9,321          | \$ 8,982                |
| Work in progress  | 1,171            | 1,720                   |
| Finished goods    | 14,222           | 9,991                   |
| Total inventories | \$24,714         | \$ 20,693               |

NOTE 4 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 2013 and December 31, 2012 are summarized as follows:

|                                   | June 30,<br>2013 | December<br>31,<br>2012 |
|-----------------------------------|------------------|-------------------------|
| Land                              | \$1,977          | \$1,998                 |
| Building                          | 19,341           | 16,526                  |
| Equipment                         | 81,488           | 70,859                  |
| Construction in progress          | 2,991            | 11,446                  |
|                                   | 105,797          | 100,829                 |
| Less: accumulated depreciation    | 51,285           | 48,104                  |
| Net property, plant and equipment | \$54,512         | \$52,725                |

NOTE 5 – INTANGIBLE ASSETS

The Company had goodwill in the amount of \$28,515 as of June 30, 2013 and December 31, 2012 subject to the provisions of ASC 350, “Intangibles-Goodwill and Other.”

Identifiable intangible assets with finite lives at June 30, 2013 and December 31, 2012 are summarized as follows:

|                               | Amortization<br>Period<br>(in years) | Gross<br>Carrying<br>Amount<br>at<br>6/30/13 | Accumulated<br>Amortization<br>at<br>6/30/13 | Gross<br>Carrying<br>Amount<br>at<br>12/31/12 | Accumulated<br>Amortization<br>at<br>12/31/12 |
|-------------------------------|--------------------------------------|--|--|---|---|
| Customer lists                | 10                                   | \$37,142                                     | \$ 22,732                                    | \$37,142                                      | \$ 20,912                                     |
| Regulatory registration costs | 5-10                                 | 1,619  | 437  | 1,411   | 361   |
| Patents & trade secrets       | 15-17                                | 1,586  | 807  | 1,581   | 765   |
| Trademarks & trade names      | 17                                   | 910  | 434  | 909   | 408   |
| Other                         | 5-10                                 | 754  | 517  | 754   | 493   |
|                               |                                      | \$42,011                                     | \$ 24,927                                    | \$41,797                                      | \$ 22,939                                     |

Amortization of identifiable intangible assets was approximately \$1,988 for the six months ended June 30, 2013. Assuming no change in the gross carrying value of identifiable intangible assets, the estimated amortization expense for the remainder of 2013 is \$1,990, approximately \$4,000 per annum for 2014 through 2016, \$1,400 in 2017 and \$600 in 2018. At June 30, 2013, 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 six months ended June 30, 2013.

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:

|  | Net<br>Earnings<br>(Numerator) | Number of<br>Shares<br>(Denominator) | Per<br>Share<br>Amount |
|--|--------------------------------|--------------------------------------|------------------------|
| Three months ended June 30, 2013   |                                |                                      |                        |
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 11,582                      | 29,505,151                           | \$ .39                 |
| Effect of dilutive securities – stock options and restricted stock   |                                | 1,280,234                            |                        |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 11,582                      | 30,785,385                           | \$ .38                 |
| Three months ended June 30, 2012   |                                |                                      |                        |
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 9,972                       | 28,956,523                           | \$ .34                 |
| Effect of dilutive securities – stock options and restricted stock   |                                | 1,316,409                            |                        |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 9,972                       | 30,272,932                           | \$ .33                 |
| Six months ended June 30, 2013   |                                |                                      |                        |
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 22,470                      | 29,410,802                           | \$ .76                 |
| Effect of dilutive securities – stock options and restricted stock   |                                | 1,289,759                            |                        |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 22,470                      | 30,700,561                           | \$ .73                 |

| Six months ended June 30, 2012   | Net Earnings (Numerator) | Number of Shares (Denominator) | Per Share Amount |
|--|--------------------------|--------------------------------|------------------|
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 19,240                | 28,940,875                     | \$ .66           |
| Effect of dilutive securities – stock options and restricted stock   |                          | 1,354,177                      |                  |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 19,240                | 30,295,052                     | \$ .64           |

