

PHIBRO ANIMAL HEALTH CORP

Form 10-Q

May 15, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2006**

**or**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number 333-64641  
Phibro Animal Health Corporation**

*(Exact name of registrant as specified in its charter)*

**New York**

*(State or other jurisdiction of  
incorporation or organization)*

**13-1840497**

*(I.R.S. Employer  
Identification No.)*

**65 Challenger Road,  
Ridgefield Park, New Jersey**

*(Address of principal executive offices)*

**07660**

*(Zip Code)*

**(201) 329-7300**

*(Registrant's telephone number, including area code)*

Indicate by 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 such filing requirements for the past 90 days. Yes  No

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

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

The number of shares outstanding of the Registrant's Common Stock as of May 9, 2006: 24,488.50

**Class A Common Stock, \$.10 par value: 12,600.00**

**Class B Common Stock, \$.10 par value: 11,888.50**

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This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Company's actual results could differ materially from those set forth in the forward-looking statements. Certain factors that might cause such a difference are discussed in the Company's Annual Report on Form 10-K for its fiscal year ended June 30, 2005 and/or throughout this Form 10-Q and in particular in Item 2 of Part I of this Form 10-Q under the caption Certain Factors Affecting Future Operating Results. Unless the context otherwise requires, references in this report to the Company or to we or our refer to Phibro Animal Health Corporation and/or one or more of its subsidiaries, as applicable.

**PART I FINANCIAL INFORMATION**

**Item 1. *Condensed Consolidated Financial Statements (Unaudited)***

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	March 31, 2006	June 30, 2005
	(Unaudited) (In thousands)	
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 9,752	\$ 13,001
Accounts receivable, net	60,009	56,417
Inventories	93,911	96,621
Prepaid expenses and other current assets	10,832	12,787
Total current assets	174,504	178,826
Property, plant and equipment, net	48,972	49,960
Intangibles, net	9,096	10,201
Other assets	11,234	14,070
Total assets	\$ 243,806	\$ 253,057
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
Current liabilities		
Loans payable to banks	\$	\$ 8,038
Current portion of long-term debt	223	1,625
Accounts payable	38,781	36,537
Accrued expenses and other current liabilities	53,985	53,815
Total current liabilities	92,989	100,015
Long-term debt	176,451	176,501
Other liabilities	23,231	21,465
Total liabilities	292,671	297,981
Commitments and contingencies		
Stockholders deficit		
Preferred stock	521	521
Common stock	2	2
Paid-in capital	27,260	27,260
Accumulated deficit	(80,544)	(74,379)
Accumulated other comprehensive income		
Gain on derivative instruments, net of income taxes	79	123
Cumulative foreign currency translation adjustment, net of income taxes	3,817	1,549
Total stockholders deficit	(48,865)	(44,924)
Total liabilities and stockholders deficit	\$ 243,806	\$ 253,057

See notes to unaudited condensed consolidated financial statements

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND**  
**COMPREHENSIVE INCOME (LOSS)**

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
	(Unaudited)			
	(In thousands)			
Net sales	\$ 100,905	\$ 90,255	\$ 293,211	\$ 269,169
Cost of goods sold (includes Belgium Plant Transactions costs of \$975 and \$4,372 for the three months ended March 31, 2006 and 2005, respectively, and \$10,211 and \$13,908 for the nine months ended March 31, 2006 and 2005, respectively)	76,442	71,504	229,343	214,682
Gross profit	24,463	18,751	63,868	54,487
Selling, general and administrative expenses	17,527	17,019	49,372	49,771
Operating income	6,936	1,732	14,496	4,716
Interest expense	6,726	6,757	19,183	18,656
Interest (income)	(53)	(19)	(259)	(77)
Other (income) expense, net	31	77	(2,561)	(691)
Income (loss) from continuing operations before income taxes	232	(5,083)	(1,867)	(13,172)
Provision for income taxes	1,591	773	4,298	699
(Loss) from continuing operations	(1,359)	(5,856)	(6,165)	(13,871)
Income from discontinued operations, net of income taxes		272		575
Net (loss)	(1,359)	(5,584)	(6,165)	(13,296)
Other comprehensive income (loss):				
Change in derivative instruments, net of income taxes	76	(27)	(44)	295
Change in foreign currency translation adjustment, net of income taxes	2,482	(1,207)	2,268	7,104
Comprehensive income (loss)	\$ 1,199	\$ (6,818)	\$ (3,941)	\$ (5,897)
Net (loss)	(1,359)	(5,584)	(6,165)	(13,296)
Excess of the reduction of Series B and C preferred stock over total assets divested and costs and liabilities incurred on the Prince Transactions		4,000		4,973
Dividends and equity value adjustment on Series C preferred stock		(3,582)		(1,723)
Net (loss) attributable to common stockholders	\$ (1,359)	\$ (5,166)	\$ (6,165)	\$ (10,046)





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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' DEFICIT**  
**For the Three Months and Nine Months Ended March 31, 2006**

	Preferred Stock Series A	Common Stock Class A    Class B		Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
<b>(Unaudited)</b> <b>(In thousands)</b>							
Balance as of June 30, 2005	\$ 521	\$ 1	\$ 1	\$ 27,260	\$ (74,379)	\$ 1,672	\$ (44,924)
Change in derivative instruments, net of income taxes						100	100
Change in foreign currency translation adjustment, net of income taxes						2,040	2,040
Net (loss)					(2,791)		(2,791)
Balance as of September 30, 2005	\$ 521	\$ 1	\$ 1	\$ 27,260	\$ (77,170)	\$ 3,812	\$ (45,575)
Change in derivative instruments, net of income taxes						(220)	(220)
Change in foreign currency translation adjustment, net of income taxes						(2,254)	(2,254)
Net (loss)					(2,015)		(2,015)
Balance as of December 31, 2005	\$ 521	\$ 1	\$ 1	\$ 27,260	\$ (79,185)	\$ 1,338	\$ (50,064)
Change in derivative instruments, net of income taxes						76	76
Change in foreign currency translation adjustment, net of income taxes						2,482	2,482
Net (loss)					(1,359)		(1,359)
Balance as of March 31, 2006	\$ 521	\$ 1	\$ 1	\$ 27,260	\$ (80,544)	\$ 3,896	\$ (48,865)

See notes to unaudited condensed consolidated financial statements



**Table of Contents****PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended March 31,	
	2006	2005
	(Unaudited) (In thousands)	
<b>OPERATING ACTIVITIES</b>		
Net (loss)	\$ (6,165)	\$ (13,296)
Adjustment for discontinued operations		(575)
(Loss) from continuing operations	(6,165)	(13,871)
Adjustments to reconcile (loss) from continuing operations to net cash provided (used) by operating activities:		
Depreciation and amortization (includes accelerated depreciation from the Belgium Plant Transactions of \$4,533 and \$3,628 for the nine months ended March 31, 2006 and 2005, respectively)	11,849	11,586
Amortization of deferred financing costs	2,486	2,130
Deferred income taxes	(424)	(202)
Net gain from sales of assets	(464)	(789)
Effects of changes in foreign currency	(226)	(760)
Other	(428)	430
Changes in operating assets and liabilities:		
Accounts receivable	(4,041)	4,460
Inventories	4,006	(16,378)
Prepaid expenses and other current assets	2,845	1,647
Other assets	121	(618)
Accounts payable	2,173	(11,378)
Accrued expenses and other liabilities	(1,984)	9,120
Accrued expenses: non-completed transaction		(3,970)
Accrued expenses: Belgium Plant Transactions	(1,608)	10,280
Cash provided (used) by discontinued operations		808
Net cash provided (used) by operating activities	8,140	(7,505)
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(11,244)	(5,098)
Proceeds from Belgium Plant Transactions	7,997	
Proceeds from sales of assets	1,934	1,353
Other investing	(106)	(119)
Discontinued operations		(93)
Net cash (used) by investing activities	(1,419)	(3,957)
<b>FINANCING ACTIVITIES</b>		
Net increase (decrease) in book overdrafts	(27)	1,930

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Net (decrease) in short-term debt	(8,038)	(7,049)
Proceeds from long-term debt		24,292
Payments of long-term debt and capital leases	(2,005)	(3,913)
Proceeds from capital contribution by PAHC Holdings Corporation		26,400
Redemption of Series C preferred stock		(26,400)
Debt financing costs		(2,027)
Net cash provided (used) by financing activities	(10,070)	13,233
Effect of exchange rate changes on cash	100	66
Net increase (decrease) in cash and cash equivalents	(3,249)	1,837
Cash and cash equivalents at beginning of period	13,001	5,568
Cash and cash equivalents at end of period	\$ 9,752	\$ 7,405
<b>Supplemental Cash Flow Information</b>		
Interest paid	\$ 11,552	\$ 10,431
Income taxes paid	2,814	1,130
Capital lease additions	522	

See notes to unaudited condensed consolidated financial statements

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**  
**(In Thousands)**

**1. General**

***Principles of Consolidation and Basis of Presentation***

In the opinion of Phibro Animal Health Corporation (the Company or PAHC), the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to state fairly its financial position at March 31, 2006 and its results of operations and cash flows for the three months and nine months ended March 31, 2006 and 2005. The financial results for any interim period are not necessarily indicative of results for the full year. The Company presents its financial statements on the basis of its fiscal year ending June 30. All references to 2007, 2006 and 2005 refer to the fiscal year ended June 30 of that year.

The Company is a wholly-owned subsidiary of PAHC Holdings Corporation, which was formed in February 2005.

The condensed consolidated financial statements include the accounts of the Company and all majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in the condensed consolidated financial statements.

The Company consolidates the financial statements of Koffolk (1949) Ltd. (Israel) (Koffolk) and Planalquimica Industrial Ltda. (Brazil) (Planalquimica) on the basis of their March 31 fiscal year-ends to facilitate the timely inclusion of such entities in the Company's consolidated financial reporting. The condensed consolidated financial statements include Koffolk's and Planalquimica's financial position as of December 31, 2005 and their results of operations and cash flows for the three months and nine months ended December 31, 2005 and 2004.

The condensed consolidated balance sheet as of June 30, 2005 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. Additionally it should be noted the accompanying condensed consolidated financial statements and notes thereto have been prepared in accordance with accounting standards appropriate for interim financial statements. While the Company believes the disclosures presented are adequate to make the information herein not misleading, these financial statements should be read in conjunction with the audited consolidated financial statements as found in the Company's annual report filed on Form 10-K for the year ended June 30, 2005.

