PHIBRO ANIMAL HEALTH CORP
Form 10-Q
February 09, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2015
OR

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

For the transition period from_____ to_____
Commission File Number: 001-36410

Phibro Animal Health Corporation
(Exact name of registrant as specified in its charter)

Delaware	13-1840497
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Glenpointe Centre East, 3rd Floor 300 Frank W. Burr Boulevard, Suite 21 Teaneck, New Jersey	 07666-6712 (Zip Code)
(Address of Principal Executive Offices)	

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer

Non-accelerated filer Smaller reporting company

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

Yes No

As of February 1, 2016, there were 18,489,757 shares of the registrant's Class A common stock, par value $0.0001 per share, and 20,899,811 shares of the registrant's Class B common stock, par value $0.0001 per share, outstanding.

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PHIBRO ANIMAL HEALTH CORPORATION

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months		Six Months	
For the Periods Ended December 31	2015	2014	2015	2014
	(unaudited) (in thousands, except per share amounts)			
Net sales	$ 191,773	$ 188,688	$ 378,893	$ 376,146
Cost of goods sold	129,357	132,603	256,317	259,732
Gross profit	62,416	56,085	122,576	116,414
Selling, general and administrative expenses	39,795	36,298	78,097	71,522
Operating income	22,621	19,787	44,479	44,892
Interest expense, net	3,967	3,515	7,786	7,005
Foreign currency (gains) losses, net	2,557	(1,018)	(2,896)	(2,222)
Income before income taxes	16,097	17,290	39,589	40,109
Provision (benefit) for income taxes	(14,081)	3,042	(9,342)	6,929
Net income	$ 30,178	$ 14,248	$ 48,931	$ 33,180
Net income per share:				
basic	$ 0.77	$ 0.37	$ 1.25	$ 0.85
diluted	$ 0.75	$ 0.36	$ 1.22	$ 0.84
Weighted average common shares outstanding:				
basic	39,163	38,957	39,128	38,928
diluted	39,978	39,813	39,995	39,690
Dividends per share	$ 0.10	$ 0.10	$ 0.20	$ 0.20

The accompanying notes are an integral part of these consolidated financial statements

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PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months		Six Months	
For the Periods Ended December 31	2015	2014	2015	2014
	(unaudited) (in thousands)			
Net income	$ 30,178	$ 14,248	$ 48,931	$ 33,180
Change in fair value of derivative instruments	1,909	(294)	(2,994)	(723)
Foreign currency translation adjustment	2,014	(7,358)	(19,715)	(17,338)
Unrecognized net pension gains (losses)	508	417	892	702
(Provision) benefit for income taxes	(1,371)	1,157	2,315	2,706
Other comprehensive income (loss)	3,060	(6,078)	(19,502)	(14,653)
Comprehensive income (loss)	$ 33,238	$ 8,170	$ 29,429	$ 18,527

The accompanying notes are an integral part of these consolidated financial statements

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PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

As of	December 31, 2015	June 30, 2015
	(unaudited)	
	(in thousands, except share and per share amounts)	
ASSETS		
Cash and cash equivalents	$ 25,372	$ 29,216
Accounts receivable, net	114,572	111,099
Inventories, net	154,422	149,786
Other current assets	15,807	23,627
Total current assets	310,173	313,728
Property, plant and equipment, net	112,921	104,414
Intangibles, net	34,755	37,281
Other assets	63,648	37,895
Total assets	$ 521,497	$ 493,318
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current portion of long-term debt	$ 2,814	$ 2,809
Accounts payable	61,226	63,061
Accrued expenses and other current liabilities	50,491	45,463
Total current liabilities	114,531	111,333
Revolving credit facility	20,000	3,000
Long-term debt	282,307	283,709
Other liabilities	51,351	65,648
Total liabilities	468,189	463,690
Commitments and contingencies (Note 11)		
Common stock, par value $0.0001; 300,000,000 Class A shares authorized, 18,283,834 and 17,747,793 shares issued and outstanding at December 31, 2015 and June 30, 2015, respectively; 30,000,000 Class B shares authorized, 20,959,811 and 21,320,275 shares issued and outstanding at December 31, 2015 and June 30, 2015, respectively	4	4
Preferred stock, par value $0.0001; 16,000,000 shares authorized, no shares issued and outstanding	—	—
Paid-in capital	116,360	118,192
Retained earnings (accumulated deficit)	8,046	(36,968)
Accumulated other comprehensive income (loss)	(71,102)	(51,600)
Total stockholders' equity	53,308	29,628
Total liabilities and stockholders' equity	$ 521,497	$ 493,318

The accompanying notes are an integral part of these consolidated financial statements