The Company had stock options covering 161,286 and 519,455 shares at June 30, 2013 and 2012, 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 June 30, 2013, 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 six months ended June 30, 2013 and 2012, there was no significant change to the amount of unrecognized tax benefits. As of June 30, 2013 and December 31, 2012, the Company had approximately \$2,700 and \$2,300, 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 June 30, 2013 and December 31, 2012 was approximately \$765 and \$600, 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      |          | Six Months Ended |           |
|---------------------------|-------------------|----------|------------------|-----------|
|                           | Ended<br>June 30, |          | June 30,         |           |
|                           | 2013              | 2012     | 2013             | 2012      |
| Specialty Products        | \$13,219          | \$12,457 | \$25,999         | \$24,714  |
| Food, Pharma & Nutrition  | 12,146            | 11,776   | 23,154           | 22,513    |
| Animal Nutrition & Health | 57,931            | 54,781   | 118,794          | 107,990   |
| Total                     | \$83,296          | \$79,014 | \$167,947        | \$155,217 |

Business Segment Earnings Before Income Taxes:

|                                     | Three Months      |          | Six Months Ended |          |
|-------------------------------------|-------------------|----------|------------------|----------|
|                                     | Ended<br>June 30, |          | June 30,         |          |
|                                     | 2013              | 2012     | 2013             | 2012     |
| Specialty Products                  | \$5,279           | \$4,849  | \$10,188         | \$9,578  |
| Food, Pharma & Nutrition            | 3,269             | 3,389    | 5,776            | 6,098    |
| Animal Nutrition & Health           | 8,068             | 6,587    | 16,517           | 12,824   |
| Interest and other income (expense) | 66                | (1 )     | 64               | 12       |
| Total                               | \$16,682          | \$14,824 | \$32,545         | \$28,512 |

The following table summarizes domestic (U.S.) and foreign sales for the three and six months ended June 30, 2013 and June 30, 2012:

|          | Three Months      |          | Six Months Ended |           |
|----------|-------------------|----------|------------------|-----------|
|          | Ended<br>June 30, |          | June 30,         |           |
|          | 2013              | 2012     | 2013             | 2012      |
| Domestic | \$57,673          | \$52,875 | \$113,113        | \$103,753 |
| Foreign  | 25,623            | 26,139   | 54,834           | 51,464    |
| Total    | \$83,296          | \$79,014 | \$167,947        | \$155,217 |

NOTE 9 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the six months ended June 30, 2013 and 2012 for income taxes and interest is as follows:

|              | Six Months        |         |
|--------------|-------------------|---------|
|              | Ended<br>June 30, |         |
|              | 2013              | 2012    |
| Income taxes | \$7,022           | \$3,510 |
| Interest     | \$21              | \$5     |





NOTE 10 – ACCUMULATED OTHER COMPREHENSIVE INCOME - NEW ACCOUNTING PRONOUNCEMENT

In February 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-02, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income” (“ASU 2013-02”). This guidance is the culmination of the FASB’s deliberation on reporting reclassification adjustments from accumulated other comprehensive income (“AOCI”). The amendments in ASU 2013-02 do not change the current requirements for reporting net income or other comprehensive income. However, the amendments require disclosure of amounts reclassified out of AOCI in its entirety, by component, on the face of the statement of operations or in the notes thereto. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This standard is effective prospectively for annual and interim reporting periods beginning after December 15, 2012. Other than the additional disclosure requirements (see below), the adoption of these changes had no impact on the Company’s consolidated financial statements.

The changes in accumulated other comprehensive income (loss) were as follows:

|   | Three<br>Months<br>Ended<br>June 30,<br>2013 2012 |         |
|---|---|---------|
| Net foreign currency translation adjustment                                     | \$242   | \$(792) |
| Net change in postretirement benefit plan (see Note 11 for further information) |   |         |
| Amortization of prior service credit  | (4 )  | (4 )    |
| Amortization of loss/(gain)   | 7   | (1 )    |
| Total before tax  | 3   | (5 )    |
| Tax   | -   | 1       |
| Net of tax  | 3   | (4 )    |
| Total other comprehensive income (loss)   | 245   | (796)   |
|   |   |         |
|   | Six Months<br>Ended<br>June 30,<br>2013 2012      |         |
| Net foreign currency translation adjustment                                     | \$(265)   | \$(409) |
| Net change in postretirement benefit plan (see Note 11 for further information) |   |         |
| Amortization of prior service credit  | (9 )  | (9 )    |
| Amortization of loss/(gain)   | 6   | (6 )    |
| Total before tax  | (3 )  | (15 )   |
| Tax   | 1   | 3       |
| Net of tax  | (2 )  | (12 )   |
| Total other comprehensive loss  | \$(267)   | \$(421) |

