

BALCHEM CORP  
Form 10-Q  
November 10, 2014

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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 September 30, 2014

Or

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

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

Commission File Number 1-13648

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

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

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

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

Large accelerated filer  Accelerated filer   
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 November 7, 2014 the registrant had 30,741,994 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)

|   | September<br>30, 2014<br>(unaudited) | December<br>31,<br>2013 |
|---|--------------------------------------|-------------------------|
| <u>Assets</u>   |                                      |                         |
| Current assets:   |                                      |                         |
| Cash and cash equivalents   | \$ 25,404                            | \$ 208,747              |
| Accounts receivable, net of allowance for doubtful accounts of \$289 and \$115 at September 30, 2014 and December 31, 2013  | 72,607                               | 39,386                  |
| Inventories   | 58,189                               | 24,824                  |
| Prepaid expenses  | 2,488                                | 2,580                   |
| Prepaid income taxes  | 949                                  | 899                     |
| Deferred income taxes   | 991                                  | 893                     |
| Other current assets  | 3,167                                | 445                     |
| Total current assets  | 163,795                              | 277,774                 |
| Property, plant and equipment, net  | 128,237                              | 54,916                  |
| Goodwill  | 385,646                              | 28,515                  |
| Intangible assets with finite lives, net  | 167,291                              | 15,126                  |
| Other assets  | 3,831                                | 541                     |
| Total assets  | \$ 848,800                           | \$ 376,872              |
| <u>Liabilities and Stockholders' Equity</u>   |                                      |                         |
| Current liabilities:  |                                      |                         |
| Trade accounts payable  | \$ 20,648                            | \$ 12,395               |
| Accrued expenses  | 17,951                               | 10,660                  |
| Accrued compensation and other benefits   | 6,774                                | 4,770                   |
| Customer deposits and other deferred revenue  | -                                    | 72                      |
| Dividends payable   | -                                    | 7,856                   |
| Current portion of long-term debt   | 35,000                               | -                       |
| Total current liabilities   | 80,373                               | 35,753                  |
| Long-term debt  | 306,250                              | -                       |
| Deferred income taxes   | 79,507                               | 5,884                   |
| Other long-term obligations   | 6,033                                | 3,877                   |
| Total liabilities   | 472,163                              | 45,514                  |
| Commitments and contingencies (note 14)   |                                      |                         |
| 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; 30,695,494 shares issued and outstanding at September 30, 2014 and 30,225,763 shares issued and outstanding at December 31, 2013 | 2,047                                | 2,016                   |
| Additional paid-in capital  | 90,901                               | 77,517                  |

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|  |            |            |
|--|------------|------------|
| Retained earnings                          | 285,431    | 251,627    |
| Accumulated other comprehensive income     | (1,742 )   | 198        |
| Total stockholders' equity                 | 376,637    | 331,358    |
| Total liabilities and stockholders' equity | \$ 848,800 | \$ 376,872 |

See accompanying notes to condensed consolidated financial statements.

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

|   | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|--|----------|------------------------------------|-----------|
|   | 2014                                   | 2013     | 2014                               | 2013      |
| Net sales                               | \$160,490                              | \$87,593 | \$378,715                          | \$255,540 |
| Cost of sales                           | 116,003                                | 63,071   | 278,678                            | 181,901   |
| Gross margin                            | 44,487                                 | 24,522   | 100,037                            | 73,639    |
| Operating expenses:                     |  |          |                                    |           |
| Selling expenses                        | 11,458                                 | 3,679    | 24,199                             | 12,012    |
| Research and development expenses       | 1,445                                  | 876      | 3,337                              | 2,661     |
| General and administrative expenses     | 6,300                                  | 2,991    | 17,353                             | 9,509     |
|   | 19,203                                 | 7,546    | 44,889                             | 24,182    |
| Earnings from operations                | 25,284                                 | 16,976   | 55,148                             | 49,457    |
| Other expenses (income):                |  |          |                                    |           |
| Interest income                         | (3 )                                   | (65 )    | (62 )                              | (178 )    |
| Interest expense                        | 2,052                                  | 2        | 3,368                              | 5         |
| Other, net                              | 26                                     | (21 )    | (30 )                              | 25        |
| Earnings before income tax expense      | 23,209                                 | 17,060   | 51,872                             | 49,605    |
| Income tax expense                      | 8,031                                  | 5,403    | 18,068                             | 15,478    |
| Net earnings                            | \$15,178                               | \$11,657 | \$33,804                           | \$34,127  |
| Net earnings per common share - basic   | \$0.50                                 | \$0.39   | \$1.12                             | \$1.16    |
| Net earnings per common share - diluted | \$0.49                                 | \$0.38   | \$1.09                             | \$1.11    |

See accompanying notes to condensed consolidated financial statements.

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

|  | Three Months<br>Ended<br>September 30,<br>2014 |          | September 30,<br>2013 |          | Nine Months<br>Ended<br>September 30,<br>2014 |  | September 30,<br>2013 |  |
|--|--|----------|-----------------------|----------|---|--|-----------------------|--|
| Net earnings   | \$15,178                                       | \$11,657 | \$33,804              | \$34,127 |   |  |                       |  |
| Other comprehensive (loss) income, net of tax:   |  |          |                       |          |   |  |                       |  |
| Net foreign currency translation adjustment  | (1,739 )                                       | 749      | (1,934 )              | 484      |   |  |                       |  |
| Net change in postretirement benefit plan, net of taxes of \$1 and \$-0- for the three months ended September 30, 2014 and 2013, and \$3 and \$1 for the nine months ended September 30, 2014 and 2013 | (2 )   | 1        | (6 )                  | (1 )     |   |  |                       |  |
| Other comprehensive (loss) income  | (1,741 )                                       | 750      | (1,940 )              | 483      |   |  |                       |  |
| Comprehensive income   | \$13,437                                       | \$12,407 | \$31,864              | \$34,610 |   |  |                       |  |

See accompanying notes to condensed consolidated financial statements.

