BALCHEM CORP
Form 10-Q
November 08, 2006

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, 2006

or

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

For the transition period from ____________ to ____________

Commission File Number 1-13648

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

Maryland	13-2578432
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
P.O. Box 600 New Hampton, New York	10958
(Address of principal executive offices)	(Zip Code)

845-326-5600

Registrant's telephone number, including area code:

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

Yes |X| No |_|

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

Large accelerated filer |_| Accelerated filer |X| Non-accelerated filer |_|

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes |_| No |X|

As of November 3, 2006 the registrant had 11,653,917 shares of its Common Stock, $.06 2/3 par value, outstanding.

Part 1 - Financial Information
Item 1. Financial Statements

BALCHEM CORPORATION
Condensed Consolidated Balance Sheets
(In thousands)
(unaudited)

Assets	September 30, 2006	Decemb 20
Current assets:		
Cash and cash equivalents	$ 2,660	$
Accounts receivable	11,283	
Inventories	8,716	
Prepaid income taxes	--	
Prepaid expenses and other	716	
Deferred income taxes	280	
Total current assets	23,655	
Property, plant and equipment, net	30,970	
Goodwill	25,152	
Intangible assets with finite lives, net	7,073	
Total assets	$ 86,850	$
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade accounts payable	$ 3,450	$
Accrued expenses	1,449	
Accrued compensation and other benefits	1,701	
Customer deposits and other deferred revenue	270	
Dividends payable	--	
Income tax payable	983	
Total current liabilities	7,853	
Deferred income taxes	6,376	
Other long-term obligations	1,073	
Total liabilities	15,302	
Stockholders' equity:		
Preferred stock, $25 par value. Authorized 2,000,000 shares; none issued and outstanding	--	
Common stock, $.0667 par value. Authorized 25,000,000 shares; 11,655,087 shares issued and 11,633,030 shares outstanding at September 30, 2006 and 11,640,964 shares issued and 11,576,948 shares outstanding at December 31, 2005	777	
Additional paid-in capital	8,803	
Retained earnings	62,370	
Treasury stock, at cost: 22,057 and 64,016 shares at September 30, 2006 and December 31, 2005,		

respectively	(402)	
Total stockholders' equity	71,548	
Total liabilities and stockholders' equity	$ 86,850	$

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Net sales	$ 25,122	$ 21,145	$ 74,819	$ 59,969
Cost of sales	16,449	13,496	49,124	38,026
Gross profit	8,673	7,649	25,695	21,943
Operating expenses:				
Selling expenses	1,683	1,200	5,293	3,511
Research and development expenses	549	492	1,561	1,537
General and administrative expenses	1,460	1,226	4,521	3,854
	3,692	2,918	11,375	8,902
Earnings from operations	4,981	4,731	14,320	13,041
Other expenses (income):				
Interest (income)	(13)	(46)	(102)	(155)
Interest expense	16	2	186	6
Other, net	--	(82)	--	(82)
Earnings before income tax expense	4,978	4,857	14,236	13,272
Income tax expense	1,827	1,833	5,172	4,950
Net earnings	$ 3,151	$ 3,024	$ 9,064	$ 8,322
Net earnings per common share - basic	$ 0.27	$ 0.26	$ 0.78	$ 0.72
Net earnings per common share - diluted	$ 0.26	$ 0.25	$ 0.75	$ 0.69

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2006	2005
Cash flows from operating activities:		
Net earnings	$ 9,064	$ 8,322
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	2,573	2,078
Shares issued under employee benefit plans	281	215
Deferred income taxes	(11)	97
Stock compensation expense	786	--
Excess tax benefits from stock compensation	--	176
Provision for doubtful accounts	23	(32)
Gain on sale of equipment	--	(82)
Changes in assets and liabilities net of effects of acquisition:		
Accounts receivable	215	(1,474)
Inventories	376	(1,717)
Prepaid expenses and other current assets	1,074	842
Income taxes	1,125	826
Customer deposits and other deferred revenue	(916)	(687)
Accounts payable and accrued expenses	(318)	1,217
Other long-term obligations	41	46
Net cash provided by operating activities	14,313	9,827
Cash flows from investing activities:		
Capital expenditures	(1,235)	(1,186)
Proceeds from sale of property, plant & equipment	--	389
Cash paid for intangible assets acquired	(71)	(102)
Acquisition of assets	(22,772)	(11,419)
Net cash used in investing activities	(24,078)	(12,318)
Cash flows from financing activities:		
Proceeds from borrowings	10,000	--
Principal payments on borrowings	(10,000)	--
Proceeds from stock options	321	1,263
Excess tax benefits from stock compensation	163	--
Dividends paid	(1,045)	(685)
Purchase of treasury stock	--	(88)
Other financing activities	(10)	(10)
Net cash (used in) provided by financing activities	(571)	480

Decrease in cash and cash equivalents	(10,336)	(2,011)
Cash and cash equivalents beginning of period	12,996	12,734
Cash and cash equivalents end of period	$ 2,660	$ 10,723

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1 - CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements presented herein have been prepared by the Company in accordance with the accounting policies described in its December 31, 2005 consolidated financial statements, and should be read in conjunction with the consolidated financial statements and notes, which appear in our Annual Report on Form 10-K for the year ended December 31, 2005. References in this report to the "Company" mean Balchem Corporation and/or its subsidiaries, BCP Ingredients, Inc., Balchem Minerals Corporation and Chelated Minerals Corporation, as the context requires.

In the opinion of management, the unaudited condensed consolidated financial statements furnished in this Form 10-Q include all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature. The condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles governing interim financial statements and the instructions to Form 10-Q and Article 10 of Regulation S-X under the Securities Exchange Act of 1934 and therefore do not include some information and notes necessary to conform to annual reporting requirements. The results of operations for the nine months ended September 30, 2006 are not necessarily indicative of the operating results expected for the full year or any interim period.