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 six months ended June 30, 2013 and June 30, 2012 was as follows:

|                                      | 2013  | 2012  |
|--------------------------------------|-------|-------|
| Service cost                         | \$ 33 | \$ 26 |
| Interest cost                        | 21    | 21    |
| Amortization of prior service credit | (9 )  | (9 )  |
| Amortization of loss/(gain)          | 6     | (6 )  |
| Net periodic benefit cost            | \$ 51 | \$ 32 |

The amount recorded on the Company's balance sheet as of June 30, 2013 for this obligation is \$1,353, 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 2012, the Company entered into a six (6) year lease extension for approximately 20,000 square feet of office space. 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 six months ended June 30, 2013 and 2012 aggregated approximately \$508 and \$470, respectively. Aggregate future minimum rental payments required under all non-cancelable operating leases at June 30, 2013 are as follows:

| Year                              |         |
|-----------------------------------|---------|
| July 1, 2013 to December 31, 2013 | \$ 503  |
| 2014                              | 871     |
| 2015                              | 788     |
| 2016                              | 714     |
| 2017                              | 675     |
| 2018                              | 359     |
| Thereafter                        | 195     |
| Total minimum lease payments      | \$4,105 |

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 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 – FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company has a number of financial instruments, none of which are held for trading purposes. The Company estimates that the fair value of all financial instruments at June 30, 2013 and December 31, 2012 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying consolidated balance sheets. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. Considerable judgment is necessarily required in interpreting market data to develop the estimates of fair value, and, accordingly, the estimates are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The Company's financial instruments, principally cash equivalents, accounts receivable, accounts payable and accrued liabilities, are carried at cost which approximates fair value due to the short-term maturity of these instruments. Cash and cash equivalents at June 30, 2013 include \$66,000 in certificates of deposit and \$50,337 in a money market fund. The certificates of deposit and the money market fund are valued using level two and level one inputs, respectively, as defined by ASC 820, "Fair Value Measurement."

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 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, 2012 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.

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, NITROSHURE™, an encapsulated urea supplement, and NIASHURE™, our microencapsulated 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 required nutritional levels. We also market chelated mineral supplements for use in animal feed throughout the world, as our proprietary chelation technology provides enhanced nutrient absorption for various species of production and companion animals. 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 six months ended June 30, 2013 and June 30, 2012:

## Business Segment Net Sales:

|                           | Three Months              |          | Six Months Ended |           |
|---------------------------|---------------------------|----------|------------------|-----------|
|                           | Ended<br>June 30,<br>2013 | 2012     | June 30,<br>2013 | 2012      |
| Specialty Products        | \$13,219                  | \$12,457 | \$25,999         | \$24,714  |
| Food, Pharma & Nutrition  | 12,146                    | 11,776   | 23,154           | 22,513    |
| Animal Nutrition & Health | 57,931                    | 54,781   | 118,794          | 107,990   |
| Total                     | \$83,296                  | \$79,014 | \$167,947        | \$155,217 |

## Business Segment Earnings From Operations:

|                           | Three Months |          | Six Months Ended |          |
|---------------------------|--------------|----------|------------------|----------|
|                           | Ended        |          | June 30,         |          |
|                           | June 30,     | 2012     | 2013             | 2012     |
| Specialty Products        | \$5,279      | \$4,849  | \$10,188         | \$9,578  |
| Food, Pharma & Nutrition  | 3,269        | 3,389    | 5,776            | 6,098    |
| Animal Nutrition & Health | 8,068        | 6,587    | 16,517           | 12,824   |
| Total                     | \$16,616     | \$14,825 | \$32,481         | \$28,500 |

RESULTS OF OPERATIONS

Three months ended June 30, 2013 compared to three months ended June 30, 2012.