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PHIBRO ANIMAL HEALTH CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months	
For the Periods Ended December 31	2015	2014
	(unaudited) (in thousands)	
OPERATING ACTIVITIES		
Net income	$ 48,931	$ 33,180
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	10,822	10,594
Amortization of deferred financing costs and debt discount	484	483
Acquisition related accrued compensation	840	—
Acquisition related accrued interest	689	—
Deferred income taxes valuation allowance	(18,787)	—
Deferred income taxes	(2,828)	176
Foreign currency (gains) losses, net	(2,790)	(1,046)
Other	149	(21)
Changes in operating assets and liabilities:		
Accounts receivable, net	(6,885)	(3,440)
Inventories, net	(12,794)	(9,281)
Prepaid expenses and other current assets	(309)	4,557
Other assets	(3,343)	101
Accounts payable	(4,842)	(1,999)
Accrued expenses and other liabilities	(3,733)	(7,541)
Net cash provided (used) by operating activities	5,604	25,763
INVESTING ACTIVITIES		
Capital expenditures	(17,653)	(7,728)
Other, net	263	809
Net cash provided (used) by investing activities	(17,390)	(6,919)
FINANCING ACTIVITIES		
Borrowings under the revolving credit facility	100,500	—
Repayments of the revolving credit facility	(83,500)	—
Payments of long-term debt, capital leases and other	(2,466)	(1,604)
Proceeds from common shares issued	2,078	158
Dividends paid	(7,827)	(7,791)
Net cash provided (used) by financing activities	8,785	(9,237)
Effect of exchange rate changes on cash	(843)	(739)
Net increase (decrease) in cash and cash equivalents	(3,844)	8,868
Cash and cash equivalents at beginning of period	29,216	11,821
Cash and cash equivalents at end of period	$ 25,372	$ 20,689

The accompanying notes are an integral part of these consolidated financial statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share amounts)
(unaudited)

1.
Description of Business

Phibro Animal Health Corporation ("Phibro" or "PAHC") and its subsidiaries (collectively, the "Company") is a diversified global developer, manufacturer and marketer of a broad range of animal health and mineral nutrition products for food animals including poultry, swine, cattle, dairy and aquaculture. The Company is also a manufacturer and marketer of performance products for use in the personal care, automotive, industrial chemical and chemical catalyst industries.

Unless otherwise indicated or the context requires otherwise, references in this report to "we," "our," "us," "the Company" and similar expressions refer to Phibro and its subsidiaries.

The unaudited consolidated financial information for the three and six months ended December 31, 2015 and 2014 is presented on the same basis as the financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2015 (the "Annual Report"), filed with the Securities and Exchange Commission on September 10, 2015 (File no. 001-36410). In the opinion of management, these financial statements include all adjustments necessary for a fair statement of financial position, results of operations and cash flows for the interim periods, and the adjustments are of a normal and recurring nature. The financial results for any interim period are not necessarily indicative of the results for the full year. The consolidated balance sheet information as of June 30, 2015 was derived from the audited consolidated financial statements, which include the accounts of Phibro and its consolidated subsidiaries, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The unaudited consolidated financial information should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report.

The consolidated financial statements include the accounts of Phibro and its consolidated subsidiaries. The decision whether or not to consolidate an entity requires consideration of majority voting interests, as well as effective control over the entity. Intercompany balances and transactions have been eliminated in the consolidated financial statements.

2.
Correction of Prior Year Interim Consolidated Financial Statements

We have revised the consolidated financial statements for the three and six months ended December 31, 2014 to correct errors in accounting for income taxes arising from long-term intercompany investments. We incorrectly recorded the benefits in the provision for income taxes instead of recording the benefits in other comprehensive income. The correcting adjustments increased the provision for income taxes, reduced net income and increased other comprehensive income. We concluded the corrections were not material to the periods.

For the Periods Ended December 31, 2014	Three Months	Six Months
Consolidated statements of operations		
As reported		
Provision (benefit) for income taxes	$ 1,885	$ 4,223
Net income (loss)	15,405	35,886
Net income (loss) per share – basic	0.40	0.92
Net income (loss) per share – diluted	0.39	0.90
Correction		
Provision (benefit) for income taxes	$ 1,157	$ 2,706
Net income (loss)	(1,157)	(2,706)
Net income (loss) per share – basic	(0.03)	(0.07)
Net income (loss) per share – diluted	(0.03)	(0.06)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For the Periods Ended December 31, 2014	Three Months	Six Months
Consolidated statements of operations		
As corrected		
Provision (benefit) for income taxes	$ 3,042	$ 6,929
Net income (loss)	14,248	33,180
Net income (loss) per share – basic	0.37	0.85
Net income (loss) per share – diluted	0.36	0.84
Consolidated statements of comprehensive income		
As reported		
Net income (loss)	$ 15,405	$ 35,886
Other comprehensive income (loss)	(7,235)	(17,359)
Comprehensive income (loss)	8,170	18,527
Correction		
Net income (loss)	$ (1,157)	$ (2,706)
Other comprehensive income (loss)	1,157	2,706
Comprehensive income (loss)	—	—
As corrected		
Net income (loss)	$ 14,248	$ 33,180
Other comprehensive income (loss)	(6,078)	(14,653)
Comprehensive income (loss)	8,170	18,527
Consolidated statement of cash flows		
As reported		
Net income (loss)		$ 35,886
Deferred income tax		(2,530)
Net cash provided (used) by operating activities		25,763
Correction		
Net income (loss)		$ (2,706)
Deferred income tax		2,706
Net cash provided (used) by operating activities		—
As corrected		
Net income (loss)		$ 33,180
Deferred income tax		176
Net cash provided (used) by operating activities		25,763