NOTE 2 - ACQUISITION OF ASSETS

On August 24, 2006, the Company acquired an animal feed grade aqueous choline chloride manufacturing facility and related assets located in St. Gabriel, Louisiana from BioAdditives, LLC, CMB Additives, LLC and CMB Realty of Louisiana. The St. Gabriel assets are not yet in service, and it is anticipated that manufacturing in the facility will commence in November 2006.

NOTE 3 - CMC ACQUISITION

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

part. The remaining balance of the purchase price of the Acquisition was funded through the Company's cash on hand. At September 30, 2006, the Term Loan had been repaid in full.

The CMC acquisition has been accounted for using the purchase method of accounting and the purchase price of the acquisition has been assigned to the net assets acquired based on the fair value of such assets and liabilities at the date of acquisition. The

preliminary allocation of the total purchase price, including acquisition costs, of CMC's net tangible and intangible assets was based on the estimated fair values as of February 8, 2006. Adjustments to these estimates will be included in the allocation of the purchase price of CMC upon settlement of any working capital or other adjustments. The excess of the purchase price over the identifiable intangible and net tangible assets was allocated to goodwill. The preliminary purchase price has been allocated as follows (in thousands):

	Fair Value Recorded in Purchase Accounting
Accounts receivable	$ 884
Inventory	552
Property, plant and equipment	1,980
Current liabilities	(388)
Other long-term liabilities	(2,368)
Goodwill	11,826
Financing costs	49
Other intangible assets	5,285
Total	$ 17,820

The consolidated financial statements include the results of operations of the acquired product lines from the date of purchase.

Pro Forma Summary of Operations

The following unaudited pro forma information has been prepared as if the CMC acquisition had occurred on January 1, 2005 and does not include cost savings expected from the transaction. In addition to including the results of operations, the pro forma information gives effect primarily to changes in depreciation and amortization of tangible and intangible assets resulting from the acquisition.

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

	Pro-Forma Three months Ended September 30,	
	2006	2005
Net sales	$ 25,122	$ 22,460

Net earnings	3,151	3,111
Basic EPS	.27	.27
Diluted EPS	.26	.26

	Pro-Forma Nine months Ended September 30, 2006	2005
Net sales	$ 75,553	$ 64,426
Net earnings	9,078	8,716
Basic EPS	.78	.76
Diluted EPS	.75	.73

NOTE 4 - ACQUISITION OF ASSETS

Effective June 30, 2005, pursuant to an asset purchase agreement of same date (the "Loders Asset Purchase Agreement"), the Company acquired certain assets of Loders Croklaan USA, LLC ("Seller") relating to the encapsulation, agglomeration and granulation business for a purchase price including acquisition costs of $9,885 plus $725 for certain product inventories and $809 for certain accounts receivable. With the exception of $985, which was paid during the quarter ended June 30, 2005, all of such payment was made on July 1, 2005 from the Company's cash reserves.

The Loders Asset Purchase Agreement also provides for the contingent payment by the Company to Seller of additional consideration based upon the volume of sales during the three year period following the acquisition associated with one particular product acquired by the Company. Such contingent consideration, if earned and paid, will be recorded as an additional cost of the acquired product lines.

The Loders Croklaan acquisition has been accounted for using the purchase method of accounting and the purchase price of the acquisition has been assigned to the net assets acquired based on the fair value of such assets and liabilities at the date of acquisition. The allocation of the purchase price of the acquisition has been assigned to the long-term net assets acquired as follows:

	Fair Value Recorded in Purchase Accounting
Equipment	$ 1,436
Customer List	1,350
Patent	140
Goodwill	6,959
Total	$ 9,885

The purchase price allocations have been made on the basis of estimates made by the Company. The financial statement amounts are subject to subsequent revision to give effect to other pre-acquisition contingencies that may become resolved during subsequent periods.

The consolidated financial statements include the results of operations of the acquired product lines from the date of purchase.

Pro Forma Summary of Operations

The following unaudited pro forma information has been prepared as if the Loders Croklaan acquisition had occurred on January 1, 2005 and does not include cost savings expected from the transaction. In addition to including the results of operations, the pro forma information gives effect primarily to changes in depreciation and amortization of tangible and intangible assets resulting from the acquisition.

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

	Pro-Forma Three months Ended September 30, 2005
Net sales	$ 21,145
Net earnings	3,024
Basic EPS	.26
Diluted EPS	.25

	Pro-Forma Nine months Ended September 30, 2005
Net sales	$ 63,256
Net earnings	8,894
Basic EPS	.77
Diluted EPS	.74

NOTE 5 - STOCK INCENTIVE PLAN

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 123 (revised 2004), "Share Based Payment," ("SFAS 123R"). SFAS 123R establishes the accounting for transactions in which an entity pays for employee services in share-based payment transactions. SFAS 123R eliminates the ability to account for share-based compensation transactions using the intrinsic value method and requires companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The

fair value of employee share options and similar instruments is estimated using option-pricing models that take into account the unique characteristics of those instruments. That cost is recognized over the period during which an employee is required to provide service in exchange for the award. The Company adopted SFAS 123R effective January 1, 2006, using the modified prospective transition method. Under this method, compensation cost is recognized for awards granted and for awards modified, repurchased or cancelled in the period after adoption. Compensation cost is also recognized for the unvested portion of awards granted prior to adoption over the

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remaining requisite service period. Prior year financial statements are not restated to reflect and do not include, the effect of SFAS 123R. The Company's results for the three and nine months ended September 30, 2006 reflected the following compensation cost as a result of adopting SFAS 123R and such compensation cost had the following effects on net earnings and basic and diluted earnings per share:

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Cost of sales	$ 27	$ 81
Operating expenses	235	705
Net earnings	(206)	(665)
Basic earnings per common share	(0.02)	(0.06)
Diluted earnings per common share	$ (0.02)	$ (0.05)

Additionally, upon adoption of SFAS 123R, excess tax benefits related to stock compensation are presented as a cash inflow from financing activities. This change had the effect of decreasing cash flows from operating activities and increasing cash flows from financing activities by $-0- and $163 for the three and nine months ended September 30, 2006, respectively.