***Risks, Uncertainties and Liquidity***

The Company's ability to fund its operating plan relies upon the continued availability of borrowing under the domestic senior credit facility. The Company believes that it will be able to comply with the terms of its covenants under the domestic senior credit facility based on its forecasted operating plan. In the event of adverse operating results and/or violation of covenants under this facility, there can be no assurance that the Company would be able to obtain waivers or amendments on favorable terms, if at all. The Company's 2006 operating plan projects adequate liquidity throughout the year, with periods of reduced availability around the dates of the semi-annual interest payments due December 1 and June 1 related to PAHC's 13% Senior Secured Notes due 2007 and PAHC's 7.9% Senior Subordinated Notes due 2008. The Company is pursuing additional cost reduction activities, working capital improvement plans, and sales of non-strategic assets to provide additional liquidity. The Company also has availability under foreign credit lines that would be available as needed. There can be no assurance the Company will be successful in any of the above-noted actions.

The use of antibiotics in medicated feed additives is a subject of legislative and regulatory interest. The issue of potential for increased bacterial resistance to certain antibiotics used in certain food-producing animals is the subject of discussions on a worldwide basis and, in certain instances, has led to government

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

restrictions on the use of antibiotics in food-producing animals. The sale of feed additives containing antibiotics is a material portion of the Company's business. Should regulatory or other developments result in further restrictions on the sale of such products, it could have a material adverse impact on the Company's financial position, results of operations and cash flows.

The testing, manufacturing, and marketing of certain products are subject to extensive regulation by numerous government authorities in the United States and other countries.

The Company has significant assets located outside of the United States, and a significant portion of the Company's sales and earnings are attributable to operations conducted abroad.

The Company has assets located in Israel and a portion of its sales and earnings are attributable to operations conducted in Israel. The Company is affected by social, political and economic conditions affecting Israel, and any major hostilities involving Israel as well as the Middle East or curtailment of trade between Israel and its current trading partners, either as a result of hostilities or otherwise, could have a material adverse effect on the Company.

The Company's operations, properties and subsidiaries are subject to a wide variety of complex and stringent federal, state, local and foreign environmental laws and regulations, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain materials and wastes, the remediation of contaminated soil and groundwater, the manufacture, sale and use of pesticides and the health and safety of employees. As such, the nature of the Company's current and former operations and those of its subsidiaries exposes the Company and its subsidiaries to the risk of claims with respect to such matters.

***New Accounting Pronouncements***

The Company adopted the following new accounting pronouncements in 2006:

Statement of Financial Accounting Standards No. 151, *Inventory Costs*, an amendment to Accounting Research Bulletin No. 43, Chapter 4 (SFAS No. 151). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing* to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Paragraph 5 of ARB No. 43, Chapter 4, previously stated . . . under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges. . . . SFAS No. 151 requires that those items be recognized as current period charges regardless of whether they meet the criterion of so abnormal. In addition, SFAS No. 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 30, 2005 and the provisions of this statement shall be applied prospectively. The adoption of SFAS No. 151 did not impact the Company's financial statements.

Statement of Financial Accounting Standards No. 153, *Exchanges of Nonmonetary Assets*, an amendment of APB Opinion No. 29 (SFAS No. 153). SFAS No. 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The provisions of this statement shall be applied prospectively. The adoption of SFAS No. 153 did not impact the Company's financial statements.

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company will adopt the following new accounting pronouncement in 2006:

FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations ( FIN No. 47 ). FIN No. 47 clarifies that the term conditional asset retirement obligation as used in FASB Statement No. 143, Accounting for Asset Retirement Obligations ( ARO ) refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. Thus, the timing and/or method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional ARO if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional ARO should be recognized when incurred; generally upon acquisition, construction, or development and/or through the normal operation of the asset. Uncertainty about the timing and/or method of settlement of a conditional ARO should be factored into the measurement of the liability when sufficient information exists. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an ARO. FIN No. 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company anticipates that the adoption of FIN No. 47 will not result in a material impact on the Company's financial statements.

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. Balance Sheet Information**

	As of	
	March 31, 2006	June 30, 2005
<b>Accounts receivable, net</b>		
Trade accounts receivable	\$ 58,325	\$ 54,178
Less: allowance for doubtful accounts	1,307	1,372
Trade accounts receivable, net	57,018	52,806
Other receivables	2,991	3,611
Total	\$ 60,009	\$ 56,417
<b>Inventories</b>		
Raw materials	\$ 19,816	\$ 23,703
Work-in-process	869	434
Finished goods	73,226	72,484
Total	\$ 93,911	\$ 96,621
<b>Property, plant and equipment, net</b>		
Land	\$ 4,225	\$ 6,250
Buildings and improvements	21,472	25,967
Machinery and equipment	101,129	108,762
	126,826	140,979
Less: accumulated depreciation	77,854	91,019
Total	\$ 48,972	\$ 49,960
<b>Intangibles, net</b>		
Cost	\$ 14,918	\$ 14,907
Less: accumulated amortization	5,822	4,706
Total	\$ 9,096	\$ 10,201

Resulting from the Belgium Plant Transactions discussed below, as of November 30, 2005, the Company removed \$1,896 of land, \$6,103 of buildings and improvements, \$16,301 of machinery and equipment and \$22,182 of accumulated depreciation from property, plant and equipment, net on the condensed consolidated balance sheet.

Amortization expense for intangibles was \$370 and \$375 for the three months ended March 31, 2006 and 2005, respectively, and \$1,113 and \$1,121 for the nine months ended March 31, 2006 and 2005, respectively.

**3. Belgium Plant Transactions**



On November 30, 2005, Phibro Animal Health SA ( PAH Belgium ) sold to GlaxoSmithKline Biologicals ( GSK ) substantially all of PAH Belgium s facilities in Rixensart, Belgium (the Belgium Plant ). The sale (the Belgium Plant Transactions ) included the following elements (U.S. dollar amounts at the March 31, 2006 exchange rate except where otherwise indicated): (i) the transfer of substantially all of the land and buildings and certain equipment of PAH Belgium at the Belgium Plant, as well as the industrial activities and intellectual property relating to certain solvent technology of PAH Belgium for a purchase price of EUR 6,200 (\$7,310 at the November 30, 2005 exchange rate), paid at closing; (ii) the transfer to GSK of a

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majority of the employees of the Belgium Plant and the corresponding responsibility for statutory severance obligations; (iii) GSK agreed to be responsible for cleaning-up, by demolition or otherwise, certain buildings not to be used by it, but for PAH Belgium to reimburse GSK up to a maximum of EUR 700 (\$849) for such cleaning-up costs; (iv) in recognition of the benefits to PAHC from the proposed transaction, PAH Belgium agreed to pay to GSK EUR 1,500 (\$1,821) within six months from the closing date, EUR 1,500 (\$1,821) within eighteen months from the closing date, EUR 1,500 (\$1,821) within thirty months from the closing date, and EUR 500 (\$607) within forty-two months from the closing date; (v) PAH Belgium sold certain excess land for its own account; (vi) PAH Belgium was responsible for certain plant closure costs and legally required severance indemnities in connection with workforce reductions; and (vii) PAH Belgium retained certain equipment at the Belgium Plant, and has transferred or will transfer such equipment, together with other assets and rights related to the production of virginiamycin, to Phibro Saude Animal Internacional Ltda. ( PAH Brazil ) which owns a facility in Guarulhos, Brazil or in connection with alternative production arrangements.

The Dutch Notes (as defined below) and related guarantees were collateralized by a mortgage on the Belgium Plant which was released in connection with the sale of the Belgium Plant to GSK.

As a result of the Belgium Plant Transactions, the Company depreciated the Belgium Plant to its estimated salvage value, recorded expense of early-retirement and severance programs for those employees not transferred to GSK, other transaction-related expenses, a curtailment gain on the Belgium pension plan and a gain on the sales of the Belgium Plant and excess land. Other transaction-related expenses were primarily related to employee retention agreements, plant dismantling and decommissioning, plant shutdown, and site demolition costs payable to GSK.

The following table includes the amounts of these charges and gains.

**Belgium Plant Transactions Costs**

	<b>Twelve Months Ended</b>	<b>Three Months Ended</b>			<b>Nine Months Ended</b>	<b>Cumulative Total</b>
	<b>June 30, 2005</b>	<b>September 30, 2005</b>	<b>December 31, 2005</b>	<b>March 31, 2006</b>	<b>March 31, 2006</b>	
Incremental depreciation	\$ 7,467	\$ 2,747	\$ 1,786	\$	\$ 4,533	\$ 12,000
Employee termination expenses	12,808	287	699		986	13,794
Other transaction-related expenses	1,916	979	3,759	975	5,713	7,629
Net (gain) on the curtailment and settlement of the pension plan			(432)		(432)	(432)
(Gain) on the sale of the Belgium Plant and excess land		(510)	(79)		(589)	(589)
	\$ 22,191	\$ 3,503	\$ 5,733	\$ 975	\$ 10,211	\$ 32,402

All costs and gains of the Belgium Plant Transactions are included in cost of goods sold on the condensed consolidated statements of operations and comprehensive income (loss) in the periods as described in the table above.

As of March 31, 2006, accrued expenses and other long term liabilities on the condensed consolidated balance sheet included \$6,919 payable to GSK and \$10,333 payable for employee termination and other transaction-related

expenses.

The Company expects to record in future periods an estimated additional \$800 of other transaction-related expenses, primarily for plant dismantling and decommissioning, primarily during the remainder of 2006.

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In anticipation of transferring production of virginiamycin from the Belgium Plant to an alternative production location, the Company increased inventory levels of virginiamycin until the Belgium Plant sale in November 2005 to ensure adequate supplies during the transfer period. Virginiamycin inventories were approximately \$33,400 at March 31, 2006 and \$38,800 at June 30, 2005.

**4. Discontinued Operations**

The Company divested Wychem Ltd. (U.K.) ( Wychem ) during 2005. Wychem has been classified as a discontinued operation. The condensed consolidated financial statements have been revised to report separately the operating results, financial position and cash flows of the discontinued operation.

Operating results of Wychem were:

	<b>Three Months Ended March 31, 2005</b>	<b>Nine Months Ended March 31, 2005</b>
Net sales	\$ 1,487	\$ 3,908
Cost of goods sold	924	2,590
Selling, general and administrative expenses	174	511
Other expense	5	6
Income before income taxes	384	801
Provision for income taxes	112	226
Income from operations	\$ 272	\$ 575
Depreciation and amortization	\$ 105	\$ 309

**5. Debt*****Loans Payable to Banks***

At March 31, 2006, PAHC had no amounts borrowed under its domestic senior credit facility, and had \$17,500 of borrowings available under the working capital facility that is provided under its domestic senior credit facility.

On October 28, 2005, PAHC amended its domestic senior credit facility in connection with, among other things, yearly determination of certain financial covenants to: (i) amend the EBITDA definition to exclude charges and expenses related to the sale of the Belgium Plant in an aggregate amount not to exceed \$33,200 for purposes of calculating a certain financial covenant; (ii) establish the Minimum Domestic EBITDA for the 12 month periods ended July 31, 2005 through June 30, 2006 at \$17,500 for purposes of calculating a certain financial covenant; (iii) establish the Consolidated Minimum EBITDA for the 12 month periods ended July 31, 2005 through June 30, 2006 at \$32,000 for purposes of calculating a certain financial covenant; and (iv) amend the maximum aggregate amount of borrowing available under the working capital and letter of credit facilities from \$32,500 to \$35,000. The amount of aggregate borrowings available under the working capital facility remained unchanged at \$17,500.