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

|   | Nine Months Ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2014                               | 2013     |
| Cash flows from operating activities:   |                                    |          |
| Net earnings  | \$33,804                           | \$34,127 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                    |          |
| Depreciation and amortization   | 20,190                             | 7,838    |
| Stock compensation expense  | 3,449                              | 2,887    |
| Deferred income taxes   | (3,788 )                           | 73       |
| Provision for doubtful accounts   | 239                                | -        |
| Foreign currency transaction loss   | 84                                 | 69       |
| Loss on sale of assets  | 140                                | -        |
| Changes in assets and liabilities   |                                    |          |
| Accounts receivable   | (8,639 )                           | 1,710    |
| Inventories   | (1,698 )                           | (3,965 ) |
| Prepaid expenses and other current assets   | 1,531                              | 1,564    |
| Accounts payable and accrued expenses   | 3,681                              | (5,347 ) |
| Income taxes  | 214                                | 255      |
| Customer deposits and other deferred revenue  | (535 )                             | 233      |
| Other   | 569                                | 428      |
| Net cash provided by operating activities   | 49,241                             | 39,872   |
| Cash flows from investing activities:   |                                    |          |
| Capital expenditures  | (5,934 )                           | (6,644 ) |
| Proceeds from sale of property, plant and equipment                                 | -                                  | 40       |
| Cash paid for acquisition, net of cash acquired                                     | (566,607)                          | -        |
| Intangible assets acquired  | (91 )                              | (218 )   |
| Net cash used in investing activities   | (572,632)                          | (6,822 ) |
| Cash flows from financing activities:   |                                    |          |
| Proceeds from long-term debt  | 350,000                            | -        |
| Principal payments on long-term debt  | (8,750 )                           | -        |
| Proceeds from revolving loan  | 50,000                             | -        |
| Principal payments on revolving loan  | (50,000 )                          | -        |
| Cash paid for financing costs   | (2,593 )                           | -        |
| Repayments of short-term obligations  | (89 )                              | (89 )    |
| Proceeds from stock options exercised   | 6,608                              | 6,742    |
| Excess tax benefits from stock compensation   | 3,626                              | 5,715    |
| Dividends paid  | (7,856 )                           | -        |
| Purchase of treasury stock  | (267 )                             | (86 )    |
| Net cash provided by financing activities   | 340,679                            | 12,282   |
| Effect of exchange rate changes on cash   | (631 )                             | 110      |

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|  |           |           |
|--|-----------|-----------|
| (Decrease) increase in cash and cash equivalents | (183,343) | 45,442    |
| Cash and cash equivalents beginning of period    | 208,747   | 144,737   |
| Cash and cash equivalents end of period          | \$25,404  | \$190,179 |

Supplemental Cash Flow Information - see Note 11

See accompanying notes to condensed consolidated financial statements.

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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, 2013 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, 2013. 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 Italia Srl, Performance Chemicals & Ingredients Company, SensoryEffects Powder Systems, Inc., SensoryEffects Cereal Systems, Inc., SensoryEffects Flavor Company, SensoryEffects International Sales, Inc., and SEPS Reading LLC, on a consolidated basis, as the context requires.

In the opinion of management, the unaudited condensed consolidated financial statements furnished in this Form 10-Q include all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature. The condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP” or “GAAP”) governing interim financial statements and the instructions to Form 10-Q and Article 10 of Regulation S-X under the Securities Exchange Act of 1934 and therefore do not include some information and notes necessary to conform to annual reporting requirements. Certain prior year amounts have been reclassified to conform to current year presentation. The results of operations for the nine months ended September 30, 2014 are not necessarily indicative of the operating results expected for the full year or any interim period.

NOTE 2—ACQUISITION OF PERFORMANCE CHEMICALS & INGREDIENTS COMPANY

On May 7, 2014, the Company acquired 100 percent (the “Acquisition”) of the outstanding common shares of Performance Chemicals & Ingredients Company (d/b/a SensoryEffects), a privately held supplier of customized food and ingredient systems, headquartered in St. Louis, Missouri, for a purchase price of approximately \$569 million, including working capital acquired. SensoryEffects is a leader in powder, solid and liquid flavor systems, creamer and specialty emulsified powders, cereal-based products and other functional ingredient food and beverage delivery systems. The Acquisition of SensoryEffects accelerates the Company’s growth into the health and wellness markets. SensoryEffects was merged with the Company’s Food, Pharma & Nutrition segment, strengthening its market leadership position, and the segment was renamed SensoryEffects.

The estimated goodwill of \$357,131 arising from the Acquisition consists largely of expected synergies, including the combined entities experience and technical problem solving capabilities, and acquired workforce. The goodwill is assigned to the SensoryEffects segment and approximately \$20,466 is expected to be tax deductible for income tax purposes.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed.

|                                    |           |
|------------------------------------|-----------|
| Cash and cash equivalents          | \$2,635   |
| Accounts receivable, net           | 25,674    |
| Inventories                        | 32,000    |
| Property, plant and equipment, net | 75,850    |
| Customer relationships             | 130,300   |
| Trade names                        | 31,100    |
| Developed technology               | 3,200     |
| Other assets                       | 3,955     |
| Indemnification asset              | 1,650     |
| Trade accounts payable             | (10,427 ) |
| Accrued expenses                   | (6,326 )  |
| Deferred income taxes              | (77,500 ) |
| Goodwill                           | 357,131   |
| Total purchase price               | \$569,242 |

The estimated valuation of the fair value of tangible and intangible assets acquired and liabilities assumed are based on management's estimates and assumptions that are subject to change. In preparing our preliminary fair value estimates of the intangible assets and certain tangible assets acquired, management, among other things, consulted an independent advisor. The purchase price and related allocation to assets acquired and liabilities assumed is preliminary pending finalizing actual working capital acquired as of the Acquisition date. Additionally, certain intangible assets are not tax deductible and the related deferred tax liabilities are preliminary pending management's final review.

Customer relationships are amortized over a 10-year period utilizing an accelerated method based on the estimated average customer attrition rate. Trade names and developed technology are amortized over 10 years and 5 years, respectively, utilizing the straight-line method as the consumption pattern of the related economic benefits cannot be reliably determined.

The Company is indemnified for tax liabilities prior to the Acquisition date. The indemnification asset balance increased by \$129 from June 30, 2014 to September 30, 2014, as well as from May 7, 2014 to September 30, 2014.

Transaction and integration related costs included in selling, general, and administrative expenses for the nine months ended September 30, 2014 are \$3,110.

The following unaudited pro forma information has been prepared as if the Acquisition had occurred on January 1, 2013.

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|   | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                 |
|---|-------------------------------------|-----------------|------------------------------------|-----------------|
|   | Net<br>Net Sales                    | Net<br>Earnings | Net<br>Net Sales                   | Net<br>Earnings |
| SensoryEffects actual results included in the Company’s consolidated income statement from May 7, 2014 through September 30, 2014 | \$58,884                            | \$ 3,467        | \$95,278                           | \$ 3,009        |
| 2014 Supplemental pro forma combined financial information  | \$ 160,490                          | \$ 15,502       | \$462,732                          | \$ 41,985       |
| Basic earnings per share  |                                     | \$ .51          |                                    | \$ 1.39         |
| Diluted earnings per share  |                                     | \$ .50          |                                    | \$ 1.35         |
| 2013 Supplemental pro forma combined financial information  | \$ 138,478                          | \$ 11,332       | \$402,642                          | \$ 32,558       |
| Basic earnings per share  |                                     | \$ .38          |                                    | \$ 1.10         |
| Diluted earnings per share  |                                     | \$ .37          |                                    | \$ 1.06         |

2014 supplemental pro forma earnings for the three months ended September 30, 2014, exclude \$494 of acquisition-related costs incurred. 2014 supplemental pro forma earnings for the nine months ended September 30, 2014, exclude \$16,706 of acquisition-related costs incurred and \$4,735 of nonrecurring expenses related to the fair value adjustment to acquisition-date inventory. The pro forma information presented does not purport to be indicative of the results that actually would have been attained if the SensoryEffects acquisition had occurred at the beginning of the periods presented and is not intended to be a projection of future results.