Prior to the adoption of SFAS 123R on January 1, 2006, the Company accounted for stock based compensation plans under Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25"). Compensation cost related to stock options issued to employees was recorded only if the grant-date market price of the underlying stock exceeded the exercise price. The following table illustrates the effect on net earnings and earnings per share if a fair value based method had been applied to all awards:

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Net earnings	$ 3,024	8,322
Stock-based employee compensation expense included in net earnings, net of related tax effects	--	--
Stock-based employee compensation expense determined under fair value based method, net of related tax effects		

		259	645
Pro forma net earnings	$	2,765	7,677
Basic earnings per common share:			
As reported	$	0.26	0.72
Pro forma		0.24	0.67
Diluted earnings per common share:			
As reported	$	0.25	0.69
Pro forma		0.23	0.64

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The Company's stock incentive plans allow for the granting of restricted stock awards and options to purchase common stock. Both incentive stock options and nonqualified stock options can be awarded under the plans. No option will be exercisable for longer than ten years after the date of grant. The shares to be issued upon exercise of the outstanding options have been approved, reserved and are adequate to cover all exercises. As of September 30, 2006, the plans had 726,540 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 and seven years for 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, 2006 is summarized below:

	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Term
Outstanding as of December 31, 2005	1,435,465	$ 12.57	10,479	
Granted	10,300	22.59		
Exercised	(43,048)	7.47		
Expired	--			--
Forfeited	(14,100)	14.47		
Outstanding as of September 30, 2006	1,388,617	$ 12.79	$ 9,720	6.8
Exercisable as of September 30, 2006	910,317	$ 10.53	$ 8,430	5.9

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 0.4% and 0.4%; expected volatilities of 26% and 29%; risk-free interest rates of 3.8% and 3.6%; and expected lives of 4.5 and 4.9 for the nine months ended September 30, 2006 and 2005, respectively.

For the nine month periods ended September 30, 2006 and September 30, 2005, the Company used a projected expected life for each award granted based on historical experience of employees' exercise behavior. For the nine month periods ended September 30, 2006 and September 30, 2005, expected volatility is based on the Company's historical volatility levels. For the nine month periods

ended September 30, 2006 and September 30, 2005, dividend yields are based on the Company's historical dividend yields. Risk-free interest rates are based on the implied yields currently available on U.S. Treasury zero coupon issues with a remaining term equal to the expected life.

Other information pertaining to option activity during the three and nine months ended September 30, 2006 and 2005 was as follows:

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	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Month Septembe 2006	
Weighted-average fair value of options granted	$ N/A	$ 4.50	$ 5.25	$
Total intrinsic value of stock options exercised	$ 89	$ 65	$ 613	$

Non-vested restricted stock activity for the nine months ended September 30, 2006 is summarized below:

	Shares	Weighted Average Grant Date Fair Value
Non-vested balance as of December 31, 2005	22,500	$ 19.83
Granted	-	-
Vested	-	-
Forfeited	-	-
Non-vested balance as of September 30, 2006	22,500	$ 19.83

As of September 30, 2006 there was $1,625 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the plans; that cost is expected to be recognized over a weighted-average period of 1.5 years.

NOTE 6 - INVENTORIES

Inventories at September 30, 2006 and December 31, 2005 consisted of the following:

	September 30, 2006	December 31, 2005
Raw materials	$ 3,560	$ 4,809
Finished goods	5,156	3,731
Total inventories	$ 8,716	$ 8,540

NOTE 7 - PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at September 30, 2006 and December 31, 2005 are summarized as follows:

	September 30, 2006	December 31, 2005
Land	$ 650	$ 290
Building	11,614	10,509
Equipment	37,515	31,196
Construction in Progress	1,259	332
	51,038	42,327
Less: Accumulated depreciation	20,068	17,927
Net property, plant and equipment	$ 30,970	$ 24,400

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NOTE 8 - INTANGIBLE ASSETS

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of SFAS No. 141, Business Combinations, and SFAS No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. These standards require the use of the purchase method of accounting for a business combination and define an intangible asset. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but are instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, Accounting for Impairment or Disposal of Long-Lived Assets.

As of December 31, 2005, the Company performed an impairment test of its goodwill balance. As of such date, the Company's reporting units' fair values exceeded their carrying amounts, and therefore there was no indication that goodwill was impaired. Accordingly, the Company was not required to perform any further impairment tests. The Company will perform its impairment test next as of December 31, 2006.

The Company had goodwill in the amount of $25,152 and $13,327 at September 30, 2006 and December 31, 2005, respectively, subject to the provisions of SFAS Nos. 141 and 142. At September 30, 2006, the balance of goodwill includes the cost in excess of net assets acquired of both the CMC acquisition, as described in Note 3, of $11,826 and the acquired assets of the Loders Croklaan StateStateUSA, LLC encapsulation, agglomeration and granulation business, described in Note 4, of $6,959.

As of September 30, 2006 and December 31, 2005, the Company had identifiable intangible assets with finite lives with a gross carrying value of approximately $7,789 and $2,432, respectively, less accumulated amortization of $716 and $284, respectively. At September 30, 2006, the gross carrying amount included a customer list, trade names and trade secrets acquired as part of the CMC acquisition, as described in Note 3, as well as a customer list and patent acquired as part of the acquisition of certain assets of the Loders Croklaan USA, LLC encapsulation, agglomeration and granulation business, described in Note 4.