As of March 31, 2006, PAHC was in compliance with the financial covenants of its domestic senior credit facility, as amended. The domestic senior credit facility requires, among other things, the maintenance of certain levels of trailing consolidated and domestic EBITDA (earnings before interest, taxes, depreciation and amortization) calculated on a monthly basis, and an acceleration clause should an event of default (as defined in the agreement) occur. In addition, there are certain restrictions on additional borrowings, additional liens on PAHC's assets, guarantees, dividend payments, redemption or purchase of PAHC's stock, sale of subsidiaries' stock, disposition of assets,

investments, and mergers and acquisitions.

**Table of Contents****PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

PAHC's domestic senior credit facility contains a lock-box requirement and a material adverse change clause should an event of default (as defined in the agreement) occur. Accordingly, the amounts outstanding have been classified as short-term and are included in loans payable to banks on the condensed consolidated balance sheet.

***Long-Term Debt***

	As of	
	March 31, 2006	June 30, 2005
Senior secured notes due December 1, 2007	\$ 127,491	\$ 127,491
Senior subordinated notes due June 1, 2008	48,029	48,029
Foreign bank loans	701	2,606
Capitalized lease obligations and other	453	
	176,674	178,126
Less: current maturities	223	1,625
	\$ 176,451	\$ 176,501

Koffolk has aggregate credit lines available for borrowing and letters of credit of \$10,500. At March 31, 2006, Koffolk had \$9,082 available under these credit lines.

**6. Employee Benefit Plans**

PAHC and its domestic subsidiaries maintain noncontributory defined benefit pension plans for all eligible domestic nonunion employees who meet certain requirements of age, length of service and hours worked per year. The Company's Belgium subsidiary maintains a defined contribution and defined benefit plan for eligible employees.

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Components of net periodic pension expense were:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
<b>Domestic Pension Expense</b>				
Service cost – benefits earned during the period	\$ 394	\$ 291	\$ 1,201	\$ 915
Interest cost on benefit obligation	246	228	765	707
Expected return on plan assets	(233)	(218)	(727)	(676)
Amortization of initial unrecognized net transition (asset)		(1)		(3)
Amortization of prior service cost	(34)	(35)	(108)	(107)
Amortization of net actuarial loss	36		106	
Net periodic pension expense – domestic	\$ 409	\$ 265	\$ 1,237	\$ 836
<b>Belgium Pension Expense</b>				
Service cost – benefits earned during the period	\$ 73	\$ 131	\$ 288	\$ 367
Interest cost on benefit obligation	168	105	386	314
Expected return on plan assets	(128)	(84)	(290)	(263)
Amortization of prior service cost	4		5	
Amortization of net actuarial loss		6	18	7
Curtailment benefit			(508)	
Settlement charges			76	
Net periodic pension (benefit) expense – Belgium	\$ 117	\$ 158	\$ (25)	\$ 425

The reduction of participants in the Belgium pension plan by transfer of employees to GSK, an early retirement program and terminations resulted in a curtailment benefit of \$508.

The Company transferred Belgium plan assets of \$3,186 and related liabilities to GSK which resulted in a settlement loss of \$76.

The approximate funded status of the Belgium plan was:

	As of March 31, 2006	As of June 30, 2005
Benefit obligation	\$ 6,465	\$ 11,264
Fair value of plan assets	5,031	7,408
Funded status of the plan	(1,434)	(3,856)
Unrecognized net actuarial loss and prior service cost	255	2,002
(Accrued) pension liability	(1,179)	(1,854)

**7. Contingencies**

***Litigation***

On or about April 17, 1997, C.P. Chemicals, Inc., a subsidiary ( CP ), and PAHC were served with a complaint filed by Chevron U.S.A. Inc. ( Chevron ) in the United States District Court for the District of New Jersey, alleging that the operations of CP at its Sewaren plant affected adjoining property owned by Chevron and alleging that PAHC, as the parent of CP, is also responsible to Chevron. In July 2002, a phased settlement agreement was reached and a Consent Order entered by the Court. The Consent Order provided



**Table of Contents****PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

for a period of due diligence investigation of the property owned by Chevron and upon completion of the review of the results of the investigation, a decision was to be made whether to opt out of the settlement or proceed.

Negotiations with Chevron regarding its allocation of responsibility and associated costs under the Consent Order reached an impasse and it became necessary for PAHC and another defendant, Vulcan Materials Company ( Vulcan ), to opt out of the settlement on April 21, 2005. Since then, settlement negotiations have continued and the parties are in the process of memorializing the terms of a revised settlement. The Court will reopen the case if a revised settlement is not finalized.

As proposed, CP, PAHC and Vulcan, through an acquisition entity known as NFE, LLC ( NFE ), would acquire a portion of the property. NFE will then proceed with the remediation of the acquired property. Vulcan will pay a share of the remediation costs. Vulcan's share has not yet been determined. Another defendant will also make a contribution toward the remediation costs to be incurred by NFE in an amount that has not yet been determined but which is estimated to be approximately \$175. Chevron will retain title to a portion of the property and will also retain responsibility for further investigation and remediation of certain identified environmental conditions on the property. In addition, Chevron will also be required to complete any necessary remediation in a certain area of the property. While the costs and liabilities cannot be estimated with any degree of certainty at this time, the Company believes that insurance recoveries will be available to offset most of those costs.

The Company's subsidiary, Phibro-Tech, Inc. ( Phibro-Tech ), was named in 1993 as a potentially responsible party ( PRP ) in connection with an action commenced under the Federal Comprehensive Environmental Response, Compensation, and Liability Act ( CERCLA ) by the United States Environmental Protection Agency (the EPA ), involving a former third-party fertilizer manufacturing site in Jericho, South Carolina. An agreement has been reached under which such subsidiary agreed to contribute up to \$900 of the first series of contributions of all remaining responsible PRPs (of which \$691 has been paid as of March 31, 2006) and up to \$1,200 of additional contingent contributions, the payment of which is considered to be remote, and otherwise subject to the PRPs' right to dispute additional costs. Some recovery from insurance and other sources is expected.

The Company and its subsidiaries are party to a number of claims and lawsuits arising out of the normal course of business including product liabilities and governmental regulation. Certain of these actions seek damages in various amounts. In most cases, such claims are covered by insurance. The Company believes that none of the claims or pending lawsuits, either individually or in the aggregate, will have a material adverse effect on its financial position or results of operations.

***Environmental Remediation***

The Company's operations, properties and subsidiaries are subject to a wide variety of complex and stringent federal, state, local and foreign environmental laws and regulations, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain materials and wastes, the remediation of contaminated soil and groundwater, the manufacture, sale and use of pesticides and the health and safety of employees. As such, the nature of the Company's current and former operations and those of its subsidiaries exposes the Company and its subsidiaries to the risk of claims with respect to such matters. Under certain circumstances, the Company or any of its subsidiaries might be required to curtail operations until a particular problem is remedied. Known costs and expenses under environmental laws incidental to ongoing operations are generally included within operating results. Potential costs and expenses may also be incurred in connection with the repair or upgrade of facilities to meet existing or new requirements under environmental laws or to investigate or remediate potential or actual contamination and from time to time the Company establishes reserves for such contemplated investigation and remediation costs. In many instances, the ultimate costs under environmental laws and the time period during which such costs are likely to be incurred are difficult to predict.

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company's subsidiaries have, from time to time, implemented procedures at their facilities designed to respond to obligations to comply with environmental laws. The Company believes that its operations are currently in material compliance with such environmental laws, although at various sites its subsidiaries are engaged in continuing investigation, remediation and/or monitoring efforts to address contamination associated with their historic operations.

Israel's Ministry of the Environment has imposed revised business license terms on Koffolk's Ramat Hovav manufacturing facilities. The Company has taken steps to contest the revised terms and can not currently estimate the costs or the timing of the final resolution of the issue.

The nature of the Company's and its subsidiaries' current and former operations exposes the Company and its subsidiaries to the risk of claims with respect to environmental matters and the Company cannot assure it will not incur material costs and liabilities in connection with such claims. Based upon its experience to date, the Company believes that the future cost of compliance with existing environmental laws, and liability for known environmental claims pursuant to such environmental laws, will not have a material adverse effect on the Company's financial position.

Based upon information available, the Company estimates the cost of litigation proceedings described above and the cost of further investigation and remediation of identified soil and groundwater problems at operating sites, closed sites and third-party sites, and closure costs for closed sites to be approximately \$2,494 at March 31, 2006, which is included in current and long-term liabilities on the condensed consolidated balance sheet (approximately \$2,743 at June 30, 2005).

**8. Business Segments**

The Company's reportable segments are Animal Health and Nutrition, Industrial Chemicals and Distribution. Reportable segments have been determined primarily on the basis of the nature of products and services and certain similar operating units have been aggregated. The Company's Animal Health and Nutrition segment manufactures and markets more than 500 formulations and concentrations of medicated feed additives and nutritional feed additives including antibiotics, antibacterials, anticoccidials, anthelmintics, trace minerals, vitamins, vitamin premixes and other animal health and nutrition products. The Industrial Chemicals segment manufactures and markets a number of chemicals for use in the pressure-treated wood, chemical catalyst, semiconductor, automotive and aerospace industries, and copper-based fungicides. The Distribution segment markets and distributes a variety of industrial, specialty and fine organic chemicals and intermediates produced primarily by third parties. Intersegment sales and transfers were not significant. The following segment data includes information only for continuing operations.