NOTE 3 – STOCKHOLDERS’ EQUITY

STOCK-BASED COMPENSATION

The Company records stock-based compensation in accordance with the provisions of ASC 718, “Compensation-Stock Compensation.” The Company’s results for the three and nine months ended September 30, 2014 and 2013 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 September<br>30, |        |
|--------------------|--|--------|
|                    | 2014   | 2013   |
| Cost of sales      | \$ 141   | \$ 152 |
| Operating expenses | 961  | 754    |
| Net earnings       | (690 )   | (556 ) |



|                    | Increase/(Decrease)<br>for the<br>Nine Months<br>Ended September<br>30, |          |
|--------------------|---|----------|
|                    | 2014  | 2013     |
| Cost of sales      | \$ 452  | \$ 456   |
| Operating expenses | 2,997   | 2,431    |
| Net earnings       | (2,189 )  | (1,799 ) |

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

The Company's stock incentive plans allow for the granting of restricted stock awards and options to purchase common stock. Both incentive stock options and nonqualified stock options can be awarded under the plans. No option will be exercisable for longer than ten years after the date of grant. The Company has approved and reserved a number of shares to be issued upon exercise of the outstanding options that is adequate to cover all exercises. As of September 30, 2014, the plans had 4,072,896 shares available for future awards. Compensation expense for stock options and restricted stock awards is recognized on a straight-line basis over the vesting period, generally three years for stock options, four years for employee restricted stock awards, and four to seven years for non-employee director restricted stock awards. Certain awards provide for accelerated vesting if there is a change in control (as defined in the plans) or other qualifying events.

Option activity for the nine months ended September 30, 2014 and 2013 is summarized below:

|  | 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 |
|--|------------------|--|---|---|
| For the nine months ended September 30, 2014 |                  |  |   |   |
| Outstanding as of December 31, 2013          | 1,893            | \$ 20.94                                 | \$ 71,465                                   |   |
| Granted                                      | 313              | 53.38                                    |   |   |
| Exercised                                    | (456 )           | 14.49                                    |   |   |
| Forfeited                                    | (126 )           | 56.03                                    |   |   |
| Outstanding as of September 30, 2014         | 1,624            | \$ 26.29                                 | \$ 49,192                                   | 5.6   |
| Exercisable as of September 30, 2014         | 1,220            | \$ 20.83                                 | \$ 43,583                                   | 4.6   |

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|  | 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 |
|--|------------------|--|---|---|
| For the nine months ended September 30, 2013 |                  |  |   |   |
| Outstanding as of December 31, 2012          | 2,543            | \$ 16.87                                 | \$ 49,845                                   |   |
| Granted                                      | 175              | 38.58                                    |   |   |
| Exercised                                    | (602 )           | 11.21                                    |   |   |
| Forfeited                                    | (31 )            | 33.90                                    |   |   |
| Outstanding as of September 30, 2013         | 2,085            | \$ 20.08                                 | \$ 66,048                                   | 5.3   |
| Exercisable as of September 30, 2013         | 1,604            | \$ 15.97                                 | \$ 57,399                                   | 4.3   |

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 34% and 39%; risk-free interest rates of 1.8% and 1.0%; and expected lives of 5.6 and 5.0 years, in each case for the nine months ended September 30, 2014 and 2013, 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 nine months ended September 30, 2014 and 2013 was as follows:

|   | Three Months<br>Ended<br>September 30,<br>2014 |         | Nine Months<br>Ended<br>September 30,<br>2013 |          |
|---|--|---------|---|----------|
| Weighted-average fair value of options granted            | \$16.38  | \$17.83 | \$17.36                                       | \$13.02  |
| Total intrinsic value of stock options exercised (\$000s) | \$7,241  | \$8,260 | \$18,185                                      | \$20,244 |

Non-vested restricted stock activity for the nine months ended September 30, 2014 and 2013 is summarized below:

|   | Shares<br>(000s) | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|---|------------------|--|
| Nine months ended September 30, 2014        |                  |  |
| Non-vested balance as of December 31, 2013  | 172              | \$ 33.69   |
| Granted                                     | 25               | 51.03  |
| Vested                                      | (24 )            | 37.61  |
| Forfeited                                   | (6 )             | 45.32  |
| Non-vested balance as of September 30, 2014 | 167              | \$ 35.27   |



| Nine months ended September 30, 2013        | Shares<br>(000s) | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
|---|------------------|--|
| Non-vested balance as of December 31, 2012  | 258              | \$ 26.88   |
| Granted                                     | 21               | 38.10  |
| Vested                                      | (5 )             | 35.79  |
| Forfeited                                   | (24 )            | 31.97  |
| Non-vested balance as of September 30, 2013 | 250              | \$ 27.11   |

As of September 30, 2014 and 2013, there was \$6,537 and \$6,185, respectively, of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans. As of September 30, 2014, 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, 2014 will be approximately \$4,600.

#### 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 2,092,703 shares have been purchased, none of which remained in treasury at September 30, 2014. During the nine months ended September 30, 2014, a total of 4,969 shares have been purchased at an average cost of \$53.81 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 4 – INVENTORIES

Inventories at September 30, 2014 and December 31, 2013 consisted of the following:

|                   | September<br>30,<br>2014 | December<br>31, 2013 |
|-------------------|--------------------------|----------------------|
| Raw materials     | \$ 23,097                | \$ 8,454             |
| Work in progress  | 2,395                    | 1,330                |
| Finished goods    | 32,697                   | 15,040               |
| Total inventories | \$ 58,189                | \$ 24,824            |

#### NOTE 5 – PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at September 30, 2014 and December 31, 2013 are summarized as follows:





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|                                    | September<br>30,<br>2014 | December<br>31,<br>2013 |
|------------------------------------|--------------------------|-------------------------|
| Land                               | \$ 3,184                 | \$ 2,054                |
| Building                           | 30,838                   | 19,732                  |
| Equipment                          | 149,846                  | 86,147                  |
| Construction in progress           | 5,927                    | 1,754                   |
|                                    | 189,795                  | 109,687                 |
| Less: accumulated depreciation     | 61,558                   | 54,771                  |
| Property, plant and equipment, net | \$ 128,237               | \$ 54,916               |

NOTE 6 – INTANGIBLE ASSETS

The Company had goodwill in the amount of \$385,646 as of September 30, 2014 and \$28,515 as of December 31, 2013 subject to the provisions of ASC 350, “Intangibles-Goodwill and Other.”