Identifiable intangible assets with finite lives at September 30, 2006 and December 31, 2005 are summarized as follows:

	Amortization Period (in years)	Gross Carrying Amount at 9/30/06	Accumulated Amortization at 9/30/06	Gross Carrying Amount at 12/31/05	A Am a
Customer lists	10	$ 4,888	$ 375	$ 1,350	$
Regulatory re-registration costs	10	28	--	18	
Patents & trade secrets	15-17	1,542	199	753	
Trademarks & trade names	17	874	81	210	
Other	5	457	61	101	
		$ 7,789	$ 716	$ 2,432	$

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Amortization of identifiable intangible assets was $432 for the first nine months of 2006. Assuming no change in the gross carrying value of identifiable intangible assets, the estimated amortization expense for the remainder of 2006 is $162, approximately $634 per annum for 2007 through 2009, $625 in 2010 and $618 in 2011. At September 30, 2006, there were no identifiable intangible assets with indefinite useful lives as defined by SFAS No. 142. Identifiable intangible assets are reflected in "Intangible assets with finite lives, net" in the Company's condensed consolidated balance sheet. There were no changes to the useful lives of intangible assets subject to amortization during the nine months ended September 30, 2006.

NOTE 9 - NET EARNINGS PER SHARE

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

Three months ended September 30, 2006	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Sha Amount
Basic EPS - Net earnings and weighted average common shares outstanding	$ 3,151	11,630,050	$
Effect of dilutive securities - stock options and restricted stock		518,985	
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	$ 3,151	12,149,035	$

Three months ended September 30, 2005	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Sha Amount
Basic EPS - Net earnings and weighted average common shares outstanding	$ 3,024	11,591,802	$
Effect of dilutive securities - stock options		551,181	
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options	$ 3,024	12,142,983	$

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Nine months ended September 30, 2006	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Sha Amount
Basic EPS - Net earnings and weighted average common shares outstanding	$ 9,064	11,614,311	$
Effect of dilutive securities - stock options and restricted stock		541,138	
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options and restricted stock	$ 9,064	12,155,449	$

Nine months ended September 30, 2005	Net Earnings (Numerator)	Number of Shares (Denominator)	Per Sha Amount
Basic EPS - Net earnings and weighted average common shares outstanding	$ 8,322	11,549,027	$
Effect of dilutive securities - stock options		490,355	
Diluted EPS - Net earnings and weighted average common shares outstanding and effect of stock options	$ 8,322	12,039,382	$

The Company had stock options covering 349,300 and 306,000 shares at September 30, 2006 and 2005, respectively, that could potentially dilute basic earnings per share in future periods that were not included in diluted earnings per share

because their effect on the period presented was anti-dilutive.

NOTE 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, encapsulated / nutritional products and BCP Ingredients, its unencapsulated feed supplements segment.

Business Segment Net Sales:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Specialty Products	$ 7,967	$ 7,352	$ 23,927	$ 22,088
Encapsulated/Nutritional Products	10,348	8,503	30,676	23,131
BCP Ingredients	6,807	5,290	20,216	14,750
Total	$ 25,122	$ 21,145	$ 74,819	$ 59,969

Business Segment Earnings:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Specialty Products	$ 2,864	$ 2,846	$ 8,400	$ 8,377
Encapsulated/Nutritional Products	1,027	945	3,079	2,431
BCP Ingredients	1,090	940	2,841	2,233
Interest and other income (expense)	(3)	126	(84)	231
Earnings before income taxes	$ 4,978	$ 4,857	$ 14,236	$ 13,272

NOTE 11- SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid during the nine months ended September 30, 2006 and 2005 for income taxes and interest is as follows:

	Nine months ended September 30,	
	2006	2005
Income taxes	$ 3,896	$ 3,846
Interest	$ 186	$ 6

NOTE 12- COMMON STOCK

On December 15, 2005, the Board of Directors of the Company approved a three-for-two split of the Company's common stock to be effected in the form of a stock dividend to shareholders of record on December 30, 2005. Such distribution was made on January 20, 2006. Accordingly, the stock split was recognized by reclassifying the par value of the additional shares resulting from the split, from additional paid-in capital to common stock. All references to number of common shares and per share amounts except shares authorized in the accompanying condensed consolidated financial statements were retroactively adjusted to reflect the effect of the stock split.

In June 1999, the board of directors authorized the repurchase of shares of the Company's outstanding common stock over a two-year period commencing July 2, 1999. Under this program, which was subsequently extended, the Company had, as of December 31, 2004, repurchased a total 514,974 shares at an average cost of $6.17 per share, none of which remain in treasury. In June 2005, the board of directors authorized another extension to the stock repurchase program for up to an additional 600,000 shares, that is, over and above those 514,974 shares previously repurchased under the program. Under this extension, a total of 66,300 shares have been purchased at an average cost of $18.07, 22,057 of which remain in treasury at September 30, 2006. During the nine months ended September 30, 2006, no additional shares have been purchased.

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NOTE 13 - LONG TERM DEBT AND CREDIT AGREEMENTS

On February 6, 2006, the Company and its principal bank entered into a Loan Agreement providing for the Term Loan, the proceeds of which were used to fund the Acquisition, as described in Note 3, in part. The remaining balance of the purchase price of the Acquisition was funded through Balchem's cash on hand. During the nine months ended September 30, 2006, the Company repaid in full the $10,000 of principal under the Term Loan. The Loan Agreement also provides for an unsecured short-term revolving credit facility of $3,000 (the "Revolving Facility"). Borrowings under the Revolving Facility bear interest at LIBOR plus 1.00%. No amounts have been drawn on the Revolving Facility as of September 30, 2006. The Revolving Facility expires in February 2007. Management believes that such facility will be renewed in the normal course of business.

NOTE 14 - EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) savings and profit sharing plan for eligible employees. The plan allows participants to make pretax contributions and the Company matches certain percentages of those pretax contributions with shares of the Company's common stock. The profit sharing portion of the plan is discretionary and non-contributory. All amounts contributed to the plan are deposited into a trust fund administered by independent trustees.