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
<b>Net Sales</b>				
Animal Health & Nutrition	\$ 79,733	\$ 68,405	\$ 233,471	\$ 203,699
Industrial Chemicals	10,264	13,412	31,992	40,047
Distribution	10,908	8,438	27,748	25,423
Corporate				
	\$ 100,905	\$ 90,255	\$ 293,211	\$ 269,169
<b>Operating Income</b>				
Animal Health & Nutrition	\$ 9,671	\$ 3,157	\$ 20,045	\$ 8,856
Industrial Chemicals	(35)	1,371	2,078	3,541
Distribution	1,705	1,158	4,366	3,414
Corporate	(4,405)	(3,954)	(11,993)	(11,095)
	\$ 6,936	\$ 1,732	\$ 14,496	\$ 4,716
<b>Depreciation and Amortization</b>				
Animal Health & Nutrition	\$ 1,469	\$ 5,303	\$ 10,148	\$ 10,203
Industrial Chemicals	668	374	1,466	1,190
Distribution	6	6	18	14
Corporate	70	63	217	179
	\$ 2,213	\$ 5,746	\$ 11,849	\$ 11,586
			<b>As of March 31, 2006</b>	<b>As of June 30, 2005</b>
<b>Identifiable Assets</b>				
Animal Health & Nutrition		\$ 195,538	\$ 204,799	
Industrial Chemicals		21,522	21,473	
Distribution		9,680	8,092	
Corporate		17,066	18,693	
		\$ 243,806	\$ 253,057	

The Animal Health and Nutrition segment includes Belgium Plant Transactions costs as follows:

	<b>Three Months Ended March 31,</b>		<b>Nine Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Depreciation expense	\$	\$ 3,095	\$ 4,533	\$ 3,628
Employee termination and other transaction-related expenses	975	1,277	5,678	10,280
	\$ 975	\$ 4,372	\$ 10,211	\$ 13,908

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**9. Consolidating Financial Statements**

The units of Senior Secured Notes due 2007, consisting of notes issued by PAHC (the U.S. Notes ) and notes issued by Philipp Brothers Netherlands III B.V., an indirect wholly-owned subsidiary of PAHC (the Dutch Issuer , and such notes issued by it the Dutch Notes ), are guaranteed by certain subsidiaries. PAHC and its U.S. subsidiaries ( U.S. Guarantor Subsidiaries ), excluding PMC Quincy, Inc. ( PMC ), Prince Mfg., LLC and Mineral Resource Technologies, Inc. ( MRT ) (the Unrestricted Subsidiaries , as defined in the Indenture), fully and unconditionally guarantee all of the Senior Secured Notes due 2007 on a joint and several basis. In addition, the Dutch Issuer s subsidiaries, presently consisting of Phibro Animal Health SA (the Belgium Guarantor ), fully and unconditionally guarantee the Dutch Notes. The Dutch Issuer and the Belgium Guarantor do not guarantee the U.S. Notes. Other foreign subsidiaries ( Non-Guarantor Subsidiaries ) do not presently guarantee the Senior Secured Notes due 2007. The U.S. Guarantor Subsidiaries include all domestic subsidiaries of PAHC other than the Unrestricted Subsidiaries and include: C.P. Chemicals, Inc.; Phibro-Tech, Inc.; Prince Agriproducts, Inc.; Phibrochem, Inc.; Phibro Chemicals, Inc.; Western Magnesium Corp.; Phibro Animal Health Holdings, Inc.; and Phibro Animal Health U.S., Inc.

The Senior Subordinated Notes due 2008, issued by PAHC, are guaranteed by certain subsidiaries. PAHC s U.S. subsidiaries, including the U.S. Guarantor Subsidiaries and the Unrestricted Subsidiaries, fully and unconditionally guarantee the Senior Subordinated Notes due 2008 on a joint and several basis. The Dutch Issuer, Belgium Guarantor and Non-Guarantor Subsidiaries do not presently guarantee the Senior Subordinated Notes due 2008. The U.S. Guarantor Subsidiaries and Unrestricted Subsidiaries include all domestic subsidiaries of PAHC including: C.P. Chemicals, Inc.; Phibro-Tech, Inc.; Prince Agriproducts, Inc.; PMC; Prince Mfg., LLC; MRT (until it was divested); Phibrochem, Inc.; Phibro Chemicals, Inc.; Western Magnesium Corp.; Phibro Animal Health Holdings, Inc.; and Phibro Animal Health U.S., Inc.

The following consolidating financial data summarizes the assets, liabilities and results of operations and cash flows of PAHC, the Unrestricted Subsidiaries, U.S. Guarantor Subsidiaries, Dutch Issuer, Belgium Guarantor and Non-Guarantor Subsidiaries. The Unrestricted Subsidiaries, U.S. Guarantor Subsidiaries, Dutch Issuer, Belgium Guarantor and Non-Guarantor Subsidiaries are directly or indirectly wholly owned as to voting stock by PAHC.

Investments in subsidiaries are accounted for by PAHC using the equity method. Income tax expense (benefit) is allocated among the consolidating entities based upon taxable income (loss) by jurisdiction within each group. The principal consolidation adjustments are to eliminate investments in subsidiaries and intercompany balances and transactions.

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING BALANCE SHEET**  
**As of March 31, 2006**

	U.S. Guarantor PAHC	Dutch Subsidiaries	Dutch Issuer	Belgium Guarantor	Non-Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
<b>ASSETS</b>							
Current assets							
Cash and cash equivalents	\$ 567	\$ 844	\$ 81	\$ 484	\$ 7,776	\$	\$ 9,752
Accounts receivable, net	4,183	27,443		2,884	25,499		60,009
Inventory	2,984	35,298		22,346	33,283		93,911
Prepaid expenses and other	3,030	445	7	1,003	6,347		10,832
<b>Total current assets</b>	<b>10,764</b>	<b>64,030</b>	<b>88</b>	<b>26,717</b>	<b>72,905</b>		<b>174,504</b>
Property, plant & equipment, net							
	1,031	11,554		467	35,920		48,972
Intangibles, net		3,508		1,182	4,406		9,096
Other assets	9,617	721			896		11,234
Investment in subsidiaries	103,088		(24,724)		(1,007)	(77,357)	
Intercompany	10,775	103,298	30,847	(1,764)	(20,818)	(122,338)	
<b>Total assets</b>	<b>\$ 135,275</b>	<b>\$ 183,111</b>	<b>\$ 6,211</b>	<b>\$ 26,602</b>	<b>\$ 92,302</b>	<b>\$ (199,695)</b>	<b>\$ 243,806</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>							
Current liabilities							
Loan payable to banks	\$	\$	\$	\$	\$	\$	\$
Current portion of long-term debt					223		223
Accounts payable	1,950	23,067		644	13,120		38,781
Accrued expenses and other	19,469	8,108	1,021	11,796	13,591		53,985
<b>Total current liabilities</b>	<b>21,419</b>	<b>31,175</b>	<b>1,021</b>	<b>12,440</b>	<b>26,934</b>		<b>92,989</b>
Long-term debt	151,236		24,284		931		176,451
Other liabilities	11,485	5,461		4,900	1,385		23,231
Intercompany debt		26,581	5,654	33,986	56,117	(122,338)	

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Total liabilities	184,140	63,217	30,959	51,326	85,367	(122,338)	292,671
Stockholders' equity (deficit)							
Preferred stock	521						521
Common stock	2	33				(33)	2
Paid-in capital	27,260	108,383	21	52	(21)	(108,435)	27,260
Retained earnings (accumulated deficit)	(80,544)	11,738	(28,696)	(28,703)	6,727	38,934	(80,544)
Accumulated other comprehensive income (loss)							
Gain on derivative instruments, net of income taxes	79	79				(79)	79
Cumulative currency translation adjustment, net of income taxes	3,817	(339)	3,927	3,927	229	(7,744)	3,817
Total stockholders' equity (deficit)	(48,865)	119,894	(24,748)	(24,724)	6,935	(77,357)	(48,865)
Total liabilities and stockholders' equity (deficit)	\$ 135,275	\$ 183,111	\$ 6,211	\$ 26,602	\$ 92,302	\$ (199,695)	\$ 243,806

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**  
**For The Three Months Ended March 31, 2006**

	PAHC	U.S. Guarantor Subsidiaries	Dutch Issuer	Belgium Guarantor	Non-Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
Net sales	\$ 8,654	\$ 61,887	\$	\$ 2,240	\$ 28,124	\$	\$ 100,905
Net sales intercompany	265			3,837	2,863	(6,965)	
Cost of goods sold (includes Belgium Plant Transactions costs of \$975)	6,523	46,518		5,788	24,578	(6,965)	76,442
Gross profit	2,396	15,369		289	6,409		24,463
Selling, general and administrative expenses	5,398	7,637	7	766	3,719		17,527
Operating income (loss)	(3,002)	7,732	(7)	(477)	2,690		6,936
Interest expense	5,593		789	66	278		6,726
Interest (income)	(10)	(15)			(28)		(53)
Other (income) expense, net		598		(227)	(340)		31
Intercompany interest and other	(6,053)	5,133	(796)	1,096	620		
(Profit) loss relating to subsidiaries	(1,579)		1,412			167	
Income (loss) before income taxes	(953)	2,016	(1,412)	(1,412)	2,160	(167)	232
Provision for income taxes	406	145			1,040		1,591
Net income (loss)	\$ (1,359)	\$ 1,871	\$ (1,412)	\$ (1,412)	\$ 1,120	\$ (167)	\$ (1,359)



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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**  
**For The Nine Months Ended March 31, 2006**

	PAHC	U.S. Guarantor Subsidiaries	Dutch Issuer	Belgium Guarantor	Non-Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
Net sales	\$ 23,080	\$ 177,603	\$	\$ 9,208	\$ 83,320	\$	\$ 293,211
Net sales intercompany	380	48		24,068	8,527	(33,023)	
Cost of goods sold (includes Belgium Plant Transactions costs of \$10,211)	16,801	134,066		35,387	76,112	(33,023)	229,343
Gross profit	6,659	43,585		(2,111)	15,735		63,868
Selling, general and administrative expenses	15,053	20,903	46	1,888	11,482		49,372
Operating income (loss)	(8,394)	22,682	(46)	(3,999)	4,253		14,496
Interest expense	16,754		2,367	115	(53)		19,183
Interest (income)	(78)	(24)			(157)		(259)
Other (income) expense, net	1	347	(2)	(171)	(2,736)		(2,561)
Intercompany interest and other	(18,430)	15,388	(2,390)	3,287	2,145		
(Profit) loss relating to subsidiaries	(1,442)		7,230			(5,788)	
Income (loss) before income taxes	(5,199)	6,971	(7,251)	(7,230)	5,054	5,788	(1,867)
Provision for income taxes	966	421			2,911		4,298
Net income (loss)	\$ (6,165)	\$ 6,550	\$ (7,251)	\$ (7,230)	\$ 2,143	\$ 5,788	\$ (6,165)

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**  
**For the Nine Months Ended March 31, 2006**

	PAHC	U.S. Guarantor Subsidiaries	Dutch Issuer	Belgium Guarantor	Non- Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
<b>OPERATING ACTIVITIES</b>							
Net income (loss)	\$ (6,165)	\$ 6,550	\$ (7,251)	\$ (7,230)	\$ 2,143	\$ 5,788	\$ (6,165)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:							
Depreciation and amortization (includes accelerated depreciation from the Belgium Plant Transactions of \$4,533)	217	2,407		5,712	3,513		11,849
Amortization of deferred financing costs	2,486						2,486
Deferred income taxes					(424)		(424)
Net gain from sales of assets		200		(589)	(75)		(464)
Effects of changes in foreign currency		68		162	(456)		(226)
Other	13	3		(432)	(12)		(428)
Changes in operating assets and liabilities:							
Accounts receivable	(1,000)	(3,410)		1,185	(816)		(4,041)
Inventory	(315)	865		7,414	(3,958)		4,006
Prepaid expenses and other	1,280	350	(7)	757	465		2,845
Other assets	295	(174)					121
Accounts payable	267	2,758		(2,719)	1,867		2,173
Accrued expenses and other	3,494	(1,237)	804	(3,573)	(1,472)		(1,984)
Accrued expenses: Belgium Plant Transactions				(1,608)			(1,608)
Intercompany	5,681	(9,332)	6,518	(6,768)	9,689	(5,788)	
Net cash provided (used) by operating activities	6,253	(952)	64	(7,689)	10,464		8,140