The changes in the carrying amount of goodwill for the nine months ended September 30, 2014, are as follows:

|   |           |
|---|-----------|
| Goodwill at January 1, 2014   | \$28,515  |
| Goodwill as a result of the Acquisition of Performance Chemicals & Ingredients Company – see Note 2 | 357,131   |
| Goodwill at September 30, 2014  | \$385,646 |

There were no changes in the carrying amount of goodwill for the three months ended September 30, 2014.

Identifiable intangible assets with finite lives at September 30, 2014 and December 31, 2013 are summarized as follows:

|                               | Amortization<br>Period<br>(in years) | Gross<br>Carrying<br>Amount<br>at<br>9/30/14 | Accumulated<br>Amortization<br>at 9/30/14 | Gross<br>Carrying<br>Amount<br>at<br>12/31/13 | Accumulated<br>Amortization<br>at 12/31/13 |
|-------------------------------|--------------------------------------|--|---|---|--|
| Customer lists                | 10                                   | \$ 167,442                                   | \$ 35,264                                 | \$ 37,142                                     | \$ 24,552                                  |
| Trademarks & trade names      | 10-17                                | 32,013                                       | 1,744                                     | 910   | 461  |
| Developed technology          | 5                                    | 3,200  | 294                                       | -   | -  |
| Regulatory registration costs | 5-10                                 | 1,647  | 625                                       | 1,644   | 514  |
| Patents & trade secrets       | 15-17                                | 1,651  | 912                                       | 1,593   | 849  |
| Other                         | 5-10                                 | 754  | 577                                       | 754   | 541  |
|                               |                                      | \$206,707                                    | \$ 39,416                                 | \$ 42,043                                     | \$ 26,917                                  |

Amortization of identifiable intangible assets was approximately \$12,500 for the nine months ended September 30, 2014. Assuming no change in the gross carrying value of identifiable intangible assets, the estimated amortization expense for the remainder of 2014 is \$7,000, approximately \$26,400 for 2015, \$24,200 for 2016, \$20,300 for 2017, \$18,000 for 2018 and \$16,200 for 2019. At September 30, 2014, there were no identifiable

intangible assets with indefinite useful lives as defined by ASC 350. Identifiable intangible assets are reflected in “Intangible assets with finite lives, net” in the Company’s condensed consolidated balance sheets. There were no changes to the useful lives of intangible assets subject to amortization during the nine months ended September 30, 2014.

#### NOTE 7 – LONG-TERM DEBT

On May 7, 2014, the Company and a bank syndicate entered into a loan agreement providing for a senior secured term loan of \$350,000 and revolving loan of \$100,000 (collectively referred to as the “loans”). The term loan and \$50,000 of the revolving loan were used to fund the Performance Chemicals & Ingredients Company acquisition (see Note 2) and for general corporate purposes. At September 30, 2014, the Company had a total of \$341,250 of debt outstanding. The term loan is payable in quarterly installments of \$8,750 commencing on September 30, 2014, with the outstanding principal due on the maturity date. The Company may draw on the revolving loan at its discretion and the revolving loan does not have installments and all outstanding amounts are due on the maturity date. The loans may be voluntarily prepaid in whole or in part without premium or penalty and have a maturity date of May 7, 2019. The loans are subject to an interest rate equal to LIBOR or a fluctuating rate as defined by the loan agreement, at the Company’s discretion; plus an applicable rate. The applicable rate is based upon the Company’s consolidated leverage ratio, as defined in the loan agreement, and the interest rate was 1.90% at September 30, 2014. The Company has \$100,000 of undrawn revolving loan at September 30, 2014 that is subject to a commitment fee; which is based on the Company’s consolidated leverage ratio as defined in the loan agreement. The loan agreement contains quarterly covenants requiring the consolidated leverage ratio to be less than a certain maximum ratio and the consolidated fixed charge coverage ratio to exceed a certain minimum ratio. At September 30, 2014, the Company was in compliance with these covenants. Indebtedness under the Company’s loan agreements are secured by assets of the company.

The following table summarizes the future minimum debt payments:

|                                   | 2014    | 2015     | 2016     | 2017     | 2018     | 2019      |
|-----------------------------------|---------|----------|----------|----------|----------|-----------|
| Current portion of long-term debt | \$8,750 | \$26,250 |          |          |          |           |
| Long-term debt                    |         | 8,750    | \$35,000 | \$35,000 | \$35,000 | \$192,500 |
| Total                             | \$8,750 | \$35,000 | \$35,000 | \$35,000 | \$35,000 | \$192,500 |

Costs associated with the issuance of debt instruments are capitalized and amortized over the terms of the respective financing arrangements using the effective interest method. If debt is retired early, the related unamortized costs are expensed in the period the debt is retired. Capitalized costs net of accumulated amortization total \$2,299 at September 30, 2014. Amortization expense pertaining to these costs totaled \$193 and \$296 for the three and nine months ended September 30, 2014, respectively, and is included in interest expense in the accompanying condensed consolidated statement of earnings.

NOTE 8 – 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 September 30, 2014  |                                |                                      |                        |
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 15,178                      | 30,463,188                           | \$ .50                 |
| Effect of dilutive securities – stock options and restricted stock   |                                | 783,090                              |                        |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 15,178                      | 31,246,278                           | \$ .49                 |
|  | Net<br>Earnings<br>(Numerator) | Number of<br>Shares<br>(Denominator) | Per<br>Share<br>Amount |
| Three months ended September 30, 2013  |                                |                                      |                        |
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 11,657                      | 29,708,370                           | \$ .39                 |
| Effect of dilutive securities – stock options and restricted stock   |                                | 1,215,240                            |                        |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 11,657                      | 30,923,610                           | \$ .38                 |
|  | Net<br>Earnings<br>(Numerator) | Number of<br>Shares<br>(Denominator) | Per<br>Share<br>Amount |
| Nine months ended September 30, 2014   |                                |                                      |                        |
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 33,804                      | 30,296,753                           | \$ 1.12                |
| Effect of dilutive securities – stock options and restricted stock   |                                | 839,437                              |                        |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 33,804                      | 31,136,190                           | \$ 1.09                |

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|  | Net<br>Earnings<br>(Numerator) | Number of<br>Shares<br>(Denominator) | Per<br>Share<br>Amount |
|--|--------------------------------|--------------------------------------|------------------------|
| Nine months ended September 30, 2013   |                                |                                      |                        |
| Basic EPS – Net earnings and weighted average common shares outstanding  | \$ 34,127                      | 29,509,991                           | \$ 1.16                |
| Effect of dilutive securities – stock options and restricted stock   |                                | 1,268,110                            |                        |
| Diluted EPS – Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock | \$ 34,127                      | 30,778,101                           | \$ 1.11                |

The Company had stock options covering 184,976 and 8,800 shares at September 30, 2014 and 2013, 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 9 – INCOME TAXES