3.
Summary of Significant Accounting Policies and New Accounting Standards

Our significant accounting policies are described in the notes to the consolidated financial statements included in our Annual Report. As of December 31, 2015, there have been no material changes to any of the significant accounting policies contained therein, except for the application of Accounting Standards Update ("ASU") 2015-17, Income Taxes

(Topic 740), during the three months ended December 31, 2015. For further discussion regarding this guidance, see "—New Accounting Standards."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Net Income per Share and Weighted Average Shares
Basic net income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the reporting period.
Diluted net income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the reporting period after giving effect to potential dilutive common shares equivalents resulting from the assumed exercise of stock options and warrants. For the three and six months ended December 31, 2015 and 2014, all common share equivalents were included in the calculation of diluted net income per share.

	Three Months		Six Months	
For the Periods Ended December 31	2015	2014	2015	2014
Net income	$ 30,178	$ 14,248	$ 48,931	$ 33,180
Weighted average number of shares – basic	39,163	38,957	39,128	38,928
Dilutive effect of stock options and warrant	815	856	867	762
Weighted average number of shares – diluted	39,978	39,813	39,995	39,690
Net income per share:				
basic	$ 0.77	$ 0.37	$ 1.25	$ 0.85
diluted	$ 0.75	$ 0.36	$ 1.22	$ 0.84

New Accounting Standards
Financial Accounting Standards Board (“FASB”) ASU 2015-17, Income Taxes (Topic 740), requires entities to classify deferred tax assets and liabilities as noncurrent on the consolidated balance sheet. The guidance is effective for annual periods beginning after December 15, 2016. Early application is permitted, and either retrospective or prospective application is allowed. We have elected early application of this ASU during the quarter ended December 31, 2015 to simplify the presentation of deferred tax assets and liabilities. We applied the guidance prospectively; periods prior to December 31, 2015 were not retrospectively adjusted. The application of this guidance did not have a material impact on our consolidated balance sheet.
ASU 2015-12, Plan Accounting, has multiple parts that may potentially impact our consolidated financial statements. Plan Investment Disclosures (Part II) will eliminate the requirements to disclose individual investments that represent 5 percent or more of net assets available for benefits and the net appreciation or depreciation for investments by general type. The net appreciation or depreciation in investments for the period still will be required to be presented in the aggregate, but will no longer be required to be disaggregated and disclosed by general type. Measurement Date Practical Expedient (Part III) is applicable for fully benefit-responsive investment contracts only, and will allow for the contract value to be the only required method of measurement for these contracts. Under the current guidance these contracts are required to be measured at fair value. The guidance is effective for annual periods beginning after December 15, 2015. Early application is permitted. Retrospective application of the provisions of this guidance will be required. We are evaluating the impact of adoption of this guidance on our consolidated financial statements.
ASU 2015-11, Inventory (Topic 330), requires entities to measure inventory at the lower of cost and net realizable value (“NRV”). NRV is defined as “the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.” The guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those fiscal years. Early application is permitted. We are evaluating the impact of adoption of this guidance on our consolidated financial statements.
ASU 2015-05, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40). The amendments in this Update provide guidance to companies regarding the treatment of cloud computing arrangements and if an arrangement includes a software license. This guidance is effective for annual

reporting periods beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted for both prospective and retrospective transition methods. We do not expect adoption of this guidance will have a material effect on our consolidated financial statements.

ASU 2015-03, Interest—Imputation of Interest (Subtopic 835-30), intends to simplify presentation of debt issuance costs. The provisions of ASU 2015-03 require that debt issuance costs related to a recorded debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with the treatment required of debt discounts. The provisions of ASU 2015-03 are effective for annual reporting periods beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. We do not expect adoption of this guidance will have a material effect on our consolidated financial statements.

ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, requires management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosures in certain circumstances. ASU 2014-15 will be effective for annual periods ending after December 15, 2016. Earlier adoption is permitted. We do not expect adoption of this guidance will have a material effect on our consolidated financial statements.

ASU 2014-09, Revenue from Contracts with Customers (Topic 606), establishes principles for the recognition of revenue from contracts with customers. The underlying principle is to identify the performance obligations of a contract, allocate the revenue to each performance obligation and then to recognize revenue when the company satisfies a specific performance obligation of the contract. Subsequent to June 30, 2015, ASU 2015-14, Revenue from Contracts with Customers—Deferral of the Effective Date, was issued resulting in a one year deferral of the ASU 2014-09 effective date. Thus, ASU 2014-09 is effective for annual periods beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted for annual periods beginning after December 15, 2016. The guidance should be applied retrospectively to each prior reporting period presented. We are evaluating the impact of adoption of this guidance on our consolidated financial statements.