Net Sales

Net sales for the three months ended June 30, 2013 were \$83,296 as compared with \$79,014 for the three months ended June 30, 2012, an increase of \$4,282 or 5.4%. Net sales for the Specialty Products segment were \$13,219 for the three months ended June 30, 2013, as compared with \$12,457 for the three months ended June 30, 2012, an increase of \$762 or 6.1%. Approximately half of this increase in sales was due to higher volumes of propylene oxide for use in industrial applications and nutmeat fumigation. The balance of the increased sales was principally from ethylene oxide products for medical device sterilization, resulting primarily from increased volumes. Net sales for the Food, Pharma & Nutrition segment were \$12,146 for the three months ended June 30, 2013 compared with \$11,776 for the three months ended June 30, 2012, an increase of \$370 or 3.1%. This result was primarily due to increased sales of approximately \$575 for VITASHURE® products for nutritional enhancement, including sustained release amino acid products for sports performance products. Also contributing to the higher sales was a 5.3% increase in sales in the food sector, principally due to higher volumes sold of encapsulated ingredients for baking and prepared food markets. Partially offsetting this was a \$462 decrease in sales of human choline products for both food applications and the supplement markets. Net sales of \$57,931 were realized for the three months ended June 30, 2013 for the Animal Nutrition & Health segment, as compared with \$54,781 for the prior year comparable period, an increase of \$3,150 or 5.8%. The ANH specialty ingredients, largely targeted to the ruminant and companion animal markets, realized a 9% sales decline from the prior year comparable period. This decrease was primarily due to lower volumes, related mainly to the adverse impact of the previously announced second quarter 2012 suspension of sales of AminoShure®-L, 52% lysine (the "Product"). Sales of non-AminoShure products were up 11.4% compared with the prior year comparable period, led by strong volume growth of NitroShure™ and ReaShure®. Global feed grade choline product sales decreased by approximately 3% due to lower volumes related to a disruption to production and sales in June due to the declaration of force majeure by a key supplier. This situation corrected itself in early July and full production capability has been restored. The lower volumes were partially offset by modest price increases, implemented globally, to partially offset increased raw material costs, along with an improved product mix. Although sales volumes were negatively impacted by the aforementioned force majeure, the Company experienced increased sales of various choline and choline derivative products used for industrial applications, predominantly in North America, including usage in fracking for oil and natural gas. Industrial sales grew 28.8% over the prior year period with the increase coming primarily from higher volumes for usage in fracking. Sales for industrial applications comprised approximately 39% of the sales in this segment for the three months ended June 30, 2013.

### Gross Margin

Gross margin for the three months ended June 30, 2013 increased to \$24,885 compared to \$22,584 for the three months ended June 30, 2012, an increase of 10.2%. This \$2,301 increase was principally a result of higher sales volumes. Gross margin percentage for the three months ended June 30, 2013 increased to 29.9% as compared to 28.6% in the prior year comparative period, primarily due to operating efficiencies from increased volumes. Gross margin percentage for the Specialty Products segment increased by 2.7% primarily due to operating efficiencies from increased volumes and a favorable product mix. Gross margin percentage in the Food, Pharma & Nutrition segment decreased by 1.5% primarily due to higher raw material costs for human choline products. Gross margin percentage in the Animal Nutrition and Health segment increased by 1.6%, principally due to operating efficiencies from increased volumes and an improved product mix, partially offset by higher costs of certain petro-chemical commodities used to manufacture choline and derivatives.

### Operating Expenses

Operating expenses for the three months ended June 30, 2013 were \$8,269, as compared to \$7,759 for the three months ended June 30, 2012, an increase of \$510 or 6.6%. This was primarily due to an increase of employee headcount and additional compensation-related expenses totaling approximately \$445 and higher advertising of \$145, partially offset by the exclusion of costs of \$160 related to the Product sales suspension which were incurred in the second quarter 2012. Operating expenses were 9.9% of sales or 0.1 percentage point more than the operating expenses as a percent of sales in last year's comparable period. During the three months ended June 30, 2013 and 2012, the Company spent \$947 and \$947 respectively, on research and development programs, substantially all of which pertained to the Company's Food, Pharma & Nutrition and Animal Nutrition & Health segments.

### Earnings From Operations

Principally as a result of the above-noted details, earnings from operations for the three months ended June 30, 2013 increased to \$16,616 as compared to \$14,825 for the three months ended June 30, 2012, an increase of \$1,791 or 12.1%. Earnings from operations as a percentage of sales ("operating margin") for the three months ended June 30, 2013 increased to 19.9% from 18.8% for the three months ended June 30, 2012. The Company is continuing to focus on leveraging its plant capabilities, driving efficiencies from core volume growth, broadening product applications of human and animal health specialty products into both the domestic and international markets, as well as capitalizing logistically on the Company's varied choline production capabilities. Earnings from operations for the Specialty Products segment were \$5,279, an increase of \$430 or 8.9%, primarily due to the above-noted higher sales of propylene oxide and ethylene oxide, a favorable product mix, and operating efficiencies from increased volumes, partially offset by certain higher operating expenses. Earnings from operations for Food, Pharma & Nutrition were \$3,269, a decrease of \$120 or 3.5%, due largely to the aforementioned higher raw material costs. Earnings from operations for Animal Nutrition & Health increased by \$1,481 to \$8,068, a 22.5% increase from the prior year comparable period, principally due to the aforementioned higher sales and operating efficiencies from increased volumes, partially offset by higher costs of certain petro-chemical commodities used to manufacture choline and derivatives and certain higher operating expenses.