The Company accounts for uncertainty in income taxes in accordance with ASC 740-10, “Accounting for Uncertainty in Income Taxes.” ASC 740-10 clarifies whether or not to recognize assets or liabilities for tax positions taken that may be challenged by a tax authority. All of the unrecognized tax benefits, if recognized in future periods, would impact the Company’s effective tax rate. The Company files income tax returns in the U.S. and in various states and foreign countries. As of September 30, 2014, in the major jurisdictions where the Company operates, it is generally no longer subject to income tax examinations by tax authorities for years before 2010. During the nine months ended September 30, 2014, the increase in the amount of unrecognized tax benefits was primarily related to the aforementioned Acquisition (See Note 2) of Performance Chemicals & Ingredients Company (d/b/a SensoryEffects). The Acquisition resulted in an assumed liability for unrecognized tax benefits based on an estimated fair value of \$1,650. The Company is indemnified for this liability, and as such, has recognized a corresponding indemnification asset of \$1,650. During the nine months ended September 30, 2013, there was no significant change to the amount of unrecognized tax benefits. As of September 30, 2014 and December 31, 2013, the Company had approximately \$5,200 and \$3,100, respectively, of unrecognized tax benefits, which are included in other long-term obligations on the Company’s consolidated balance sheets. Other than potential changes to the estimated fair value of the assumed liability for unrecognized tax benefits related to the Acquisition of Performance Chemicals & Ingredients Company, the Company does not anticipate any material change in the total amount of unrecognized tax benefits to occur within the next twelve months. The Company includes interest expense or income as well as potential penalties on unrecognized tax positions as a component of income tax expense

in the consolidated statements of earnings. The total amount of accrued interest and penalties related to uncertain tax positions at September 30, 2014 and December 31, 2013 was approximately \$1,550 and \$1,050, respectively, and is included in other long-term obligations.

#### NOTE 10 – 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; SensoryEffects; and Animal Nutrition & Health.

#### Business Segment Net Sales:

|                           | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|---------------------------|----------------------------------|----------|---------------------------------|-----------|
|                           | 2014                             | 2013     | 2014                            | 2013      |
| Specialty Products        | \$13,652                         | \$12,420 | \$40,086                        | \$38,419  |
| SensoryEffects            | 71,821                           | 12,348   | 133,170                         | 35,502    |
| Animal Nutrition & Health | 75,017                           | 62,825   | 205,459                         | 181,619   |
| Total                     | \$160,490                        | \$87,593 | \$378,715                       | \$255,540 |

#### Business Segment Earnings Before Income Taxes:

|                                     | Three Months Ended September 30, |          | Nine Months Ended September 30, |          |
|-------------------------------------|----------------------------------|----------|---------------------------------|----------|
|                                     | 2014                             | 2013     | 2014                            | 2013     |
| Specialty Products                  | \$5,306                          | \$4,848  | \$15,576                        | \$15,036 |
| SensoryEffects                      | 8,743                            | 2,760    | 14,218                          | 8,536    |
| Animal Nutrition & Health           | 11,729                           | 9,368    | 28,696                          | 25,885   |
| Transaction and integration costs   | (494 )                           | -        | (3,342 )                        | -        |
| Interest and other income (expense) | (2,075 )                         | 84       | (3,276 )                        | 148      |
| Total                               | \$23,209                         | \$17,060 | \$51,872                        | \$49,605 |

Transaction and integration costs are primarily related to the definitive agreement to acquire Performance Chemicals & Ingredients Company (d/b/a SensoryEffects; see Note 2).

The following table summarizes domestic (U.S.) and foreign sales for the three and nine months ended September 30, 2014 and September 30, 2013:

|          | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|----------|----------------------------------|----------|---------------------------------|-----------|
|          | 2014                             | 2013     | 2014                            | 2013      |
| Domestic | \$124,088                        | \$60,742 | \$278,422                       | \$173,855 |
| Foreign  | 36,402                           | 26,851   | 100,293                         | 81,685    |
| Total    | \$160,490                        | \$87,593 | \$378,715                       | \$255,540 |

NOTE 11 – SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the nine months ended September 30, 2014 and 2013 for income taxes and interest is as follows:

|              | Nine Months<br>Ended<br>September 30, |         |
|--------------|---------------------------------------|---------|
|              | 2014                                  | 2013    |
| Income taxes | \$17,920                              | \$9,274 |
| Interest     | \$3,006                               | \$22    |

NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

|   | Three Months<br>Ended<br>September 30, |       |
|---|--|-------|
|   | 2014                                   | 2013  |
| Net foreign currency translation adjustment                                     | \$(1,739)                              | \$749 |
| Net change in postretirement benefit plan (see Note 13 for further information) |  |       |
| Amortization of prior service credit  | (5 )                                   | (5 )  |
| Amortization of loss  | 2                                      | 6     |
| Total before tax  | (3 )                                   | 1     |
| Tax   | 1                                      | -     |
| Net of tax  | (2 )                                   | 1     |
| Total other comprehensive (loss) income   | \$(1,741)                              | \$750 |
|   |  |       |
|   | Nine Months<br>Ended<br>September 30,  |       |
|   | 2014                                   | 2013  |
| Net foreign currency translation adjustment                                     | \$(1,934)                              | \$484 |
| Net change in postretirement benefit plan (see Note 13 for further information) |  |       |
| Amortization of prior service credit  | (14 )                                  | (14 ) |
| Amortization of loss  | 5                                      | 12    |
| Total before tax  | (9 )                                   | (2 )  |
| Tax   | 3                                      | 1     |
| Net of tax  | (6 )                                   | (1 )  |
| Total other comprehensive (loss) income   | \$(1,940)                              | \$483 |

NOTE 13 – 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 costs for such retirement medical plan were as follows:

|                                      | Nine<br>Months<br>Ended<br>September<br>30,<br>2014 2013 |      |
|--------------------------------------|--|------|
| Service cost                         | \$43   | \$51 |
| Interest cost                        | 36   | 32   |
| Amortization of prior service credit | (14)   | (14) |
| Amortization of loss                 | 5  | 12   |
| Net periodic benefit cost            | \$70   | \$81 |

The amount recorded for this obligation on the Company's balance sheet as of September 30, 2014 and December 31, 2013 is \$1,232 and \$1,152, respectively, and 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 14 – COMMITMENTS AND CONTINGENCIES

In 2012, the Company entered into a six (6) year lease extension for approximately 20,000 square feet of office space in New Hampton, New York. The office space serves as the Company's general offices and as a laboratory facility. In 2013, SensoryEffects entered into a three (3) year lease for approximately 40,000 square feet of warehouse space in St. Louis, Missouri. The Company leases most of its vehicles and office equipment under non-cancelable operating leases, which primarily expire at various times through 2029.