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

Net periodic benefit cost for such retirement medical plan for the nine months ended September 30, 2006 and September 30, 2005 was as follows:

	2006	2005

Service Cost	$ 21	$ 24
Interest Cost	29	38
Expected return on plan assets	--	--
Amortization of transition obligation	--	--
Amortization of prior service cost	(14)	(11)
Amortization of (gain) or loss	(2)	--
Net periodic benefit cost	$ 34	$ 51

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

NOTE 15 - LICENSE AGREEMENT

On November 7, 2005, the Company entered into a license agreement (the "License Agreement") with Project Management and Development Co., Ltd. ("PMD"), a corporation organized under the laws of Great Britain. The License Agreement gives PMD the right to utilize the Company's proprietary continuous manufacturing technology for the production of aqueous choline chloride ("Company Technology") in connection with PMD's construction and operation of an aqueous choline chloride production facility at PMD's Al-JuBail, Saudi Arabia petrochemical facility, currently scheduled for completion in 2008.

The License Agreement provides PMD with the exclusive right to use Company Technology in certain countries, as well as the non-exclusive right to market, sell and use the products derived from Company Technology on a world-wide basis. The License Agreement further provides that the Company will be PMD's exclusive North American distributor for said products during the term of the agreement. The License Agreement terminates either 10 years from the start-up of the PMD's production facility or December 31, 2020, whichever is earlier.

Pursuant to the License Agreement, PMD will pay the Company a license fee of $1,400 and fees of $840 for the delivery by the Company of certain preliminary drawings, specifications, process design documents containing Company Technology, and additional training. These fees are to be paid in installments upon achievement of certain performance milestones set forth in the License Agreement.

The Company will provide certain performance guarantees associated with Company Technology. In the event that the PMD manufacturing facility, if properly designed and constructed, fails to attain said performance guarantees, liquidated damages may be assessed. However, such damages may not exceed 70% of the license fee.

The Company is using the percentage of completion method to recognize revenue and expenses related to the License Agreement and the efforts-expended method for measuring the progress to completion. As of September 30, 2006, the Company has recognized $790 of income and $540 in expenses since the inception of the agreement. For the nine months ended September 30, 2006, the Company has recognized $632 of income and $402 in expenses, which are included in net sales and cost of sales, respectively, in the BCP Ingredients segment.

NOTE 16 - NEW ACCOUNTING PRONOUNCEMENTS

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." The new statement amends Accounting Research Bulletin No. 43, Chapter 4, "Inventory

Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. This statement requires that those items be recognized as current period charges and requires that allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. This statement is effective for fiscal years beginning after June 15, 2005. The Company has adopted the provisions of this statement as of January 1, 2006 and does not expect this statement to have a material effect on its financial condition or results of operations.

In June 2006, FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109." This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the effect of this interpretation on its financial condition and results of operations.

In September 2006, FASB issued SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Postretirement Plans." The new statement amends FASB

Statements No. 87, 88, 106 and 132(R). This statement requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity. This statement also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. This statement's requirement to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures is effective for fiscal years ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008. The Company does not expect adoption of this statement to have a material effect on its financial condition or results of operations.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. Traditionally, there have been two widely-recognized methods for quantifying the effects of financial statement misstatements: the "roll-over" method and the "iron curtain" method. The roll-over method focuses primarily on the impact of a misstatement on the income statement--including the reversing effect of prior year misstatements--but its use can lead to the accumulation of misstatements in the balance sheet. The iron-curtain method, on the other hand, focuses primarily on the effect of correcting the period-end balance sheet with less emphasis on the reversing effects of prior year errors on the income statement. We currently use the roll-over method for quantifying identified financial statement misstatements. In SAB 108, the SEC staff established an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. This model is commonly referred to as a "dual approach" because it requires quantification of errors under both the iron

curtain and the roll-over methods. SAB 108 permits existing public companies to initially apply its provisions either by (i) restating prior financial statements as if the "dual approach" had always been used or (ii) recording the cumulative effect of initially applying the "dual approach" as adjustments to the carrying values of assets and liabilities as of January 1, 2006 with an offsetting adjustment recorded to the opening balance of retained earnings. Use of the "cumulative effect" transition method requires detailed disclosure of the nature and amount of each individual error being corrected through the cumulative adjustment and how and when it arose. The Company will adopt the provisions of SAB 108 as of December 31, 2006 and does not expect this bulletin to have a material effect on its financial condition or results of operations.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value to be applied to US GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS No. 157 on its consolidated financial position and results of operations.

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 1 of our Annual Report on Form 10-K for the year ended December 31, 2005 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 reportable segments are strategic businesses that offer products and services to different markets. We presently have three reportable segments: specialty products; encapsulated / nutritional products; and BCP Ingredients.

Specialty Products

Our specialty products segment operates as ARC Specialty Products.

Ethylene oxide, at the 100% level, is sold as a sterilant gas, primarily for use in the health care industry. It is used to sterilize a wide range of medical devices because of its versatility and effectiveness in treating hard or soft surfaces, composites, metals, tubing and different types of plastics without negatively impacting the performance of the device being sterilized. Our 100% ethylene oxide product is distributed in uniquely designed, recyclable double-walled stainless steel drums to assure compliance with safety, quality and environmental standards as outlined by the U.S. Environmental Protection Agency (the "EPA") and the U.S. Department of Transportation. Our inventory of these specially built drums, along with our two filling facilities, represents a

significant capital investment. Contract sterilizers, medical device manufacturers, and medical gas distributors are our principal customers for this product. In addition, we also sell single use canisters with 100% ethylene oxide for use in medical device sterilization. As a fumigant, ethylene oxide blends are highly effective in killing bacteria, fungi, and insects in spices and other seasoning materials.