4.
Statements of Operations—Additional Information

	Three Months		Six Months	
For the Periods Ended December 31	2015	2014	2015	2014
Interest expense, net				
Term B Loan	$ 2,927	$ 2,957	$ 5,862	$ 5,921
Revolving credit facility	342	236	602	469
Acquisition related accrued interest	344	—	689	—
Amortization of deferred financing fees and debt discount	242	242	484	484
Other	169	115	255	228
Interest expense	4,024	3,550	7,892	7,102
Interest (income)	(57)	(35)	(106)	(97)
	$ 3,967	$ 3,515	$ 7,786	$ 7,005
Depreciation and amortization				
Depreciation of property, plant and equipment	$ 4,075	$ 4,123	$ 8,186	$ 8,351
Amortization of intangible assets	1,260	1,057	2,519	2,126
Amortization of other assets	58	61	117	117
	$ 5,393	$ 5,241	$ 10,822	$ 10,594

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5.
Balance Sheets—Additional Information

As of	December 31, 2015	June 30, 2015
Inventories		
Raw materials	$ 45,378	$ 40,012
Work-in-process	8,987	7,617
Finished goods	100,057	102,157
	$ 154,422	$ 149,786

Goodwill balances did not change during the six months ended December 31, 2015.
We evaluate our investments in equity method investees for impairment if circumstances indicate that the fair value of the investment may be impaired. The assets underlying a $4,061 equity investment are currently idled; we have concluded the investment is not currently impaired, based on expected future operating cash flows and/or disposal value.

As of	December 31, 2015	June 30, 2015
Accrued expenses and other current liabilities		
Employee related	$ 16,858	$ 22,273
Commissions and rebates	4,448	4,148
Insurance related	1,685	1,368
Professional fees	3,987	3,543
Income and other taxes	4,074	817
Deferred consideration on acquisitions	1,250	1,196
Fair value of derivatives	4,536	1,542
Other	13,653	10,576
	$ 50,491	$ 45,463

As of	December 31, 2015	June 30, 2015
Accumulated other comprehensive income (loss)		
Derivative instruments	$ (4,536)	$ (1,542)
Foreign currency translation adjustment	(52,438)	(32,723)
Unrecognized net pension gains (losses)	(18,992)	(19,884)
(Provision) benefit for income taxes on derivative instruments	(670)	63
(Provision) benefit for incomes taxes on long-term intercompany investments	8,166	4,923
(Provision) benefit for income taxes on pension gains (losses)	(2,632)	(2,437)
	$ (71,102)	$ (51,600)

6.
Debt

Revolving Credit Facility and Term B Loan

We have a revolving credit facility (the “Revolver”) and a term B loan (the “Term B Loan,” and together with the Revolver, the “Credit Facilities”). The Term B Loan has applicable margins equal to 3.00% in the case of LIBOR loans and 2.00% in the case of base rate loans. The LIBOR rate on the Term B Loan is subject to a floor of 1.00%.

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In January 2016, we amended the agreements governing our Credit Facilities to, among other things, increase the commitment available to us under the Revolver from $100,000 to $200,000. All other material terms and conditions were unchanged.

The Revolver requires, among other things, the maintenance of a maximum consolidated first lien net debt to consolidated EBITDA leverage ratio, calculated on a trailing four quarter basis, and contains an acceleration clause should an event of default (as defined in the agreement governing the Credit Facilities) occur. As of December 31, 2015, we were in compliance with the covenants of the Credit Facilities.

As of December 31, 2015, we had $20,000 in borrowings under the Revolver and had outstanding letters of credit of $14,065, leaving $65,935 available for borrowings and letters of credit under the Revolver. In January 2016 we funded the MVP acquisition with the Revolver. For additional details, see "—Subsequent Event." We obtain letters of credit in connection with certain regulatory and insurance obligations, inventory purchases and other contractual obligations. The tenors of these letters of credit are all one year or less.

The weighted-average interest rates on the Revolver and Term B Loan were 2.88% and 4.00%, respectively, for the six months ended December 31, 2015.

Long-Term Debt

As of	December 31, 2015	June 30, 2015
Term B loan due April 2021	$ 285,650	$ 287,100
Capitalized lease obligations	19	18
	285,669	287,118
Unamortized debt discount	(548)	(600)
	285,121	286,518
Less: current maturities	(2,814)	(2,809)
	$ 282,307	$ 283,709

7.
Dividends

We intend to pay regular quarterly dividends to holders of our Class A and Class B common stock out of assets legally available for this purpose. We declared and paid quarterly cash dividends totaling $3,917, and $7,827 for the three and six months ended December 31, 2015, to holders of our Class A common stock and Class B common stock. Our future ability to pay dividends will depend upon our results of operations, financial condition, capital requirements, our ability to obtain funds from our subsidiaries and other factors that our Board of Directors deems relevant. Additionally, the terms of our current and any future agreements governing our indebtedness could limit our ability to pay dividends or make other distributions.

8.
Related Party Transactions

Certain relatives of Jack C. Bendheim provided services to us as employees or consultants and received aggregate compensation and benefits of approximately $428 and $1,127 during the three and six months ended December 31, 2015, respectively, and $418 and $1,169 during the three and six months ended December 31, 2014, respectively. Mr. Bendheim has sole authority to vote shares of our stock owned by BFI Co., LLC, an investment vehicle of the Bendheim family.