## INVESTING ACTIVITIES

Capital expenditures	(70)	(1,619)	(112)	(9,443)	(11,244)
Proceeds from Belgium Plant Transactions			7,997		7,997
Proceeds from sale of assets		1,655	42	237	1,934
Other investing	(106)				(106)
Net cash provided (used) by investing activities	(176)	36	7,927	(9,206)	(1,419)

## FINANCING ACTIVITIES

Net (decrease) in book overdrafts		(27)			(27)
Net (decrease) in short-term debt	(8,000)			(38)	(8,038)
Payments of long-term debt				(2,005)	(2,005)
Net cash provided (used) by financing activities	(8,000)	(27)		(2,043)	(10,070)
Effect of exchange rate changes on cash			(9)	109	100
Net increase (decrease) in cash and cash equivalents	(1,923)	(943)	64	229	(676)
Cash and cash equivalents at beginning of period	2,490	1,787	17	255	8,452
Cash and cash equivalents at end of period	\$ 567	\$ 844	\$ 81	\$ 484	\$ 7,776
					\$ 9,752

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING BALANCE SHEET**  
**As of June 30, 2005**

	PAHC	U.S. Guarantor Subsidiaries	Dutch Issuer	Belgium Guarantor	Non- Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
<b>ASSETS</b>							
Current assets							
Cash and cash equivalents	\$ 2,490	\$ 1,787	\$ 17	\$ 255	\$ 8,452	\$	\$ 13,001
Accounts receivable, net	3,377	25,762		4,784	22,494		56,417
Inventory	2,669	36,289		29,691	27,972		96,621
Prepaid expenses and other	4,118	921		1,203	6,545		12,787
<b>Total current assets</b>	<b>12,654</b>	<b>64,759</b>	<b>17</b>	<b>35,933</b>	<b>65,463</b>		<b>178,826</b>
Property, plant & equipment, net	1,178	13,564		8,122	27,096		49,960
Intangibles, net		3,827		1,339	5,035		10,201
Other assets	12,303	796			971		14,070
Investment in subsidiaries	101,464		(17,469)			(83,995)	
Intercompany	9,384	93,463	31,103	(1,427)	(14,325)	(118,198)	
<b>Total assets</b>	<b>\$ 136,983</b>	<b>\$ 176,409</b>	<b>\$ 13,651</b>	<b>\$ 43,967</b>	<b>\$ 84,240</b>	<b>\$ (202,193)</b>	<b>\$ 253,057</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>							
Current liabilities							
Loan payable to banks	\$ 8,000	\$	\$	\$	\$ 38	\$	\$ 8,038
Current portion of long-term debt					1,625		1,625
Accounts payable	1,683	20,327		3,320	11,207		36,537
Accrued expenses and other	10,910	9,222	248	21,195	12,240		53,815
<b>Total current liabilities</b>	<b>20,593</b>	<b>29,549</b>	<b>248</b>	<b>24,515</b>	<b>25,110</b>		<b>100,015</b>
Long-term debt	151,236		24,284		981		176,501
Other liabilities	10,078	5,364		1,856	4,167		21,465
Intercompany debt		28,047	6,591	35,065	48,495	(118,198)	

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Total liabilities	181,907	62,960	31,123	61,436	78,753	(118,198)	297,981
Stockholders equity (deficit)							
Preferred stock	521						521
Common stock	2	33				(33)	2
Paid-in capital	27,260	108,383	21	52	1,537	(109,993)	27,260
Retained earnings (accumulated deficit)	(74,379)	5,188	(21,445)	(21,473)	6,074	31,656	(74,379)
Accumulated other comprehensive income (loss)							
Gain on derivative instruments, net of income taxes	123	123				(123)	123
Cumulative currency translation adjustment, net of income taxes	1,549	(278)	3,952	3,952	(2,124)	(5,502)	1,549
Total stockholders equity (deficit)	(44,924)	113,449	(17,472)	(17,469)	5,487	(83,995)	(44,924)
Total liabilities and stockholders equity (deficit)	\$ 136,983	\$ 176,409	\$ 13,651	\$ 43,967	\$ 84,240	\$ (202,193)	\$ 253,057

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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**  
**For The Three Months Ended March 31, 2005**

	PAHC	U.S. Guarantor Subsidiaries	Dutch Issuer	Belgium Guarantor	Non-Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
Net sales	\$ 6,769	\$ 54,591	\$	\$ 3,328	\$ 25,567	\$	\$ 90,255
Net sales intercompany	44			9,787	2,115	(11,946)	
Cost of goods sold (includes Belgium Transactions costs of \$4,372)	4,876	40,751		14,492	23,331	(11,946)	71,504
Gross profit	1,937	13,840		(1,377)	4,351		18,751
Selling, general and administrative expenses	4,929	7,520	8	736	3,826		17,019
Operating income (loss)	(2,992)	6,320	(8)	(2,113)	525		1,732
Interest expense	5,779		652	15	311		6,757
Interest (income)	(3)				(16)		(19)
Other (income) expense, net		587		301	(811)		77
Intercompany interest and other	(6,847)	5,176	(797)	1,095	1,373		
Loss relating to subsidiaries	3,755		3,505			(7,260)	
Income (loss) from continuing operations before income taxes	(5,676)	557	(3,368)	(3,524)	(332)	7,260	(5,083)
Provision (benefit) for income taxes	180	171		(19)	441		773
Income (loss) from continuing operations	(5,856)	386	(3,368)	(3,505)	(773)	7,260	(5,856)
Income from discontinued operations, net of income taxes					272		272
Profit relating to discontinued operations	272					(272)	

Net income (loss)	\$ (5,584)	\$	386	\$ (3,368)	\$	(3,505)	\$	(501)	\$	6,988	\$	(5,584)
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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS**  
**For The Nine Months Ended March 31, 2005**

	PAHC	U.S. Guarantor Subsidiaries	Dutch Issuer	Belgium Guarantor	Non- Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
Net sales	\$ 20,165	\$ 167,837	\$	\$ 7,556	\$ 73,611	\$	\$ 269,169
Net sales intercompany	137	131		20,447	5,534	(26,249)	
Cost of goods sold (includes Belgium Plant Transactions costs of \$13,908)	14,840	125,433		35,276	65,382	(26,249)	214,682
Gross profit	5,462	42,535		(7,273)	13,763		54,487
Selling, general and administrative expenses	14,197	21,555	14	2,102	11,903		49,771
Operating income (loss)	(8,735)	20,980	(14)	(9,375)	1,860		4,716
Interest expense	15,980		1,951	38	687		18,656
Interest (income)	(5)	(4)			(68)		(77)
Other (income) expense, net	4	213		90	(998)		(691)
Intercompany interest and other	(20,781)	15,562	(2,113)	2,976	4,356		
Loss relating to subsidiaries	9,244		11,009			(20,253)	
Income (loss) from continuing operations before income taxes	(13,177)	5,209	(10,861)	(12,479)	(2,117)	20,253	(13,172)
Provision (benefit) for income taxes	694	470		(1,470)	1,005		699
Income (loss) from continuing operations	(13,871)	4,739	(10,861)	(11,009)	(3,122)	20,253	(13,871)
Income from discontinued operations, net of income taxes					575		575
Profit relating to discontinued	575					(575)	



operations

Net income (loss)	\$ (13,296)	\$ 4,739	\$ (10,861)	\$ (11,009)	\$ (2,547)	\$ 19,678	\$ (13,296)
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**PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS**  
**For the Nine Months Ended March 31, 2005**

	PAHC	U.S. Guarantor Subsidiaries	Dutch Issuer	Belgium Guarantor	Non- Guarantor Subsidiaries	Consolidation Adjustments	PAHC Consolidated
<b>OPERATING ACTIVITIES</b>							
Net income (loss)	\$ (13,296)	\$ 4,739	\$ (10,861)	\$ (11,009)	\$ (2,547)	\$ 19,678	\$ (13,296)
Adjustment for discontinued operations	(575)				(575)	575	(575)
Income (loss) from continuing operations	(13,871)	4,739	(10,861)	(11,009)	(3,122)	20,253	(13,871)
Adjustments to reconcile income (loss) from continuing operations to net cash provided (used) by operating activities:							
Depreciation and amortization (includes accelerated depreciation from the Belgium Plant Transactions of \$3,628)	179	2,113		5,880	3,414		11,586
Amortization of deferred financing costs	2,130						2,130
Deferred income taxes					(202)		(202)
Net gain from sales of assets		(777)			(12)		(789)
Effects of changes in foreign currency		(554)		(87)	(119)		(760)
Other	289	37			104		430
Changes in operating assets and liabilities:							
Accounts receivable	(392)	2,066		(575)	3,361		4,460
Inventory	(428)	2,772		(9,857)	(8,865)		(16,378)
Prepaid expenses and other	1,656	631		(1,277)	637		1,647
Other assets	(2)	(241)			(375)		(618)
Accounts payable	(1,610)	(8,573)		(152)	(1,043)		(11,378)
Accrued expenses and other	4,707	1,285	650	237	2,241		9,120

Accrued expenses: non-completed transaction	(3,970)						(3,970)
Accrued expenses: Belgium Plant Transactions				10,280			10,280
Intercompany	2,274	(4,843)	5,926	7,605	9,291	(20,253)	
Cash provided by discontinued operations					808		808
Net cash provided (used) by operating activities	(9,038)	(1,345)	(4,285)	1,045	6,118		(7,505)
<b>INVESTING ACTIVITIES</b>							
Capital expenditures	(909)	(1,626)		(726)	(1,837)		(5,098)
Proceeds from sale of assets		1,320			33		1,353
Other investing	(119)			(154)	154		(119)
Discontinued operations					(93)		(93)
Net cash (used) by investing activities	(1,028)	(306)		(880)	(1,743)		(3,957)
<b>FINANCING ACTIVITIES</b>							
Net increase in book overdraft		1,930					1,930
Net increase (decrease) in short-term debt	(7,083)				34		(7,049)
Proceeds from long-term debt	19,107		4,284		901		24,292
Payments of long-term debt		(103)			(3,810)		(3,913)
Proceeds from capital contribution from PAHC Holdings Corporation	26,400						26,400
Redemption of Series C preferred stock	(26,400)						(26,400)
Debt financing costs	(2,027)						(2,027)
Net cash provided (used) by financing activities	9,997	1,827	4,284		(2,875)		13,233
Effect of exchange rate changes on cash		8		16	42		66
Net increase (decrease) in cash and cash equivalents	(69)	184	(1)	181	1,542		1,837

Cash and cash equivalents at beginning of period	136	801	17	212	4,402	5,568
Cash and cash equivalents at end of period	\$ 67	\$ 985	\$ 16	\$ 393	\$ 5,944	\$ 7,405

**Table of Contents****Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

This information should be read in conjunction with the condensed consolidated financial statements and related notes contained in this Report. Phibro Animal Health Corporation (the Company or PAHC) presents its annual consolidated financial statements on the basis of its fiscal year ending June 30.