Other Expenses (Income)

Interest income for the three months ended June 30, 2013 totaled \$61 as compared to \$1 for the three months ended June 30, 2012. The Company has invested available cash primarily in certificates of deposit and money market investments that have been classified as cash equivalents due to the short maturities of these investments. Interest expense was \$2 for the three months ended June 30, 2013 compared to \$3 for the three months ended June 30, 2012. Other income of \$7 and \$1 for the three months ended June 30, 2013 and 2012, respectively, is primarily the result of favorable fluctuations in foreign currency exchange rates between the U.S. dollar (the reporting currency) and functional foreign currencies.

Income Tax Expense

The Company's effective tax rate for the three months ended June 30, 2013 and 2012 was 30.6% and 32.7%, respectively. This decrease in the effective tax rate is primarily attributable to the timing of certain tax credits and deductions.

Net Earnings

Principally as a result of the above-noted details, net earnings were \$11,582 for the three months ended June 30, 2013, as compared with \$9,972 for the three months ended June 30, 2012, an increase of 16.1%.

Six months ended June 30, 2013 compared to six months ended June 30, 2012.

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### Net Sales

Net sales for the six months ended June 30, 2013 were \$167,947 as compared with \$155,217 for the six months ended June 30, 2012, an increase of \$12,730 or 8.2%. Net sales for the Specialty Products segment were \$25,999 for the six months ended June 30, 2013, as compared with \$24,714 for the six months ended June 30, 2012, an increase of \$1,285 or 5.2%. Approximately half of this increase in sales was due to higher volumes of propylene oxide for use in industrial applications and nutmeat fumigation. The balance of the increased sales was principally from ethylene oxide products for medical device sterilization, resulting from slightly higher average selling prices and increased volumes. Net sales for the Food, Pharma & Nutrition segment were \$23,154 for the six months ended June 30, 2013 compared with \$22,513 for the six months ended June 30, 2012, an increase of \$641 or 2.8%. This result was primarily due to a 6.7% increase in sales in the food sector, principally due to higher volumes sold of encapsulated ingredients for baking and prepared food markets. Also contributing to the higher sales was increased sales of approximately \$903 for VitaShure® products for nutritional enhancement, including sustained release amino acid products for sports performance products. Partially offsetting these increases in FPN was a \$903 decrease in sales of human choline products for both food applications and the supplement markets. Net sales of \$118,794 were realized for the six months ended June 30, 2013 for the Animal Nutrition & Health segment, as compared with \$107,990 for the prior year comparable period, an increase of \$10,804 or 10.0%. The ANH specialty ingredients, largely targeted to the ruminant and companion animal markets, realized 1% sales growth from the prior year comparable period. The slight improvement was due to modest price increases partially to offset higher raw material costs, and an improved product mix. This was offset by lower volumes, including related to the Product sales suspension. Sales of non-AminoShure® products were up 23.9% compared with the prior year comparable period, led by strong volume growth of ReaShure® and NitroShure.™ Global feed grade choline product sales increased by approximately 2% due to modest price increases, implemented globally, to partially offset increased raw material costs, along with an improved product mix. This was partially offset by lower volumes related to a disruption to production and sales in June due to the declaration of force majeure by a key supplier. This situation corrected itself in early July and full production capability has been restored. The Company experienced increased sales of various choline and choline derivative products used for industrial applications, predominantly in North America, including usage in fracking for oil and natural gas. Industrial sales grew 28.9% over the prior year period with the increase coming primarily from higher volumes for usage in fracking. Sales for industrial applications comprised approximately 35% of the sales in this segment for the six months ended June 30, 2013.