9.
Employee Benefit Plans

The Company maintains a noncontributory defined benefit pension plan for all domestic nonunion employees employed on or prior to December 31, 2013, who meet certain requirements of age, length of service and hours worked per year. Plan benefits are based upon years of service and average compensation, as defined within the plan.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table details the net periodic pension expense:

	Three Months		Six Months	
For the Periods Ended December 31	2015	2014	2015	2014
Service cost – benefits earned during the period	$ 751	$ 656	$ 1,470	$ 1,477
Interest cost on benefit obligation	757	574	1,446	1,309
Expected return on plan assets	(846)	(648)	(1,588)	(1,414)
Amortization of net actuarial (gain) loss and prior service costs	508	417	892	702
Net periodic pension expense	$ 1,170	$ 999	$ 2,220	$ 2,074

10.
Income Taxes

During the three months ended December 31, 2015, we concluded it was more likely than not that the value of domestic deferred tax assets would be realized and it was no longer necessary to maintain a valuation allowance. We have released the domestic valuation allowance, except for amounts that will be released against the utilization of net operating losses during the remainder of the fiscal year. We continue to maintain valuation allowances against deferred tax assets related to certain foreign jurisdictions. We review the realizability of our deferred tax assets on a quarterly basis, or whenever events or changes in circumstances indicate a review is required.
The provision (benefit) for income taxes for the three and six months ended December 31, 2015, included a benefit from the release of a valuation allowance against domestic deferred tax assets of approximately $18,787. Excluding the release of the valuation allowance, the Company’s income tax provisions were comprised primarily of income taxes relating to profitable foreign jurisdictions; income taxes relating to domestic income were substantially offset by the utilization of net operating losses that previously had been offset by the valuation allowance. The provision for income taxes also included benefits from the recognition of certain previously unrecognized tax benefits of $1,637 and $1,218 for the six months ended December 31, 2015 and 2014, respectively.
11.
Commitments and Contingencies

Environmental
Our operations and properties are subject to extensive federal, state, local and foreign laws and regulations, including those governing pollution; protection of the environment; the use, management, and release of hazardous materials, substances and wastes; air emissions; greenhouse gas emissions; water use, supply and discharges; the investigation and remediation of contamination; the manufacture, distribution, and sale of regulated materials, including pesticides; the importing, exporting and transportation of products; and the health and safety of our employees (collectively, “Environmental Laws”). As such, the nature of our current and former operations exposes us to the risk of claims with respect to such matters, including fines, penalties, and remediation obligations that may be imposed by regulatory authorities. Under certain circumstances, we might be required to curtail operations until a particular problem is remedied. Known costs and expenses under Environmental Laws incidental to ongoing operations, including the cost of litigation proceedings relating to environmental matters, are 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 we establish 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.

While we believe that our operations are currently in material compliance with Environmental Laws, we have, from time to time, received notices of violation from governmental authorities, and have been involved in civil or criminal action for such violations. Additionally, at various sites, our subsidiaries are engaged in continuing investigation, remediation and/or monitoring efforts to address contamination associated with historic operations of the sites. We devote considerable resources to complying with

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Environmental Laws and managing environmental liabilities. We have developed programs to identify requirements under, and maintain compliance with, Environmental Laws; however, we cannot predict with certainty the effect of increased and more stringent regulation on our operations, future capital expenditure requirements or the cost of compliance.

The nature of our current and former operations exposes us to the risk of claims with respect to environmental matters and we cannot assure we will not incur material costs and liabilities in connection with such claims. Based upon our experience to date, we believe that the future cost of compliance with existing Environmental Laws, and liabilities for known environmental claims pursuant to such Environmental Laws, will not have a material adverse effect on our financial position, results of operations, cash flows or liquidity.

The U.S. Environmental Protection Agency (the "EPA") is investigating and planning for the remediation of offsite contaminated groundwater that has migrated from the Omega Chemical Corporation Superfund Site ("Omega Chemical Site"), which is upgradient of a facility in Santa Fe Springs, California, operated by our subsidiary Phibro-Tech, Inc. ("Phibro-Tech"). The EPA has named Phibro-Tech and certain other subsidiaries of PAHC as potentially responsible parties ("PRPs") due to groundwater contamination from Phibro-Tech's Santa Fe Springs facility that has allegedly commingled with contaminated groundwater from the Omega Chemical Site. In September 2012, the EPA notified approximately 140 PRPs, including Phibro-Tech and the other subsidiaries, that they have been identified as potentially responsible for remedial action for the groundwater plume affected by the Omega Chemical Site and for EPA oversight and response costs. Phibro-Tech contends that groundwater contamination at its site is due to historical operations that pre-date Phibro-Tech and/or contaminated groundwater that has migrated from upgradient properties. In addition, a successor to a prior owner of the Phibro-Tech site has asserted that PAHC and Phibro-Tech are obligated to provide indemnification for its potential liability and defense costs relating to the groundwater plume affected by the Omega Chemical Site. Phibro-Tech has vigorously contested this position and has asserted that the successor to the prior owner is required to indemnify Phibro-Tech for its potential liability and defense costs. Furthermore, a nearby property owner has filed a complaint in the Superior Court of the State of California against many of the PRPs allegedly associated with the groundwater plume affected by the Omega Chemical Site (including Phibro-Tech) for alleged contamination of groundwater underneath its property, and a group of companies that sent chemicals to the Omega Chemical Site for processing and recycling has filed a complaint under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, the Resource Conservation and Recovery Act, as amended, and the common law public nuisance doctrine in the United States District Court for the Central District of California against many of the PRPs allegedly associated with the groundwater plume affected by the Omega Chemical Site (including Phibro-Tech) for contribution toward past and future costs associated with the investigation and remediation of the groundwater plume affected by the Omega Chemical Site. Due to the ongoing nature of the EPA's investigation and Phibro-Tech's dispute with the prior owner's successor, at this time we cannot predict with any degree of certainty what, if any, liability Phibro-Tech or the other subsidiaries may ultimately have for investigation, remediation and the EPA oversight and response costs associated with the affected groundwater plume.