**General**

The Company is a leading diversified global manufacturer and marketer of a broad range of animal health and nutrition products, specifically medicated feed additives (MFAs) and nutritional feed additives (NFAs), which are sold throughout the world predominantly to the poultry, swine and cattle markets. MFAs are used preventatively and therapeutically in animal feed to produce healthy livestock. The Company believes it is the third largest manufacturer and marketer of MFAs in the world, and that certain of its MFA products have leading positions in the marketplace. The Company is also a specialty chemicals manufacturer and marketer, serving primarily the United States pressure-treated wood and chemical industries. The Company has several proprietary products, and many of the Company's products provide critical performance attributes to customers' products, while representing a relatively small percentage of total end-product cost.

***Belgium Plant Transactions***

On November 30, 2005, Phibro Animal Health SA (PAH Belgium) sold to GlaxoSmithKline Biologicals (GSK) substantially all of PAH Belgium's facilities in Rixensart, Belgium (the Belgium Plant). The sale (the Belgium Plant Transactions) included the following elements (U.S. dollar amounts at the March 31, 2006 exchange rate except where otherwise indicated): (i) the transfer of substantially all of the land and buildings and certain equipment of PAH Belgium at the Belgium Plant, as well as the industrial activities and intellectual property relating to certain solvent technology of PAH Belgium for a purchase price of EUR 6.2 million (\$7.3 million at the November 30, 2005 exchange rate), paid at closing; (ii) the transfer to GSK of a majority of the employees of the Belgium Plant and the corresponding responsibility for statutory severance obligations; (iii) GSK agreed to be responsible for cleaning-up, by demolition or otherwise, certain buildings not to be used by it, but for PAH Belgium to reimburse GSK up to a maximum of EUR 0.7 million (\$0.8 million) for such cleaning-up costs; (iv) in recognition of the benefits to PAHC from the proposed transaction, PAH Belgium agreed to pay to GSK EUR 1.5 million (\$1.8 million) within six months from the closing date, EUR 1.5 million (\$1.8 million) within eighteen months from the closing date, EUR 1.5 million (\$1.8 million) within thirty months from the closing date, and EUR 0.5 million (\$0.6 million) within forty-two months from the closing date; (v) PAH Belgium sold certain excess land for its own account; (vi) PAH Belgium was responsible for certain plant closure costs and legally required severance indemnities in connection with workforce reductions; and (vii) PAH Belgium retained certain equipment at the Belgium Plant, and has transferred or will transfer such equipment, together with other assets and rights related to the production of virginiamycin, to Phibro Saude Animal Internacional Ltda. (PAH Brazil) which owns a facility in Guarulhos, Brazil or in connection with alternative production arrangements.

The Dutch Notes (as defined below) and related guarantees were collateralized by a mortgage on the Belgium Plant which was released in connection with the sale of the Belgium Plant to GSK.

As a result of the Belgium Plant Transactions, the Company depreciated the Belgium Plant to its estimated salvage value, recorded expense of early-retirement and severance programs for those employees not transferred to GSK, other transaction-related expenses, a curtailment gain on the Belgium pension plan and a gain on the sales of the Belgium Plant and excess land. Other transaction-related expenses were primarily related to employee retention agreements, plant dismantling and decommissioning, plant shutdown, and site demolition costs payable to GSK.

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The following table includes the amounts (in thousands) of these charges and gains.

**Belgium Plant Transactions Costs**

	<b>Twelve</b>	<b>Three Months Ended</b>			<b>Nine</b>	<b>Cumulative</b>
	<b>Months</b>	<b>September 30,</b>	<b>December 31,</b>	<b>March 31,</b>	<b>Months</b>	
	<b>Ended</b>	<b>2005</b>	<b>2005</b>	<b>2006</b>	<b>Ended</b>	<b>Total</b>
	<b>June 30,</b>				<b>March 31,</b>	
	<b>2005</b>		<b>2005</b>	<b>2006</b>	<b>2006</b>	
Incremental depreciation	\$ 7,467	\$ 2,747	\$ 1,786	\$	\$ 4,533	\$ 12,000
Employee termination expenses	12,808	287	699		986	13,794
Other transaction-related expenses	1,916	979	3,759	975	5,713	7,629
Net (gain) on the curtailment and settlement of the pension plan			(432)		(432)	(432)
(Gain) on the sale of the Belgium Plant and excess land		(510)	(79)		(589)	(589)
	\$ 22,191	\$ 3,503	\$ 5,733	\$ 975	\$ 10,211	\$ 32,402

All costs and gains of the Belgium Plant Transactions are included in cost of goods sold on the Company's condensed consolidated statements of operations and comprehensive income (loss) in the periods as described in the table above.

As of March 31, 2006, accrued expenses and other long term liabilities on the Company's condensed consolidated balance sheet included \$6.9 million payable to GSK and \$10.3 million payable for employee termination and other transaction-related expenses.

The Company expects to record in future periods an estimated additional \$0.8 million of other transaction-related expenses, primarily for plant dismantling and decommissioning, primarily during the remainder of 2006.

In anticipation of transferring production of virginiamycin from the Belgium Plant to an alternative production location, the Company increased inventory levels of virginiamycin until the Belgium Plant sale in November 2005 to ensure adequate supplies during the transfer period. Virginiamycin inventories were approximately \$33.4 million at March 31, 2006 and \$38.8 million at June 30, 2005.

**Risks and Uncertainties**

The Company's ability to fund its operating plan depends upon the continued availability of borrowing under its domestic senior credit facility. The Company believes that it will be able to comply with the terms of its covenants under the domestic senior credit facility based on its forecasted operating plan. In the event of adverse operating results and/or violation of covenants under this facility, there can be no assurance that the Company would be able to obtain waivers or amendments on favorable terms, if at all. The Company's 2006 operating plan projects adequate liquidity throughout the year, with periods of reduced availability around the dates of the semi-annual interest payments due December 1 and June 1 related to PAHC's 13% Senior Secured Notes due 2007 and PAHC's 7% Senior Subordinated Notes due 2008. The Company is pursuing additional cost reduction activities, working capital improvement plans, and sales of non-strategic assets to provide additional liquidity. The Company also has availability under foreign credit lines that would be available as needed. There can be no assurance the Company will be successful in any of the above-noted actions.

The use of antibiotics in medicated feed additives is a subject of legislative and regulatory interest. The issue of potential for increased bacterial resistance to certain antibiotics used in certain food-producing animals is the subject of discussions on a worldwide basis and, in certain instances, has led to government

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restrictions on the use of antibiotics in food-producing animals. The sale of feed additives containing antibiotics is a material portion of the Company's business. Should regulatory or other developments result in further restrictions on the sale of such products, it could have a material adverse impact on the Company's financial position, results of operations and cash flows.

The testing, manufacturing, and marketing of certain of the Company's products are subject to extensive regulation by numerous government authorities in the United States and other countries.

The Company has significant assets located outside of the United States, and a significant portion of the Company's sales and earnings are attributable to operations conducted abroad.

The Company has assets located in Israel and a portion of its sales and earnings are attributable to operations conducted in Israel. The Company is affected by social, political and economic conditions affecting Israel, and any major hostilities involving Israel as well as the Middle East or curtailment of trade between Israel and its current trading partners, either as a result of hostilities or otherwise, could have a material adverse effect on the Company.

The Company's operations, properties and subsidiaries are subject to a wide variety of complex and stringent federal, state, local and foreign environmental laws and regulations, including those governing the use, storage, handling, generation, treatment, emission, release, discharge and disposal of certain materials and wastes, the remediation of contaminated soil and groundwater, the manufacture, sale and use of pesticides and the health and safety of employees. As such, the nature of the Company's current and former operations and those of its subsidiaries exposes the Company and its subsidiaries to the risk of claims with respect to such matters.

**Summary Consolidated Results of Continuing Operations**

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
	(In thousands)			
Net sales	\$ 100,905	\$ 90,255	\$ 293,211	\$ 269,169
Belgium plant transaction costs	975	4,372	10,211	13,908
Gross profit	24,463	18,751	63,868	54,487
Selling, general and administrative	17,527	17,019	49,372	49,771
Operating income	6,936	1,732	14,496	4,716
Interest expense, net	6,673	6,738	18,924	18,579
Other (income) expense, net	31	77	(2,561)	(691)
Provision for income taxes	1,591	773	4,298	699
Loss from continuing operations	\$ (1,359)	\$ (5,856)	\$ (6,165)	\$ (13,871)

**Comparison of Three Months Ended March 31, 2006 and 2005**

*Net Sales* of \$100.9 million increased \$10.7 million, or 12%. Animal Health and Nutrition sales of \$79.7 million grew \$11.3 million, or 17%, due to volume increases and also higher average selling prices for NFAs related to cost increases. Specialty Chemical Group (comprised of the Industrial Chemicals and Distribution segments) sales of \$21.2 million decreased \$0.6 million due to lower unit volumes offset in part by higher average selling prices.

*Gross Profit* of \$24.5 million increased \$5.7 million, to 24.2% of net sales. The Belgium Plant Transactions costs for the three months ended March 31, 2006 and 2005 were \$1.0 million and \$4.4 million, respectively. Excluding these charges, Animal Health and Nutrition gross profit improved due to increased unit volume, favorable product mix and higher average selling prices offset in part by higher unit costs. The Specialty Chemical Group's gross profit decreased from last year due to lower sales of wood treatment



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products and lower production levels in the Industrial Chemicals segment offset in part by increased sales of higher margin products in the Distribution segment.

*Selling, General and Administrative Expenses* of \$17.5 million increased \$0.5 million. Expenses increased over the prior year due to higher salary costs offset in part by reduced registration trials and reduced advertising and promotional expenditures.

*Operating Income* of \$6.9 million increased \$5.2 million from last year. Belgium Plant Transaction costs were \$1.0 million and \$4.4 million, respectively, generating \$3.4 million of the income increase. Operating income, excluding the Belgium Plant Transactions, increased by \$3.1 million in Animal Health and Nutrition primarily due to improved margins from higher unit volumes. Specialty Chemical Group operating income decreased \$0.9 million due to lower sales of wood treatment products and lower production levels in the Industrial Chemicals segment offset in part by higher margins in the Distribution segment. Corporate expenses increased by \$0.4 million which partially offset the operating improvements.

*Interest Expense, Net* of \$6.7 million was slightly below the prior year due to a lower net effective interest rate as overall debt levels approximated the prior year.

*Other (Income) Expense, Net* principally reflects foreign currency transaction net (gains) losses related to short-term inter-company balances and foreign currency translation (gains) losses.