We sell two other products, propylene oxide and methyl chloride, principally to customers seeking smaller (as opposed to bulk) quantities and whose requirements include timely delivery and safe handling. Propylene oxide is used for fumigation in spice treatment, various chemical synthesis applications, to make paints more durable, and for manufacturing specialty starches and textile coatings. Methyl chloride is used as a raw material in specialty herbicides, fertilizers, pharmaceuticals, malt and wine preservers.

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Encapsulated / Nutritional Products

The encapsulated / nutritional products segment provides microencapsulation, granulation and agglomeration solutions to a variety of applications in food, pharmaceutical and nutritional ingredients to enhance performance of nutritional fortification, processing, mixing, packaging applications and shelf-life. Major product applications are baked goods, refrigerated and frozen dough systems, processed meats, seasoning blends, confections, nutritional supplements and animal nutrition. We also market human grade choline nutrient products through this segment for wellness applications. Choline is recognized to play a key role in the structural integrity of cell membranes, processing dietary fat, reproductive development and neural functions, such as memory and muscle function. Our portfolio of granulated calcium carbonate products are primarily used in, or in conjunction with, novel over-the-counter and prescription pharmaceuticals for the treatment of osteoporosis, gastric disorders and calcium deficiencies in the StateStateUnited States.

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

BCP Ingredients

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

dry form.

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

The following tables summarize consolidated net sales by segment and business segment earnings for the three and nine months ended September 30, 2006 and September 30, 2005:

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Business Segment Net Sales:

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Specialty Products	$ 7,967	$ 7,352	$ 23,927	$ 22,088
Encapsulated/Nutritional Products	10,348	8,503	30,676	23,131
BCP Ingredients	6,807	5,290	20,216	14,750
Total	$ 25,122	$ 21,145	$ 74,819	$ 59,969

Business Segment Earnings:

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
Specialty Products	$ 2,864	$ 2,846	$ 8,400	$ 8,377
Encapsulated/Nutritional Products	1,027	945	3,079	2,431
BCP Ingredients	1,090	940	2,841	2,233
Interest and other income (expense)	(3)	126	(84)	231
Earnings before income taxes	$ 4,978	$ 4,857	$ 14,236	$ 13,272

The above results were impacted by the adoption of SFAS 123R, as described in the following paragraph.

Effective January 1, 2006, we adopted the fair value method of accounting for stock-based compensation under SFAS 123R, which allows public companies to select from two alternative transition methods when adopting SFAS 123R, the modified prospective application or the retrospective application. We have elected to adopt the provisions of SFAS 123R using the modified prospective application. Under the modified prospective application, the provisions of SFAS 123R are applied to new awards and awards modified, repurchased or cancelled after the effective date. Additionally, compensation cost for the unvested

portion of awards outstanding as of January 1, 2006 will be recognized as the requisite service is rendered after January 1, 2006. Financial statements for periods prior to January 1, 2006 are not restated to reflect, and do not include, the effect of SFAS 123R. Share-based compensation expense of $786 was recognized for the first nine months of 2006 for the unvested portion of awards outstanding as of January 1, 2006. We estimate that share-based compensation expense for 2006 will be approximately $1,048.

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RESULTS OF OPERATIONS

Three months ended September 30, 2006 compared to three months ended September 30, 2005

Net Sales

Net sales for the three months ended September 30, 2006 were $25,122 compared with $21,145 for the three months ended September 30, 2005, an increase of $3,977 or 18.8%. Net sales for the specialty products segment were $7,967 for the three months ended September 30, 2006, as compared with $7,352 for the three months ended September 30, 2005, an increase of $615 or 8.4%. This increase was principally due to an increase in sales volume along with modest price increases for our ethylene oxide products for medical device sterilization. Net sales for the encapsulated / nutritional products segment were $10,348 for the three months ended September 30, 2006, as compared with $8,503 for the three months ended September 30, 2005, an increase of $1,845 or 21.7%. Sales for the three months ended September 30, 2006, includes $1,200 of sales from CMC, which we acquired in February 2006 (see Note 3). Additional organic growth was derived principally from strength in sales of food, nutritional and human choline products, which grew 9.0% over the prior year comparable period. Net sales of $6,807 were realized for the three months ended September 30, 2006 for the BCP Ingredients (unencapsulated feed supplements) segment, as compared with $5,290 for the three months ended September 30, 2005, an increase of $1,517 or 28.7%. This increase was due to increased volumes sold in dry and aqueous choline, along with modest price increases in all product lines.

Gross Margin

Gross margin for the three months ended September 30, 2006 increased to $8,673, as compared to $7,649 for the three months ended September 30, 2005, an increase of $1,024 or 13.4%, due largely to the above-noted increase in sales. Gross margin percentage for the three months ended September 30, 2006 was 34.5%, as compared to 36.2% for the three months ended September 30, 2005. This decrease in gross margin percentage was primarily a result of product mix and higher raw material and fuel costs. Gross margin dollars for the specialty products segment increased slightly as increases in sales volume and modest sales price increases were partially offset by higher raw material prices. Gross margin dollars in the encapsulated/nutritional products segment increased 23.5% as margins were favorably affected by sales volumes from the newly acquired CMC, as well as increased volumes sold in the international food, human choline and ruminant animal markets. Gross margin dollars for the BCP Ingredients segment increased 16.4% and was favorably affected by increased sales volumes, partially offset by higher raw material costs and unfavorable changes in product mix.

Operating Expenses

Operating expenses for the three months ended September 30, 2006 were $3,692, as compared to $2,918 for the three months ended September 30, 2005, an increase of $774 or 26.5%. This increase was primarily a result of increased payroll costs for new hires, stock based compensation expenses relating to the adoption of the provisions of SFAS No. 123R, expenditures in support of the Company's pharmaceutical initiative, and

increased amortization expense resulting from the CMC acquisition. Total operating expenses as a percentage of sales were 14.7% for the three months ended September 30, 2006, as compared to 13.8% for the three months ended September 30, 2005. During the three months ended September 30, 2006 and 2005, the Company spent $549 and $492, respectively, on research and development programs, substantially all of which pertained to the Company's encapsulated / nutritional products segment for both human and animal health.