Rent expense charged to operations under such lease agreements for the nine months ended September 30, 2014 and 2013 aggregated approximately \$1,114 and \$771, respectively. Aggregate future minimum rental payments required under all non-cancelable operating leases at September 30, 2014 are as follows:

| Year                                 |         |
|--------------------------------------|---------|
| October 1, 2014 to December 31, 2014 | \$476   |
| 2015                                 | 1,813   |
| 2016                                 | 1,424   |
| 2017                                 | 1,177   |
| 2018                                 | 926     |
| 2019                                 | 447     |
| Thereafter                           | 2,104   |
| Total minimum lease payments         | \$8,367 |



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 15 – 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 September 30, 2014 and December 31, 2013 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying condensed 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 September 30, 2014 include \$771 in money market funds. The money market funds are valued using level one inputs, 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, 2013 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; SensoryEffects (formerly Food, Pharma & Nutrition); and Animal Nutrition & Health.

Acquisition of Performance Chemicals & Ingredients Company (d/b/a SensoryEffects) and Long-term Debt

On May 7, 2014, the Company acquired 100 percent (the "Acquisition") of the outstanding common shares of Performance Chemicals & Ingredients Company (d/b/a SensoryEffects) a privately held supplier of customized food and ingredient systems, headquartered in St. Louis, Missouri, for a purchase price of approximately \$569,000, including working capital acquired. SensoryEffects is a leader in powder, solid and liquid flavor systems, creamer and specialty emulsified powders, cereal-based products and other functional ingredient food and beverage delivery systems. The Acquisition of SensoryEffects accelerates the Company's growth into health and wellness markets. SensoryEffects was merged with the Company's Food, Pharma & Nutrition segment, strengthening its market leadership position, and the segment was renamed SensoryEffects.

On May 7, 2014, the Company and a bank syndicate entered into a loan agreement providing for a senior secured term loan of \$350,000 and revolving loan of \$100,000 (collectively referred to as the "loans"). The term loan and \$50,000 of the revolving loan were used to fund the Acquisition of SensoryEffects and for general corporate purposes. The Company has made debt payments of \$58,750 related to these loans and has \$100,000 available under the revolving loan.

Specialty Products Segment

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 and medical device manufacturers 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, such as increasing paint durability and manufacturing specialty starches and textile coatings.

#### SensoryEffects Segment

Our SensoryEffects segment supplies ingredients in the food and beverage industry; providing customized solutions in powder and liquid flavor delivery systems, spray dried emulsified powder systems, and cereal systems. Our products include creamer systems, dairy replacers, powdered fats, nutritional beverage bases, beverages, juice & dairy bases, chocolate systems, ice cream bases & variegates, ready-to-eat cereals, grain based snacks, and cereal based ingredients. Additionally, we provide 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 produce and 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 Segment

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 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 business segment net sales and earnings from operations for the three and nine months ended September 30, 2014 and 2013:

Business Segment Net Sales:

|                           | Three Months Ended |                    | Nine Months Ended  |                    |
|---------------------------|--------------------|--------------------|--------------------|--------------------|
|                           | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Specialty Products        | \$13,652           | \$12,420           | \$40,086           | \$38,419           |
| SensoryEffects            | 71,821             | 12,348             | 133,170            | 35,502             |
| Animal Nutrition & Health | 75,017             | 62,825             | 205,459            | 181,619            |
| Total                     | \$160,490          | \$87,593           | \$378,715          | \$255,540          |

Business Segment Earnings From Operations:

|                                   | Three Months Ended |                    | Nine Months Ended  |                    |
|-----------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                   | September 30, 2014 | September 30, 2013 | September 30, 2014 | September 30, 2013 |
| Specialty Products                | \$5,306            | \$4,848            | \$15,576           | \$15,036           |
| SensoryEffects                    | 8,743              | 2,760              | 14,218             | 8,536              |
| Animal Nutrition & Health         | 11,729             | 9,368              | 28,696             | 25,885             |
| Transaction and integration costs | (494 )             | -                  | (3,342 )           | -                  |
| Total                             | \$25,284           | \$16,976           | \$55,148           | \$49,457           |

RESULTS OF OPERATIONS

Three months ended September 30, 2014 compared to three months ended September 30, 2013.

Net Sales

Net sales for the three months ended September 30, 2014 were \$160,490, as compared with \$87,593 for the three months ended September 30, 2013, an increase of \$72,897 or 83.2%. Net sales for the SensoryEffects segment (formerly Food, Pharma & Nutrition) were \$71,821, compared with \$12,348 for the three months ended September 30, 2013, an increase of \$59,473 or 481.6%. Net sales from the recently acquired SensoryEffects business contributed \$58,884 to the overall increase. The acquired Powder & Flavor Systems, and Cereal Systems product lines comprised \$50,224 and \$5,996 of the increase, respectively. Also contributing to the higher sales was a \$904 or 13.3% increase in encapsulated ingredients used for baking and food preservation; primarily due to greater volume. Net sales for the Animal Nutrition & Health segment were \$75,017 for the three months ended September 30, 2014, as compared with \$62,825 for the three months ended

September 30, 2013, an increase of \$12,192 or 19.4%. Sales of products targeted for ruminant animal feed markets increased by \$5,867 or 63.1% from the prior year comparable period. Strong dairy economics supported increased sales volumes of our products. Industrial sales grew \$6,144 or 26.6% over the prior year comparative principally due to volume increases of various choline and choline derivatives for industrial applications, most notably for shale fracking. Sales for industrial applications comprised approximately 38.9% of sales in the segment, as compared to 36.7% for the comparable three months ended September 30, 2013. Net sales for the Specialty Products segment were \$13,652 for the three months ended September 30, 2014, as compared with \$12,420 for the three months ended September 30, 2013, an increase of \$1,232 or 9.9%. Increased sales of ethylene oxide products used for medical device sterilization and propylene oxide products used for industrial applications contributed to the higher sales.

#### Gross Margin

For the three months ended September 30, 2014, gross margin increased to \$44,487 compared to \$24,522 for the three months ended September 30, 2013. Gross margin as a percentage of sales for the three months ended September 30, 2014 decreased to 27.7% from 28.0% in the prior year comparative period. Gross margins for the SensoryEffects segment declined 7.1% for the three months ended September 30, 2014 as compared to the three months ended September 30, 2013. The acquired product lines carry a lower gross margin; which was partially offset by a favorable product mix in the encapsulated ingredients product lines. Gross margin percentage increased for Animal Nutrition & Health by 1.3% primarily due to product mix and efficiencies resulting from higher volumes. Gross margin percentage for the Specialty Products segment was flat.

#### Operating Expenses

Operating expenses for the three months ended September 30, 2014 were \$19,203 or 12.0% of net sales as compared to \$7,546 or 8.6% of net sales for the three months ended September 30, 2013. The increase was primarily due to the Acquisition, including increased amortization expense of \$5,808 related to the acquired intangible assets, integration expenses of \$494, as well as recruiting costs.