Based upon information available, to the extent such costs can be estimated with reasonable certainty, we estimated our cost for 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 $6,544 and $6,827 at December 31, 2015 and June 30, 2015, respectively, which is included in current and long-term liabilities on the consolidated balance sheets. However, future events, such as new information, changes in existing Environmental Laws or their interpretation, and more vigorous enforcement policies of regulatory agencies, may give rise to additional expenditures or liabilities that could be material. For all purposes of the discussion under this caption and elsewhere in this report, it should be noted that we take and have taken the position that neither PAHC nor any of our subsidiaries is liable for environmental or other claims made against one or more of our other subsidiaries or for which any of such other subsidiaries may ultimately be responsible.

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Claims and Litigation
PAHC and its subsidiaries are party to a number of claims and lawsuits arising out of the normal course of business including product liabilities, payment disputes and governmental regulation. Certain of these actions seek damages in various amounts. In many cases, such claims are covered by insurance. We believe that none of the claims or pending lawsuits, either individually or in the aggregate, will have a material adverse effect on our financial position, results of operations, cash flows or liquidity.

12.
Derivatives

We monitor our exposure to commodity prices, interest rates and foreign currency exchange rates, and use derivatives to manage certain of these risks. These derivatives generally have an expiration/maturity of two years or less and are intended to hedge cash flows related to the purchase of inventory. We designate derivatives as a hedge of a forecasted transaction or of the variability of the cash flows to be received or paid in the future related to a recognized asset or liability (cash flow hedge). We record the portion of the changes in the value of the derivative, related to a hedged asset or liability (the effective portion), in accumulated other comprehensive income (loss). As the hedged item is sold, we recognize the gain or loss recorded in accumulated other comprehensive income (loss) to the consolidated statements of operations on the same line where the hedged item is charged when released/sold. We immediately recognize in the consolidated statements of operations in the same line as the hedged item, the portion of the changes in fair value of derivatives used as cash flow hedges that is not offset by changes in the expected cash flows related to a recognized asset or liability (the ineffective portion).
We routinely assess whether the derivatives used to hedge transactions are effective. If we determine a derivative ceases to be an effective hedge, we discontinue hedge accounting in the period of the assessment for that derivative, and immediately recognize any unrealized gains or losses related to the fair value of that derivative in the consolidated statements of operations.
We record derivatives at fair value in the consolidated balance sheets. For additional details regarding fair value, see “—Fair Value Measurements.”
At December 31, 2015, the following table details the Company’s outstanding derivatives that are designated and effective as cash flow hedges:

			Fair value as of	
Instrument	Hedge	Notional Amount at December 31, 2015	December 31, 2015	June 30, 2015
Options	Brazilian Real calls	R$156,000	$ 675	$ 493
Options	Brazilian Real puts	R$156,000	$ (5,211)	$ (2,035)

The unrecognized gains (losses) at December 31, 2015, are unrealized and will fluctuate based on future exchange rates until the derivative contracts mature. Other comprehensive income (loss) included $1,909 and $(2,994) of unrecognized gains (losses) for the three and six months ended December 31, 2015, respectively. Accumulated other comprehensive income (loss) at December 31, 2015 included $4,536 of unrecognized losses on derivative instruments; we anticipate that $1,196 of the losses will be recognized in earnings within the next twelve months. We realized $1,095 and $1,941 of losses related to contracts that matured during the three and six months ended December 31, 2015, respectively, and recorded the cost as a component of inventory; we anticipate the cost will be recognized in earnings within the next twelve months. We recognize gains (losses) related to these derivative instruments as a component of cost of goods sold at the time the hedged item is sold. We hedge forecasted transactions for periods not exceeding twenty-four months.