*Income Taxes* of \$1.6 million were recorded on a consolidated pre-tax income of \$0.2 million. The tax rate reflects income tax provisions in profitable foreign jurisdictions and for state income taxes. A provision for U.S. federal income taxes has not been recorded due to the utilization of net operating loss carryforwards. The Company has recorded valuation allowances related to substantially all deferred tax assets. The Company will continue to evaluate the likelihood of recoverability of these deferred tax assets based upon actual and expected operating performance.

**Comparison of Nine Months Ended March 31, 2006 and 2005**

*Net Sales* of \$293.2 million increased \$24.0 million, or 9%. Animal Health and Nutrition sales of \$233.5 million grew \$29.8 million, or 15%, due to volume increases and also higher average selling prices for NFAs related to cost increases. Specialty Chemical Group (comprised of the Industrial Chemicals and Distribution segments) sales of \$59.7 million decreased \$5.7 million due to lower unit volumes offset in part by higher average selling prices.

*Gross Profit* of \$63.9 million increased \$9.4 million, to 21.8% of net sales. The Belgium Plant Transactions costs for the nine months ended March 31, 2006 and 2005 were \$10.2 million and \$13.9 million, respectively. Excluding these charges, Animal Health and Nutrition gross profit improved due to increased unit volume, favorable product mix and higher average selling prices offset in part by higher unit costs. The Specialty Chemical Group's gross profit decreased over last year due to lower sales of wood treatment products in the Industrial Chemicals segment offset in part by increased sales of higher margin products in the Distribution segment.

*Selling, General and Administrative Expenses* of \$49.4 million decreased \$0.4 million. Expenses decreased from the prior year due to reduced advertising and promotional expenditures and registration trials offset in part by higher salary costs.

*Operating Income* of \$14.5 million increased \$9.8 million from last year. Belgium Plant Transaction costs were \$10.2 million and \$13.9 million, respectively, generating \$3.7 million of the income increase. Operating income, excluding the Belgium Plant Transactions, increased by \$7.5 million in Animal Health and Nutrition primarily due to improved margins from higher unit volumes and lower selling, general and administrative expenses. Specialty Chemical Group operating income decreased \$0.5 million due to lower sales of wood treatment products in the Industrial Chemicals segment offset in part by sales of higher margin products in the Distribution segment. Corporate expenses increased by \$0.9 million which partially offset the operating improvements.

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*Interest Expense, Net* of \$18.9 million increased \$0.3 million from last year, primarily due to lower short-term borrowing levels offset in part by higher borrowing levels associated with the issuance of additional Senior Secured Notes and increased amortization of deferred financing costs. Interest expense was also reduced by the reversal of \$0.6 million of accrued interest related to an excise tax assessment resolved in the Company's favor in the period.

*Other (Income) Expense, Net* principally reflects foreign currency transaction net (gains) losses related to short-term inter-company balances and foreign currency translation (gains) losses. During 2005, the Company received a favorable ruling on an excise tax assessment and reversed \$2.0 million previously accrued.

*Income Taxes* of \$4.3 million were recorded on a consolidated pre-tax loss of \$1.9 million. The tax rate reflects income tax provisions in profitable foreign jurisdictions and for state income taxes. A provision for U.S. federal income taxes has not been recorded due to the utilization of net operating loss carryforwards. The Company has recorded valuation allowances related to substantially all deferred tax assets. The Company will continue to evaluate the likelihood of recoverability of these deferred tax assets based upon actual and expected operating performance.

**Operating Segments**

The Animal Health and Nutrition segment manufactures and markets MFAs and NFAs to the poultry, swine and cattle markets, and includes the operations of the Phibro Animal Health business unit, Prince Agriproducts, Koffolk and Planalquimica. The Industrial Chemicals segment, through its Phibro-Tech subsidiary, manufactures and markets specialty chemicals for use in the pressure treated wood and chemical industries and also includes contract manufacturing of crop protection chemicals. The Distribution segment markets a variety of specialty chemicals, and includes PhibroChem and Ferro operations.

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2006	2005	2006	2005
<b>(In thousands)</b>				
<b>Net Sales</b>				
Animal Health & Nutrition	\$ 79,733	\$ 68,405	\$ 233,471	\$ 203,699
Industrial Chemicals	10,264	13,412	31,992	40,047
Distribution	10,908	8,438	27,748	25,423
<b>Total</b>	<b>\$ 100,905</b>	<b>\$ 90,255</b>	<b>\$ 293,211</b>	<b>\$ 269,169</b>
<b>Operating Income</b>				
<b>Animal Health &amp; Nutrition</b>				
Excluding Belgium Plant Transactions	\$ 10,646	\$ 7,529	\$ 30,256	\$ 22,764
Belgium Plant Transactions	(975)	(4,372)	(10,211)	(13,908)
<b>Total</b>	<b>9,671</b>	<b>3,157</b>	<b>20,045</b>	<b>8,856</b>
Industrial Chemicals	(35)	1,371	2,078	3,541
Distribution	1,705	1,158	4,366	3,414
Corporate expenses and adjustments	(4,405)	(3,954)	(11,993)	(11,095)
<b>Total</b>	<b>\$ 6,936</b>	<b>\$ 1,732</b>	<b>\$ 14,496</b>	<b>\$ 4,716</b>

**Operating Segments Comparison of Three Months Ended March 31, 2006 and 2005***Animal Health and Nutrition*

*Net Sales* of \$79.7 million increased \$11.3 million, or 17%. MFA net sales increased by \$5.1 million. Revenues were higher for all product types, including antibiotics, antibacterials and anticoccidials. The increase in MFA revenues was primarily due to higher unit volumes. NFA net sales increased by \$6.3 million

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principally due to overall higher average selling prices (which offset cost increases) and improved sales of higher margin products.

*Operating Income* of \$9.7 million increased \$6.5 million from last year. Operating income, excluding the Belgium Plant Transactions costs, increased \$3.1 million due to higher unit volumes and average selling prices which were partially offset by higher unit costs. Selling, general and administrative expenses approximated the prior period. Higher salary costs were offset by reduced registration trials and reduced advertising and promotional expenditures.

***Specialty Chemicals***

*Industrial Chemicals* net sales of \$10.3 million decreased \$3.1 million, or 24%. Sales of copper-related products to the wood treatment markets were below last year, but were partially offset by higher sales of other specialty copper products arising from capacity expansion. Revenues for contract manufacturing decreased due to lower unit volumes offset in part by higher average selling prices. Operating income of break-even decreased by \$1.4 million from last year due to lower unit volumes. The Company has reduced the work force and operating levels at our Sumter, South Carolina facility to mitigate these sales volume declines.

*Distribution* net sales of \$10.9 million increased \$2.5 million, or 29%. Higher domestic unit volumes and higher average selling prices were offset in part by lower sales volumes in Europe. Distribution operating income of \$1.7 million increased \$0.5 million over the prior year as increased sales of higher margin products offset unit volume declines.

**Operating Segments Comparison of Nine Months Ended March 31, 2006 and 2005*****Animal Health and Nutrition***

*Net Sales* of \$233.5 million increased \$29.8 million, or 15%. MFA net sales increased by \$16.0 million. Revenues were higher for all product types, including antibiotics, antibacterials and anticoccidials. The increase in MFA revenues was primarily due to higher unit volumes. NFA net sales increased by \$13.8 million principally due to overall higher average selling prices (which offset cost increases) and improved sales of higher margin products.

*Operating Income* of \$20.0 million increased \$11.2 million from last year. Operating income, excluding Belgium Plant Transaction costs, increased \$7.5 million due to higher unit volumes and average selling prices which were partially offset by higher unit costs. Lower selling, general and administrative expenses due to reduced registration trials and reduced advertising and promotional expenditures were offset by higher salary and related costs.

***Specialty Chemicals***

*Industrial Chemicals* net sales of \$32.0 million decreased \$8.1 million, or 20%. Sales of copper-related products to the wood treatment markets were below last year, but were partially offset by higher sales of other specialty copper products arising from capacity expansion. Revenues for contract manufacturing decreased due to lower unit volumes offset in part by higher average selling prices. Operating income of \$2.1 million decreased by \$1.5 million from last year due to lower unit volumes. The Company reduced the work-force and operating levels at our Sumter, South Carolina facility to mitigate these sales volume declines.

*Distribution* net sales of \$27.7 million increased \$2.3 million, or 9%. Higher domestic unit volumes and higher average selling prices were offset in part by lower sales volumes in Europe. Distribution operating income of \$4.4 million improved \$1.0 million due to increased sales of higher margin products.

**Discontinued Operations**

The Company divested Wychem Ltd. (U.K.) ( Wychem ) during 2005. Wychem has been classified as a discontinued operation. The condensed consolidated financial statements have been revised to report separately the operating results, financial position and cash flows of the discontinued operation.

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Operating results of Wychem were:

	<b>Three Months Ended March 31, 2005</b>	<b>Nine Months Ended March 31, 2005</b>
	<b>(In thousands)</b>	
Net sales	\$ 1,487	\$ 3,908
Cost of goods sold	924	2,590
Selling, general and administrative expenses	174	511
Other expense	5	6
Income before income taxes	384	801
Provision for income taxes	112	226
Income from operations	\$ 272	\$ 575
Depreciation and amortization	\$ 105	\$ 309

**Liquidity and Capital Resources**

*Net Cash Provided (Used) by Operating Activities.* Cash provided (used) by operations for the nine months ended March 31, 2006 and 2005 was \$8.1 million and (\$7.5) million, respectively. Cash provided by operations increased due to improved operating performance and working capital improvements, primarily in the reduction of Animal Health and Nutrition inventories. These improvements were offset in part by payments related to the Belgium Plant Transactions. The Company increased its levels of virginiamycin inventory until the Belgium Plant sale in November 2005 to support the transition of production to PAH Brazil. Inventory levels are expected to decline during the remainder of the year.

*Net Cash Provided (Used) by Investing Activities.* Net cash provided (used) by investing activities for the nine months ended March 31, 2006 and 2005 was (\$1.4) million and (\$4.0) million, respectively. Capital expenditures of \$11.2 million and \$5.1 million for 2006 and 2005, respectively, were for expansion of production capacity in Brazil in 2006, for maintaining the Company's existing asset base and for environmental, health and safety projects. The Belgium Plant Transactions provided funds of \$8.0 million during 2006. Sales of assets provided funds of \$1.9 million and \$1.4 million in 2006 and 2005, respectively.

*Net Cash Provided (Used) by Financing Activities.* Net cash provided (used) by financing activities for the nine months ended March 31, 2006 and 2005 was (\$10.1) million and \$13.2 million, respectively. The decrease in short-term debt is due to the reduction of the senior credit facility. Payments of long-term debt reflect the repayments of Koffolk borrowings. Proceeds from long-term debt reflect the borrowings of Koffolk and the issuance of additional senior secured indebtedness in December 2004.