#### Earnings from Operations

Principally as a result of the above-noted details, earnings from operations for the three months ended September 30, 2014 were \$25,284 as compared to \$16,976 for the three months ended September 30, 2013, an increase of \$8,308 or 48.9%. Earnings from operations as a percentage of sales ("operating margin") for the three months ended September 30, 2014 were 15.8%, declining from 19.4% for the three months ended September 30, 2013, primarily due to the aforementioned amortization expense associated with acquired intangible assets, integration expenses and product mix. Excluding the impact of amortization expenses and integration expenses, the earnings from operations were \$31,748 or 19.8% of sales. Earnings from the SensoryEffects segment were \$8,743, an increase of \$5,983 or 216.8% primarily due to increased sales from the Acquisition partially offset by increased amortization expense. Animal Nutrition and Health segment earnings from operations were \$11,729, an increase of \$2,361 or 25.2%, primarily the result of higher sales volumes. Earnings from operations from the Specialty Products

segment were \$5,306, an increase of \$458 or 9.5%, primarily the result of higher sales volume.

#### Other Expenses (Income)

Interest expense for the three months ended September 30, 2014 was \$2,052 and is primarily related to the loans entered into on May 7, 2014 to finance the Acquisition of SensoryEffects. Interest income was \$3 and \$65 for the three months ended September 30, 2014 and 2013, respectively. The Company has invested available cash primarily in money market investments that have been classified as cash equivalents due to the short maturities of these investments. Other expense was \$26 for the three months ended September 30, 2014, and other income was \$21 for the three months ended September 30, 2013.

#### Income Tax Expense

The Company's effective tax rate for the nine months ended September 30, 2014 and 2013 was 34.6% and 31.7%, respectively. The increase in the effective tax rate is primarily attributable to the impact of new jurisdictions related to the SensoryEffects acquisition, a change in the apportionment relating to state income taxes, a change in the income proportion towards jurisdictions with higher tax rates, and the timing of certain tax credits and deductions.

#### Net Earnings

Principally as a result of the above-noted details, net earnings for the three months ended September 30, 2014 were \$15,178 as compared with \$11,657 for the three months ended September 30, 2013, an increase of \$3,521 or 30.2%.

Nine months ended September 30, 2014 compared to nine months ended September 30, 2013.

#### Net Sales

Net sales for the nine months ended September 30, 2014 were \$378,715, as compared with \$255,540 for the nine months ended September 30, 2013, an increase of \$123,175 or 48.2%. Net sales for the SensoryEffects segment (formerly Food, Pharma & Nutrition) were \$133,170, compared with \$35,502 for the nine months ended September 30, 2013, an increase of \$97,668 or 275.1%. Net sales from the recently acquired SensoryEffects business contributed \$95,279 to the overall increase. The acquired Powder & Flavor Systems, and Cereal Systems product lines comprised \$81,345 and \$10,293 of the increase, respectively. Contributing to the higher sales was a \$2,118 or 11.4% increase in encapsulated ingredients used for baking and food preservation; due to a favorable product mix and greater volume. Additionally, sales of nutrient products for both food applications and supplements markets increased \$788 or 5.0%, primarily due to higher volume. Net sales for the Animal Nutrition & Health segment were \$205,459 for the nine months ended September 30, 2014, as compared with \$181,619 for the nine months ended September 30, 2013, an increase of \$23,840 or 13.1%. Sales of products targeted for ruminant animal feed markets increased by \$8,534 or 30.0% from the prior year comparable period, primarily due to strong dairy economics, which increased demand for our products. Global feed grade choline product sales increased \$4,490 or 5.4% primarily due to increased

volumes of choline products sourced from our Italian operation into the European and other international markets. Industrial sales grew \$10,476 or 16.1% over the prior comparative year period principally due to volume increases of various choline and choline derivatives for industrial applications, most notably for shale fracking. Sales for industrial applications comprised approximately 36.8% of sales in the segment, as compared to 35.8% for the comparable nine months ended September 30, 2013. Net sales for the Specialty Products segment were \$40,086 for the nine months ended September 30, 2014, as compared with \$38,419 for the nine months ended September 30, 2013, an increase of \$1,667 or 4.3%. Increased sales of ethylene oxide products used for medical device sterilization were partially offset by lower sales volumes of propylene oxide products used for industrial applications.

#### Gross Margin

For the nine months ended September 30, 2014, gross margin increased to \$100,037 compared to \$73,639 for the nine months ended September 30, 2013. Gross margin as a percentage of sales for the nine months ended September 30, 2014 decreased to 26.4% from 28.8% in the prior year comparative period. Gross margins for the SensoryEffects segment declined 11.1% for the nine months ended September 30, 2014 as compared to the nine months ended September 30, 2013. The acquired product lines within the SensoryEffects segment carry a lower gross margin. Additionally, the valuation of acquired inventory to fair value increased cost of sales by \$4,735. Gross margin percentage for the Animal Nutrition & Health segment decreased by 0.5% primarily due to a heavier weighting towards choline chloride products used in industrial applications along with increases in certain petrochemical raw material costs. Gross margin percentage for the Specialty Products segment was flat.

#### Operating Expenses

Operating expenses for the nine months ended September 30, 2014 were \$44,889 or 11.9% of net sales as compared to \$24,182 or 9.5% of net sales for the nine months ended September 30, 2013. The increase was primarily due to the Acquisition, including increased amortization expense of \$9,264 related to the acquired intangible assets, transaction and integration expenses of \$3,342, as well as recruiting costs.

#### Earnings From Operations

Principally as a result of the above-noted details, earnings from operations for the nine months ended September 30, 2014 were \$55,148 as compared to \$49,457 for the nine months ended September 30, 2013, an increase of \$5,691 or 11.5%. Earnings from operations as a percentage of sales ("operating margin") for the nine months ended September 30, 2014 were 14.6%, declining from 19.4% for the nine months ended September 30, 2013, primarily due to the aforementioned amortization expense associated with acquired intangible assets, the impact of the valuation of the acquired inventory, transaction and integration expenses and product mix. Excluding the impact of amortization expenses, valuation of the acquired inventory, and transaction and integration expenses, the earnings from operations were \$72,747 or 19.2% of sales. Earnings from the SensoryEffects segment were \$14,218, an increase of \$5,682 or 66.6% primarily due to increased sales from the Acquisition partially offset by increased amortization expense and the impact of the valuation of acquired inventory. Animal Nutrition and Health segment



earnings from operations were \$28,696, an increase of \$2,811 or 10.9%, primarily the result of higher sales volumes, partially offset by product mix and increases in certain petrochemical raw material costs. Earnings from operations from the Specialty Products segment were \$15,576, an increase of \$540 or 3.6%.