13.
Fair Value Measurements

Fair value is defined as the exit price that would be received to sell an asset or paid to transfer a liability. Fair value is a market-based measurement that should be determined using assumptions that market participants would use in pricing an asset or liability. Financial assets and liabilities are measured at

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

fair value using the three-level valuation hierarchy for disclosure of fair value measurements. The determination of the applicable level within the hierarchy of a particular asset or liability depends on the inputs used in the valuation as of the measurement date, notably the extent to which the inputs are market-based (observable) or internally derived (unobservable). Observable inputs are inputs that market participants would use in pricing the asset or liability developed based on market data obtained from independent sources. Unobservable inputs are inputs based on a company's own assumptions about market participant assumptions developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

Level 1—
Quoted prices in active markets for identical assets or liabilities.

Level 2—
Significant observable inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly through corroboration with observable market data.

Level 3—
Unobservable inputs for which there is little or no market data available, and which are significant to the overall fair value measurement, are employed which require the reporting entity to develop its own assumptions.

In assessing the fair value of financial instruments at December 31, 2015 and June 30, 2015, we used a variety of methods and assumptions which were based on estimates of market conditions and risks existing at the time.

Current Assets and Liabilities

We consider the carrying amounts of current assets and current liabilities to be representative of their fair value because of the current nature of these items.

Letters of Credit

We obtain letters of credit in connection with certain regulatory and insurance obligations, inventory purchases and other contractual obligations. The carrying values of these letters of credit are considered to be representative of their fair values because of the nature of the instruments. The tenors of these letters of credit are all one year or less.

Long Term Debt

We record the Term B Loan at book value in our consolidated financial statements. We believe the carrying value of the Term B Loan is approximately equal to the fair value, which is based on quoted broker prices that are Level 2 inputs.

Deferred Consideration on Acquisitions

We estimated the fair value of the deferred consideration on acquisitions using the income approach, based on the Company's current sales forecast related to the acquired business.

Derivatives

We determine the fair value of derivative instruments based upon pricing models using observable market inputs for these types of financial instruments, such as spot and forward currency translation rates.

As of	December 31, 2015			June 30, 2015		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
Derivatives	$ —	$ (4,536)	$ —	$ —	$ (1,542)	$ —
Deferred consideration on acquisitions	$ —	$ —	$ 5,958	$ —	$ —	$ 5,465

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The table below provides a summary of the changes in the fair value of Level 3 assets:

Balance, June 30, 2015	$ 5,465
Acquisition related accrued interest	689
Payment and other	(196)
Balance, December 31, 2015	$ 5,958

14.
Business Segments

The Animal Health segment manufactures and markets products for the poultry, swine, cattle, dairy, aquaculture and ethanol markets. The business includes net sales of medicated feed additives and other related products, nutritional specialty products and vaccines. The Mineral Nutrition segment manufactures and markets trace minerals for the cattle, swine, poultry and pet food markets. The Performance Products segment manufactures and markets a variety of products for use in the personal care, automotive, industrial chemical and chemical catalyst industries.
We evaluate performance and allocate resources based on the Animal Health, Mineral Nutrition and Performance Products segments. Certain of our costs and assets are not directly attributable to these segments and such costs are referred to as Corporate. We do not allocate such items to the principal segments because they are not used to evaluate their operating results or financial position. Assets include cash and cash equivalents, debt issue costs and certain other assets.
We evaluate performance of our segments based on adjusted EBITDA. We define adjusted EBITDA as EBITDA plus (a) (income) loss from, and disposal of, discontinued operations, (b) other expense or less other income, as separately reported on our consolidated statements of operations, including foreign currency gains and losses and loss on extinguishment of debt, and (c) certain items that we consider to be unusual or non-recurring. We define EBITDA as net income plus (i) interest expense, net, (ii) provision for income taxes or less benefit for income taxes and (iii) depreciation and amortization.
The accounting policies of our segments are the same as those described in the summary of significant accounting policies included herein.

	Three Months		Six Months	
For the Periods Ended December 31	2015	2014	2015	2014
Net sales				
Animal Health	$ 121,504	$ 118,785	$ 241,638	$ 236,010
Mineral Nutrition	58,853	58,742	113,322	114,189
Performance Products	11,416	11,161	23,933	25,947
	$ 191,773	$ 188,688	$ 378,893	$ 376,146
Depreciation and amortization				
Animal Health	$ 3,829	$ 3,710	$ 7,705	$ 7,538
Mineral Nutrition	612	605	1,220	1,209
Performance Products	194	147	388	293
Corporate	758	779	1,509	1,554
	$ 5,393	$ 5,241	$ 10,822	$ 10,594

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Three Months		Six Months	
For the Periods Ended December 31	2015	2014	2015	2014
Adjusted EBITDA				
Animal Health	$ 32,351	$ 28,296	$ 63,827	$ 60,750
Mineral Nutrition	4,189	3,754	7,349	7,233
Performance Products	(8)	162	78	1,198
Corporate	(8,098)	(7,184)	(15,113)	(13,695)
	$ 28,434	$ 25,028	$ 56,141	$ 55,486
Reconciliation of Adjusted EBITDA to income before income taxes				
Adjusted EBITDA	$ 28,434	$ 25,028	$ 56,141	$ 55,486
Depreciation and amortization	(5,393)	(5,241)	(10,822)	(10,594)
Acquisition related accrued compensation	(420)	—	(840)	—
Interest expense, net	(3,967)	(3,515)	(7,786)	(7,005)
Foreign currency gains (losses), net	(2,557)	1,018	2,896	2,222
Income before income taxes	$ 16,097	$ 17,290	$ 39,589	$ 40,109