Earnings From Operations

As a result of the foregoing, earnings from operations for the three months ended September 30, 2006 were $4,981, as compared to $4,731 for the three months ended September 30, 2005.

Other expenses (income)

Interest income for the three months ended September 30, 2006 was $13, as compared to $46 for the three months ended September 30, 2005. This decrease is attributable to the decrease in the average total cash balance. Interest expense was $16 for the three months ended September 30, 2006, as compared to $2 for the three months ended September 30, 2005. This increase is attributable to the increase in average current debt resulting from the CMC acquisition in February 2006. Other income for the three months ended September 30, 2006 totaled $-0-, as compared to $82 for the three months ended September 30, 2005. This decrease is attributable to the inclusion of a gain on the sale of equipment for the three months ended September 30, 2005.

Income Tax Expense

Our effective tax rate for the three months ended September 30, 2006 and 2005 was 36.7% and 37.7%, respectively. This decrease in the effective tax rate is primarily attributable to a change in allocation relating to state income taxes.

Net earnings

As a result of the foregoing, net earnings were $3,151 for the three months ended September 30, 2006 as compared with $3,024 for the three months ended September 30, 2005, an increase of 4.2%.

Nine months ended September 30, 2006 compared to nine months ended September 30, 2005

Net Sales

Net sales for the nine months ended September 30, 2006 were $74,819, as compared with $59,969 for the nine months ended September 30, 2005, an increase of $14,850 or 24.8%. Net sales for the specialty products segment were $23,927 for the nine months ended September 30, 2006, as compared with $22,088 for the nine months ended September 30, 2005, an increase of $1,839 or 8.3%. This increase was principally due to an increase in sales volume along with modest price increases for our ethylene oxide products for medical device sterilization. Net sales for the encapsulated / nutritional products segment were $30,676 for the nine months ended September 30, 2006, as compared with $23,131 for the nine months ended September 30, 2005, an increase of $7,545 or 32.6%. This increase was due principally to increased volumes sold in the human choline market, favorable changes in product mix in the domestic and international food markets and approximately $5,220 of incremental sales associated with the Company's newly acquired pharmaceutical, food, and chelated minerals business lines resulting from the Loders Croklaan asset and CMC acquisitions (see Notes 4 and 3, respectively). Net sales of the BCP Ingredients segment were $20,216 for the nine months ended September 30, 2006 for the, as compared with $14,750 for the nine months ended September 30, 2005, an increase of $5,466 or 37.1%. This increase was due to increased volumes sold in dry and aqueous choline and choline derivatives, along with modest price increases in all product lines and revenue recognized of $632 relating to the PMD license agreement (see Note 15).

Gross Margin

Gross margin for the nine months ended September 30, 2006 increased to $25,695, as compared to $21,943 for the nine months ended September 30, 2005, an increase of $3,752 or 17.1%, due largely to the above-noted increase in sales. Gross margin percentage for the nine months ended September 30, 2006 was 34.3%, as compared to 36.6% for the nine months ended September 30, 2005. This decrease in gross margin percentage was primarily a result of product mix and higher raw material and fuel costs. Gross margin dollars for the specialty products segment increased due to higher sales volume, and modest increases in average selling price. These increases were partially offset by higher raw material prices. Gross margin dollars in the encapsulated / nutritional products segment increased 32.0% as margins were favorably affected by increased sales volumes from the newly acquired CMC products, increased volumes sold in the human choline market, as well as favorable product mixes in the international food and ruminant animal markets. These increases were partially offset by unfavorable product mix in the pharmaceutical calcium product line. Gross margin dollars for the BCP Ingredients segment increased 26.5% and was favorably affected by increased sales volumes, partially offset by higher raw material and energy costs.

Operating Expenses

Operating expenses for the nine months ended September 30, 2006 were $11,375, as compared to $8,902 for the nine months ended September 30, 2005, an increase of $2,473 or 27.8%. This increase was primarily a result of increased payroll costs for new hires,

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stock-based compensation expenses relating to the adoption of the provisions of SFAS 123R, expenditures in support of the Company's pharmaceutical initiative, and increased amortization expense resulting from the CMC acquisition. Total operating expenses as a percentage of sales were 15.2% for the nine months ended September 30, 2006 compared to 14.8% for the nine months ended September 30, 2005. During the nine months ended September 30, 2006 and 2005, the Company spent $1,561 and $1,537, respectively, on research and development programs,

substantially all of which pertained to the Company's encapsulated / nutritional products segment for both human and animal health.

Earnings From Operations

As a result of the foregoing, earnings from operations for the nine months ended September 30, 2006 were $14,320 as compared to $13,041 for the nine months ended September 30, 2005.

Other expenses (income)

Interest income for the nine months ended September 30, 2006 totaled $102, as compared to $155 for the nine months ended September 30, 2005. This decrease is attributable to the decrease in the average total cash balance. Interest expense was $186 for the nine months ended September 30, 2006, as compared to $6 for the nine months ended September 30, 2005. This increase is attributable to the increase in average current and long-term debt resulting from the CMC acquisition in February 2006. Other income for the nine months ended September 30, 2006 totaled $-0-, as compared to $82 for the nine months ended September 30, 2005. This decrease is attributable to the inclusion of a gain on the sale of equipment for the nine months ended September 30, 2005.

Income Tax Expense

The Company's effective tax rate for the nine months ended September 30, 2006 and 2005 was 36.3% and 37.3%, respectively. This decrease in the effective tax rate is primarily attributable to a change in allocation relating to state income taxes.

Net earnings

As a result of the foregoing, net earnings were $9,064 for the nine months ended September 30, 2006 as compared with $8,322 for the nine months ended September 30, 2005, an increase of 8.9%.