### Gross Margin

Gross margin for the six months ended June 30, 2013 increased to \$49,117 compared to \$43,742 for the six months ended June 30, 2012, an increase of 12.3%. This \$5,375 increase was principally a result of higher sales volumes. Gross margin percentage for the six months ended June 30, 2013 increased to 29.2% as compared to 28.2% in the prior year comparative period, primarily due to operating efficiencies from increased volumes. Gross margin percentage for the Specialty Products segment increased by 2.4% primarily due to a favorable product mix and operating efficiencies from increased volumes. Gross margin percentage in the Food, Pharma & Nutrition segment decreased by 2.1% primarily due to higher raw material costs for human choline products. Gross margin percentage in the Animal Nutrition and Health segment increased by 1.8%, principally due to operating efficiencies from increased volumes and an improved product mix.

### Operating Expenses

Operating expenses for the six months ended June 30, 2013 were \$16,636, as compared to \$15,242 for the six months ended June 30, 2012, an increase of \$1,394 or 9.1%. This was primarily due to an increase of employee headcount and additional compensation-related expenses totaling approximately \$1,005 and higher advertising of \$283, partially offset by the exclusion of costs of \$160 related to the Product sales suspension which were incurred in the second quarter 2012. During the six months ended June 30, 2013 and 2012, the Company spent \$1,785 and \$1,723 respectively, on research and development programs, substantially all of which pertained to the Company's Food,

Pharma & Nutrition and Animal Nutrition & Health segments.

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### Earnings From Operations

Principally as a result of the above-noted details, earnings from operations for the six months ended June 30, 2013 increased to \$32,481 as compared to \$28,500 for the six months ended June 30, 2012, an increase of \$3,981 or 14.0%. Earnings from operations as a percentage of sales (“operating margin”) for the six months ended June 30, 2013 increased to 19.3% from 18.4% for the six months ended June 30, 2012. The Company is continuing to focus on leveraging its plant capabilities, driving efficiencies from core volume growth, broadening product applications of human and animal health specialty products into both the domestic and international markets, as well as capitalizing logistically on the Company’s varied choline production capabilities. Earnings from operations for the Specialty Products segment were \$10,188, an increase of \$610 or 6.4%, primarily due to the above-noted higher sales of propylene oxide and ethylene oxide, a favorable product mix, and operating efficiencies from increased volumes, partially offset by certain higher operating expenses. Earnings from operations for Food, Pharma & Nutrition were \$5,776, a decrease of \$322 or 5.3%, due largely to the aforementioned higher raw material costs for human choline products. Earnings from operations for Animal Nutrition & Health increased by \$3,693 to \$16,517, a 28.8% increase from the prior year comparable period, principally due to the aforementioned higher sales and operating efficiencies from increased volumes, partially offset by certain higher operating expenses.

### Other Expenses (Income)

Interest income for the six months ended June 30, 2013 totaled \$113 as compared to \$8 for the six months ended June 30, 2012. The Company has invested available cash primarily in certificates of deposit and money market investments that have been classified as cash equivalents due to the short maturities of these investments. Interest expense was \$3 for the six months ended June 30, 2013 compared to \$6 for the six months ended June 30, 2012. Other expense of \$46 for the six months ended June 30, 2013 is primarily the result of unfavorable fluctuations in foreign currency exchange rates between the U.S. dollar (the reporting currency) and functional foreign currencies. Other income of \$10 for the six months ended June 30, 2012 is primarily the result of favorable fluctuations in foreign currency exchange rates between the U.S. dollar (the reporting currency) and functional foreign currencies.

### Income Tax Expense

The Company’s effective tax rate for the six months ended June 30, 2013 and 2012 was 31.0% and 32.5%, respectively. This decrease in the effective tax rate is primarily attributable to the timing of certain tax credits and deductions.

### Net Earnings

Principally as a result of the above-noted details, net earnings were \$22,470 for the six months ended June 30, 2013, as compared with \$19,240 for the six months ended June 30, 2012, an increase of 16.8%.

### FINANCIAL CONDITION

#### LIQUIDITY AND CAPITAL RESOURCES

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

#### Contractual Obligations

The Company's contractual obligations and commitments principally include obligations associated with future minimum non-cancelable operating lease obligations and purchase obligations principally related to open purchase orders for inventory not yet received or recorded on our balance sheet.