*Working Capital and Capital Expenditures.* Working capital as of March 31, 2006 was \$81.5 million compared to \$78.8 million at June 30, 2005, an increase of \$2.7 million. The increase in working capital primarily was due to reduced short-term debt levels resulting from the proceeds of the Belgium Plant Transactions.

The Company anticipates spending approximately \$15.0 million for capital expenditures in 2006, primarily for expansion of virginiamycin production capacity at the Brazil facility and to cover the Company's asset replacement needs, to improve processes, and for environmental and regulatory compliance, subject to the availability of funds.

*Liquidity.* At March 31, 2006, PAHC had no amounts borrowed under its domestic senior credit facility and PAHC had \$17.5 million of borrowings available under the working capital facility that is provided under its domestic senior credit facility. At March 31, 2006 PAHC had \$15.9 million of letters of credit outstanding under its domestic senior credit facility. In addition, a foreign subsidiary also had availability totaling \$9.1 million under its loan

agreements.

On October 28, 2005, PAHC amended its domestic senior credit facility in connection with, among other things, yearly determination of certain financial covenants to: (i) amend the EBITDA definition to exclude

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charges and expenses related to the sale of the Belgium Plant in an aggregate amount not to exceed \$33.2 million for purposes of calculating a certain financial covenant; (ii) establish the Minimum Domestic EBITDA for the 12 month periods ended July 31, 2005 through June 30, 2006 at \$17.5 million for purposes of calculating a certain financial covenant; (iii) establish the Consolidated Minimum EBITDA for the twelve month periods ended July 31, 2005 through June 30, 2006 at \$32.0 million for purposes of calculating a certain financial covenant; and (iv) amend the maximum aggregate amount of borrowing available under the working capital and letter of credit facilities from \$32.5 million to \$35.0 million. The amount of aggregate borrowings available under the working capital facility remained unchanged at \$17.5 million.

As of March 31, 2006, PAHC was in compliance with the financial covenants of its domestic senior credit facility, as amended. The domestic senior credit facility requires, among other things, the maintenance of certain levels of trailing consolidated and domestic EBITDA (earnings before interest, taxes, depreciation and amortization) calculated on a monthly basis, and an acceleration clause should an event of default (as defined in the agreement) occur. In addition, there are certain restrictions on additional borrowings, additional liens on PAHC's assets, guarantees, dividend payments, redemption or purchase of PAHC's stock, sale of subsidiaries' stock, disposition of assets, investments, and mergers and acquisitions.

The domestic senior credit facility contains a lock-box requirement and a material adverse change clause should an event of default (as defined in the agreement) occur. Accordingly, the amounts outstanding have been classified as short-term and are included in loans payable to banks in the condensed consolidated balance sheet.

The Company's ability to fund its operating plan depends upon the continued availability of borrowing under its domestic senior credit facility. The Company believes that it will be able to comply with the terms of its covenants under the domestic senior credit facility based on its forecasted operating plan. In the event of adverse operating results and/or violation of covenants under this facility, there can be no assurance that the Company would be able to obtain waivers or amendments on favorable terms, if at all. The Company's 2006 operating plan projects adequate liquidity throughout the year, with periods of reduced availability around the dates of the semi-annual interest payments due December 1 and June 1 related to PAHC's 13% Senior Secured Notes due 2007 and PAHC's 7.9% Senior Subordinated Notes due 2008. The Company is pursuing additional cost reduction activities, working capital improvement plans, and sales of non-strategic assets to provide additional liquidity. The Company also has availability under foreign credit lines that would be available as needed. There can be no assurance the Company will be successful in any of the above-noted actions.

The Company's contractual obligations at March 31, 2006 become due as follows:

	<b>Within 1 Year</b>	<b>Over 1 to 3 Years</b>	<b>Over 3 to 5 Years</b>	<b>Over 5 Years</b>	<b>Total</b>
	(In thousands)				
Loans payable to banks	\$	\$	\$	\$	\$
Long-term debt (including current portion)	223	176,451			176,674
Interest payments	21,954	18,247			40,201
Lease commitments	1,407	2,352	1,682	1,078	6,519
Acquisition of rights	350	550			900
Employee termination payments relating to the Belgium Plant Transactions	10,333				10,333
Payments to GSK relating to the Belgium Plant Transactions	2,670	3,642	607		6,919
	\$ 36,937	\$ 201,242	\$ 2,289	\$ 1,078	\$ 241,546

Total contractual  
obligations

A significant portion of the Company's debt becomes due in December 2007 and June 2008. The Company anticipates that it will refinance these obligations prior to maturity.



**Table of Contents****Critical Accounting Policies**

Critical accounting policies are those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. However, management of the Company is required to make certain estimates and assumptions during the preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. These estimates and assumptions impact the reported amount of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the consolidated financial statements. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the period they are determined to be necessary. Actual results could differ from those estimates. The accounting policies and related risk described in our Annual Report on Form 10-K for the year ended June 30, 2005 are those that depend most heavily on these judgments and estimates. As of March 31, 2006 there have been no material changes to any of the critical accounting policies contained therein.

**New Accounting Pronouncements**

The Financial Accounting Standards Board has released new and revised standards. These standards will be adopted by the Company during 2006 and 2007 and are discussed in the notes to condensed consolidated financial statements included in this Report.

**Quantitative and Qualitative Disclosure About Market Risk**

In the normal course of operations, the Company is exposed to market risks arising from adverse changes in interest rates, foreign currency exchange rates, and commodity prices. As a result, future earnings, cash flows and fair values of assets and liabilities are subject to uncertainty. The Company uses, from time to time, foreign currency forward contracts as a means of hedging exposure to foreign currency risks. The Company also utilizes, on a limited basis, certain commodity derivatives, primarily on copper used in its manufacturing processes, to hedge the cost of its anticipated purchase requirements. The Company does not utilize derivative instruments for trading purposes. The Company does not hedge its exposure to market risks in a manner that completely eliminates the effects of changing market conditions on earnings, cash flows and fair values. The Company monitors the financial stability and credit standing of its major counterparties.

For financial market risks related to changes in interest rates, foreign currency exchange rates and commodity prices, reference is made to Part II, Item 7A, Quantitative and Qualitative Disclosure about Market Risk, in our annual report on Form 10-K for the fiscal year ended June 30, 2005 and to Notes 2 and 19 to our Consolidated Financial Statements included therein.

**Certain Factors Affecting Future Operating Results*****Forward-Looking Statements***

This Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements include statements preceded by, followed by or that include the words may, could, would, should, believe, expect, anticipate, plan, estimate, target, project, intend, or similar expressions. They include, among others, statements regarding our expected business outlook, anticipated financial and operating results, our business strategy and means to implement the strategy, our objectives, the amount and timing of capital expenditures, the likelihood of our success in expanding our business, financing plans, budgets, working capital needs and sources of liquidity.

Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management's beliefs and assumptions, which in turn are based on currently available

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information. Important assumptions relating to the forward-looking statements include, among others, assumptions regarding demand for our products, the expansion of product offerings geographically or through new applications, the timing and cost of planned capital expenditures, competitive conditions and general economic conditions. These assumptions could prove inaccurate. Forward-looking statements also involve risks and uncertainties, which could cause actual results that differ materially from those contained in any forward-looking statement. Many of these factors are beyond our ability to control or predict. Such factors include, but are not limited to, the following:

- our substantial leverage and potential inability to service our debt
- our dependence on distributions from our subsidiaries
- risks associated with our international operations and significant foreign assets
- our dependence on our Israeli operations
- competition in each of our markets
- potential environmental liability
- potential legislation affecting the use of medicated feed additives
- extensive regulation by numerous government authorities in the United States and other countries
- our reliance on the continued operation and sufficiency of our manufacturing facilities, including the transition of virginiamycin production to our Brazil facility
- our reliance upon unpatented trade secrets
- the risks of legal proceedings and general litigation expenses
- potential operating hazards and uninsured risks
- the risk of work stoppages
- our dependence on key personnel

See also the discussion under Risks, Uncertainties and Liquidity in Note 1 of our Condensed Consolidated Financial Statements included in this Report.

In addition, the issue of the potential for increased bacterial resistance to certain antibiotics used in certain food producing animals is the subject of discussions on a worldwide basis and, in certain instances, has led to government restrictions on the use of antibiotics in these food producing animals. The sale of feed additives containing antibiotics is a material portion of our business. Should regulatory or other developments result in further restrictions on the sale of such products, it could have a material adverse impact on our financial position, results of operations and cash flows.

We believe the forward-looking statements in this Report are reasonable; however, no undue reliance should be placed on any forward-looking statements, as they are based on current expectations. Further, forward-looking statements speak only as of the date they are made, and we undertake no obligation to update publicly any of them in light of new information or future events.

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

Information regarding quantitative and qualitative disclosures about market risk is set forth in Part I Item 2 of this Form 10-Q.

**Item 4. *Controls and Procedures***

(a) Based upon an evaluation, under the supervision and with the participation of our Principal Executive Officers and our Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, they have concluded that, as of the end of the period covered by this

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Report, our disclosure controls and procedures, as defined in Rule 15d-15(e) of the Securities Exchange Act of 1934, as amended, are effective.

(b) As of the end of the period covered by this Report there have been no changes in our internal controls that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

It should be noted that any system of internal controls, however well designed and operated, can provide only reasonable, but not absolute, assurance that the objectives of the system are met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential conditions, regardless of how remote.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings**

See Note 7 to the Condensed Consolidated Financial Statements.

**Item 5. Other Information**

On March 8, 2006, Mr. Richard C. Rosenzweig joined the Company as Senior Vice President, General Counsel. Mr. Rosenzweig is expected to be elected Secretary by the Board of Directors in the near future.

**Item 6. Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
10.27.7	Amendment Number Seven dated April 18, 2006 to Loan and Security Agreement dated October 21, 2003, by and among, the lenders identified on the signature pages thereto, Wells Fargo Foothill, Inc., and Registrant, and each of Registrant's Subsidiaries identified on the signature pages thereto.
31.1	Certification of Gerald K. Carlson, Chief Executive Officer, required by Rule 15d-14(a) of the Act.
31.2	Certification of Jack C. Bendheim, Chairman of the Board, required by Rule 15d-14(a) of the Act.
31.3	Certification of Richard G. Johnson, Chief Financial Officer, required by Rule 15d-14(a) of the Act.
32	Section 1350 Certifications of Phibro Animal Health Corporation.

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**SIGNATURES**

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

PHIBRO ANIMAL HEALTH CORPORATION  
By: /s/ JACK C. BENDHEIM

**Jack C. Bendheim  
Chairman of the Board**

Date: May 15, 2006

By: /s/ GERALD K. CARLSON

**Gerald K. Carlson  
Chief Executive Officer**

Date: May 15, 2006

By: /s/ RICHARD G. JOHNSON

**Richard G. Johnson  
Chief Financial Officer  
(Principal Financial Officer and  
Principal Accounting Officer)**

Date: May 15, 2006

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**Exhibit Index**

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