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FINANCIAL CONDITION

LIQUIDITY AND CAPITAL RESOURCES

Contractual Obligations

As part of the June 30, 2005 acquisition of certain assets relating to the encapsulation, agglomeration and granulation business of Loders Croklaan USA, LLC, we agreed to the contingent payment of additional consideration based upon the volume of sales associated with one particular product acquired by the Company during the three year period following the acquisition. Such contingent consideration, if any is paid, will be recorded as an additional cost of the acquired product lines. No such contingent consideration has been paid as of September 30, 2006.

The Company's other contractual obligations and commitments principally include obligations associated with future minimum non-cancelable operating lease

obligations (including a lease for our headquarters office space, which we entered into in 2002).

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

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

Cash

Cash and cash equivalents decreased to $2,660 at September 30, 2006 from $12,996 at December 31, 2005. The $10,336 decrease resulted primarily from net cash used in investing activities of $24,078, principally for the acquisition of all of the outstanding capital stock of CMC on February 8, 2006, as well as for the acquisition of the St. Gabriel, Louisiana manufacturing facility and related assets from BioAdditives, LLC and CMB Additives, LLC on August 24, 2006. Also contributing to the decrease in cash and cash equivalents was net cash used in financing activities of $571. Partially offsetting these decreases was an increase in net cash provided by operating activities of $14,313. Working capital amounted to $15,802 at September 30, 2006 as compared to $26,116 at December 31, 2005, a decrease of $10,314, primarily due to the aforementioned decrease in cash.

Operating Activities

Cash flows from operating activities provided $14,313 for the nine months ended September 30, 2006, as compared to $9,827 for the nine months ended September 30, 2005. The increase in cash flows from operating activities was primarily due to increases in net earnings, depreciation expense and current income taxes, as well as a decrease in prepaid expenses. This increase was partially offset by decreases in customer deposits and other deferred revenue and accounts payable and accrued expenses.

Investing Activities

Capital expenditures were $1,235 for the nine months ended September 30, 2006 compared to $1,186 for the nine months ended September 30, 2005 and are expected to be approximately $2,500 for all of calendar year 2006. Cash paid for acquisitions in 2006, including acquisition costs, net of acquisition accounts receivable collected, was $22,772.

Financing Activities

In June 1999, the board of directors authorized the repurchase of shares of the Company's outstanding common stock over a two-year period commencing July 2, 1999. Under this program, which was subsequently extended, the Company had, as of December 31, 2004, repurchased a total 514,974 shares at an average cost of $6.17 per share, none of which remain in treasury. In June 2005, the board of directors authorized another extension to the stock repurchase program for up to an additional 600,000 shares, that is, over and above those 514,974 shares

previously repurchased under the program. Under this extension, a total of 66,300 shares have been purchased at an average cost of $18.07, 22,057 of which remain in treasury at September 30, 2006. During the nine months ended September 30, 2006, no additional shares have been purchased.

On February 6, 2006, the Company and its principal bank entered into the Loan Agreement providing for the Term Loan of $10,000, the proceeds of which were used to fund the CMC Acquisition (see Note 3), in part. The remaining balance of the purchase price of the Acquisition was funded through Balchem's cash on hand. The Loan Agreement also provides for a Revolving Facility of $3,000. Borrowings under the Revolving Facility bear interest at LIBOR plus 1.00%. No amounts have been drawn on the Revolving Facility as of September 30, 2006. The Revolving Facility expires in February 2007. Management believes that such facility will be renewed in the normal course of business.

As of September 30, 2006, the Company made $10,000 in principal payments against the Term Loan, which paid the term loan in full.

Proceeds from stock options exercised totaled $321 and $1,263 for the nine months ended September 30, 2006 and 2005, respectively. Dividend payments were $1,045 and $685 for the nine months ended September 30, 2006 and 2005, respectively.

Pursuant to the Company's adoption of the provisions of SFAS 123R, the excess tax benefits of stock options exercised of $163 for the nine months ended September 30, 2006 is classified as a financing activity. These excess tax benefits had previously been classified as an operating activity.

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 StateStateVerona, StateMissouri facility. The amount recorded on the Company's balance sheet as of September 30, 2006 for this obligation is $1,018, and is included under "Other long-

term obligations". The postretirement plan is not funded. Historical cash payments made under such plan have approximated $50 per year.

Critical Accounting Policies

Stock Options and Restricted Stock Awards

As discussed above, effective January 1, 2006, we account for stock-based compensation under SFAS 123R. Prior to January 1, 2006, we applied the intrinsic value method in measuring stock-based compensation under APB 25. Under SFAS 123R, share-based payment awards result in a cost measured at fair value on the awards' grant dates, based on the estimated number of awards expected to vest, and that cost is recognized through earnings over the expected vesting period. Under APB 25, when the exercise price of the Company's stock options equaled the market value of the underlying stock on the date of the grant, no compensation expense was recognized.

During the nine months ended September 30, 2006, other than the adoption of SFAS 123R, there were no changes to the Company's Critical Accounting Policies, as described in its Annual Report on Form 10-K for the year ended December 31, 2005.

Related Party Transactions

The Company was not engaged in related party transactions during the nine months ended September 30, 2006.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Cash and cash equivalents are invested primarily in money market accounts. Accordingly, we believe we have limited exposure to market risk for changes in interest rates. The Company has no derivative financial instruments or derivative commodity instruments, nor does the Company have any financial instruments entered into for trading or hedging purposes. Foreign sales are generally billed in U.S. dollars. As of September 30, 2006, the Company had no borrowings under any loan agreements or other credit facilities. The Company believes that its business operations are not exposed in any material respect to market risk relating to foreign currency exchange risk or commodity price risk.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

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

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

(b) Changes in Internal Controls

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

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, 2005.

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

None.

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.

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, President and
Chief Executive Officer

Date: November 8, 2006

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Exhibit Index

Exhibit No.	Description
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.