#### Other Expenses (Income)

Interest expense for the nine months ended September 30, 2014 was \$3,368 and is primarily related to the loans entered into on May 7, 2014 to finance the Acquisition of SensoryEffects. Interest income was \$62 and \$178 for the nine months ended September 30, 2014 and 2013, respectively. 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. Other income was \$30 for the nine months ended September 30, 2014, and other expense was \$25 for the nine months ended September 30, 2013.

#### Income Tax Expense

The Company's effective tax rate for the nine months ended September 30, 2014 and 2013 was 34.8% and 31.2%, respectively. The increase in the effective tax rate is primarily attributable to the impact of new jurisdictions related to the SensoryEffects acquisition, a change in the apportionment relating the state income taxes, a change in the income proportion towards jurisdictions with higher tax rates, and the timing of certain tax credits and deductions.

#### Net Earnings

Principally as a result of the above-noted details, net earnings for the nine months ended September 30, 2014 were \$33,804 as compared with \$34,127 for the nine months ended September 30, 2013, a decrease of \$323 or 0.9%.

#### 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 are principally associated with future minimum non-cancelable operating lease obligations, long-term debt obligations and purchase orders principally with vendors for inventory not yet received or recorded on the balance sheet.

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The Company's contractual obligations as of September 30, 2014, are summarized in the table below:

| Contractual Obligations         | Total     | Payments due by period |           |           |                   |
|---------------------------------|-----------|------------------------|-----------|-----------|-------------------|
|                                 |           | Less than 1 year       | 1-3 years | 3-5 years | More than 5 years |
| Operating lease obligations (1) | \$8,367   | \$1,836                | \$2,760   | \$1,555   | \$2,216           |
| Purchase obligations (2)        | 24,649    | 24,649                 | -         | -         | -                 |
| Debt (3)                        | 341,250   | 35,000                 | 70,000    | 236,250   | -                 |
| Total                           | \$374,266 | \$61,485               | \$72,760  | \$237,805 | \$2,216           |

Principally includes obligations associated with future minimum non-cancelable operating lease obligations (1)(including the headquarters office space entered into in 2002 and extended in 2012 for six (6) years) and warehouse space entered into in 2013 for three (3) years.

(2) Principally includes open purchase orders with vendors for inventory not yet received or recorded on our balance sheet.

(3) Consists of \$341,250 senior secured term loan.

The table above excludes a \$5,235 liability for uncertain tax positions, including the related interest and penalties, recorded in accordance with ASC 740-10, as we are unable to reasonably estimate the timing of settlement, if any.

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

During the nine months ended September 30, 2014, other than the long-term debt and other obligations related to the Acquisition of Performance Chemicals & Ingredients Company (d/b/a SensoryEffects), there were no other 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, 2013. The Company expects its operations to continue generating sufficient cash flow to fund working capital requirements, capital investments and service future debt payments. The Company continues to pursue additional acquisition candidates. The Company could seek additional bank loans or access to financial markets to fund such acquisitions, its operations, working capital, capital investments, or other cash requirements as deemed necessary.

### Cash

Cash and cash equivalents decreased to \$25,404 at September 30, 2014 from \$208,747 at December 31, 2013 primarily resulting from the activity detailed below. At September 30, 2014, the Company had \$8,480 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, and potentially invest in partnerships 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 U.S. operations, we could be required to pay additional U.S. taxes to

repatriate these funds. Working capital was \$83,422 at September 30, 2014 as compared to \$242,021 at December 31, 2013, a decrease of \$158,599.

#### Operating Activities

Cash flows from operating activities provided \$49,241 for the nine months ended September 30, 2014 as compared to \$39,872 for the nine months ended September 30, 2013. The increase in cash flows from operating activities was primarily due to higher amortization and depreciation expense adjustments partially offset by unfavorable working capital changes.

#### Investing Activities

As previously noted, on May 7, 2014, the Company acquired SensoryEffects for a purchase price of approximately \$569,000. The Company continues to invest in projects across all production facilities and capital expenditures were \$5,934 for the nine months ended September 30, 2014. Capital expenditures were \$6,644 for the nine months ended September 30, 2013 and were predominately for the Company's new manufacturing facility in Covington, Virginia.

#### Financing Activities

On May 7, 2014, the Company and a bank syndicate entered into a loan agreement providing for a senior secured term loan of \$350,000 and revolving loan of \$100,000. The term loan and \$50,000 of the revolving loan were used to fund the Acquisition of SensoryEffects and for general corporate purposes. The Company has made debt payments of \$58,750 related to these loans and has \$100,000 available under the revolving loan.

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 2,092,703 shares have been purchased, none of which remained in treasury at September 30, 2014. During the nine months ended September 30, 2014, a total of 4,969 shares have been purchased at an average cost of \$53.81 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 were \$6,608 and \$6,742 for the nine months ended September 30, 2014 and 2013, respectively. Dividend payments were \$7,856 and \$-0- for the nine months ended September 30, 2014 and 2013, respectively. The Company's 2012 annual dividend was accelerated due to the anticipated increase in the federal tax on dividends paid after December 31, 2012 and no dividends were paid in 2013.

#### 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 liability recorded on the consolidated balance sheet as of September 30, 2014 is \$1,232 and the plan is not funded. Historical cash payments made under the 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, 2013 Annual Report on Form 10-K, during the nine months ended September 30, 2014.

Related Party Transactions

The Company was not engaged in related party transactions during the nine months ended September 30, 2014.

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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 September 30, 2014, the Company's borrowings were under a bank term loan and revolving loan bearing interest at LIBOR or a fluctuating rate as defined by the loan agreement, at the Company's discretion, plus an applicable rate. The applicable rate is based upon the Company's consolidated leverage ratio, as defined in the loan agreement. A 100 basis point increase or decrease in interest rates, applied to the Company's borrowings at September 30, 2014, would result in an increase or decrease in annual interest expense and a corresponding reduction or increase in cash flow of approximately \$3,413. 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.

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, except with respect to the Performance Chemicals & Ingredients Company (d/b/a SensoryEffects) acquisition described below, 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.

On May 7, 2014, we completed the acquisition of the Performance Chemicals & Ingredients Company (d/b/a SensoryEffects) business. See Note 2 of the Notes to the Consolidated Financial Statements for additional information. We are integrating SensoryEffects into our internal control over financial reporting process and expect to exclude the business from our assessment of internal control over financial reporting as of December 31, 2014. Total assets of the Performance Chemicals & Ingredients Company (d/b/a SensoryEffects) business represented approximately 76% of our consolidated total assets as of September 30, 2014, and net sales related to the Performance Chemicals & Ingredients Company (d/b/a SensoryEffects) business represented approximately 25% of our consolidated net sales for the nine months ended September 30, 2014.

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, 2013.

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/

William A.

Backus

William A.

Backus,

Chief

Financial

Officer

and

Treasurer

Date: November 10, 2014



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  |