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

During the six months ended June 30, 2013, there were no material changes outside the ordinary course of business in the specified contractual obligations set forth in our Annual Report on Form 10-K for the year ended December 31, 2012. 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

Cash and cash equivalents increased to \$171,220 at June 30, 2013 from \$144,737 at December 31, 2012 primarily resulting from the activity detailed below. At June 30, 2013, the Company had \$1,781 of cash and cash equivalents held by our foreign subsidiaries. It is our intention to permanently reinvest these funds in our foreign operations by continuing to make additional plant related investments as needed, and potentially invest in partnerships and/or acquisitions; therefore, we do not currently expect to repatriate these funds in order to fund our U.S. operations or obligations. However, if these funds are needed for our operations in the U.S., we could be required to pay additional U.S. taxes to repatriate these funds. Working capital amounted to \$213,332 at June 30, 2013 as compared to \$181,675 at December 31, 2012, an increase of \$31,657.

#### Operating Activities

Cash flows from operating activities provided \$23,784 for the six months ended June 30, 2013 compared to \$31,223 for the six months ended June 30, 2012. The decrease in cash flows from operating activities was primarily due to unfavorable changes in various components of working capital, particularly in inventories and accounts payable and accrued expenses, along with a less favorable change in income taxes.

### Investing Activities

Capital expenditures were \$5,171 for the six months ended June 30, 2013 compared to \$3,198 for the six months ended June 30, 2012. The capital expenditures for 2013 were predominantly for the Company's new manufacturing facility in Covington, Virginia.

### Financing Activities

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 2,055,434 shares have been purchased, none of which remained in treasury at June 30, 2013. During the six months ended June 30, 2013, a total of 1,266 shares have been purchased at an average cost of \$44.13 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.

Proceeds from stock options exercised totaled \$5,088 and \$877 for the six months ended June 30, 2013 and 2012, respectively. Dividend payments were \$-0- and \$5,237 for the six months ended June 30, 2013 and 2012, respectively.

### Other Matters Impacting Liquidity

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, 2013 for this obligation is \$1,353. The postretirement plan is not funded. Historical cash payments made under such plan have typically been less than \$100 per year.

### Critical Accounting Policies

There were no changes to the Company's Critical Accounting Policies, as described in its December 31, 2012 Annual Report on Form 10-K, during the six months ended June 30, 2013.

### Related Party Transactions

The Company was not engaged in related party transactions during the six months ended June 30, 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Cash and cash equivalents are held primarily in certificates of deposit and money market investment funds. 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, 2013, the Company had no borrowings. The Company is exposed to market risks for changes in foreign currency rates and has exposure to commodity price risks, including prices of our primary raw materials. Our objective is to seek a reduction in the potential negative earnings impact of changes in foreign exchange rates and raw material pricing arising in our business activities. The Company manages these financial exposures, where possible, through pricing and operational means. Our practices may change as economic conditions change.

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Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the “Exchange Act”), we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as of the end of the period covered by this report on Form 10-Q. This evaluation was carried out under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, management concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to management (including the chief executive officer and chief financial officer) to allow timely decisions regarding required disclosure and that our disclosure controls and procedures are effective to give reasonable assurance that the information required to be disclosed by us in reports that we file under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission.

(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, 2012.

Item 4. Reserved.

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.

101.INSXBRL Instance Document

101.SCHXBRL Taxonomy Extension Schema Document

101.CALXBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PREXBRL Taxonomy Extension Presentation Linkbase Document

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

By: /s/ Dino A. Rossi

Dino A. Rossi, Chairman, President and  
Chief Executive Officer

By: /s/ Francis J. Fitzpatrick

Francis J. Fitzpatrick, Chief Financial Officer and Treasurer

Date: August 2, 2013

Exhibit Index

Exhibit No. Description

|                               |   |
|-------------------------------|---|
| <u>Exhibit</u><br><u>31.1</u> | Certification of Chief Executive Officer pursuant to Rule 13a-14(a).  |
| <u>Exhibit</u><br><u>31.2</u> | Certification of Chief Financial Officer pursuant to Rule 13a-14(a).  |
| <u>Exhibit</u><br><u>32.1</u> | 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. |
| <u>Exhibit</u><br><u>32.2</u> | 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. |
| 101.INS                       | XBRL Instance Document  |
| 101.SCH                       | XBRL Taxonomy Extension Schema Document   |
| 101.CAL                       | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF                       | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB                       | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE                       | XBRL Taxonomy Extension Presentation Linkbase Document  |