As of	December 31, 2015	June 30, 2015
Identifiable assets		
Animal Health	$ 370,522	$ 361,078
Mineral Nutrition	62,771	59,881
Performance Products	23,718	22,255
Corporate	64,486	50,104
	$ 521,497	$ 493,318

The Animal Health segment includes all goodwill of the Company. The Animal Health segment includes advances to and investment in an equity method investee of $4,061 and $4,364 as of December 31, 2015 and June 30, 2015, respectively. The Performance Products segment includes an investment in equity method investee of $452 and $361 as of December 31, 2015 and June 30, 2015, respectively. Corporate includes all cash and cash equivalents.

15.
Subsequent Event

In January 2016, we purchased the assets of MVP Laboratories, Inc. (“MVP”). MVP is a developer, manufacturer and marketer of livestock vaccines, vaccine adjuvants and other products. We acquired all of the assets used in MVP’s business, including working capital, intellectual property, manufacturing equipment and real property. The purchase price of approximately $46,500 was paid at closing and was funded with the Revolver.

The acquisition will be accounted for as a business combination in accordance with ASC No. 805, “Business Combinations” (“ASC 805”). We are evaluating the allocations of the purchase price to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date. Pro forma information giving effect to the acquisition has not been provided because the results are not material to the consolidated financial statements.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Introduction

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) is provided to assist readers in understanding our performance, as reflected in the results of our operations, our financial condition and our cash flows and should be read in conjunction with the consolidated financial statements and notes thereto included as part of this interim report. The following discussion summarizes the significant factors affecting our consolidated operating results, financial condition, liquidity and cash flows as of and for the periods presented below. This MD&A should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this Quarterly Report on Form 10-Q. Our future results of operations may differ materially from those discussed in the forward-looking statements contained herein as a result of various factors, including, but not limited to those elsewhere in this Quarterly Report on Form 10-Q, including under “Forward-Looking Statements,” and those contained within the “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Risk Factors” and other portions of the Annual Report.

Overview of our business

Phibro Animal Health Corporation is a diversified global developer, manufacturer and marketer of a broad range of animal health and mineral nutrition products for food animals including poultry, swine, cattle, dairy and aquaculture. We also are a manufacturer and marketer of performance products for use in the personal care, automotive, industrial chemical and chemical catalyst industries.

Correction of Prior Year Interim Consolidated Financial Statements

We have revised the consolidated financial statements for the three and six months ended December 31, 2014 to correct errors in accounting for income taxes arising from long-term intercompany investments. We incorrectly recorded the benefits in the provision for income taxes instead of recording the benefits in other comprehensive income. The correcting adjustments increased the provision for income taxes, reduced net income and increased other comprehensive income. We concluded the corrections were not material to the periods. For additional information, see “Notes to Consolidated Financial Statements—Correction of Prior Year Interim Consolidated Financial Statements.”

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Analysis of the consolidated statements of operations

Summary Results of Operations

For the Periods Ended December 31	Three Months 2015	2014	Change		Six Months 2015	2014	Change	
	(in thousands, except per share)				(in thousands, except per share)			
Net sales	$ 191,773	$ 188,688	$ 3,085	2%	$ 378,893	$ 376,146	$ 2,747	1%
Gross profit	62,416	56,085	6,331	11%	122,576	116,414	6,162	5%
Selling, general and administrative expenses	39,795	36,298	3,497	10%	78,097	71,522	6,575	9%
Operating income	22,621	19,787	2,834	14%	44,479	44,892	(413)	(1)%
Interest expense, net	3,967	3,515	452	13%	7,786	7,005	781	11%
Foreign currency (gains) losses, net	2,557	(1,018)	3,575	*	(2,896)	(2,222)	(674)	*
Income before income taxes	16,097	17,290	(1,193)	(7)%	39,589	40,109	(520)	(1)%
Provision (benefit) for income taxes	(14,081)	3,042	(17,123)	*	(9,342)	6,929	(16,271)	*
Net income	$ 30,178	$ 14,248	$ 15,930	112%	$ 48,931	$ 33,180	$ 15,751	47%
Net income per share								
basic	$ 0.77	$ 0.37	$ 0.40		$ 1.25	$ 0.85	$ 0.40	
diluted	$ 0.75	$ 0.36	$ 0.39		$ 1.22	$ 0.84	$ 0.38	
Weighted average number of shares outstanding								
basic	39,163	38,957			39,128	38,928		
diluted	39,978	39,813			39,995	39,690		
Ratio to net sales								
Gross profit	32.5%	29.7%			32.4%	30.9%		
Selling, general and administrative expenses	20.8%	19.2%			20.6%	19.0%		

Operating income	11.8%	10.5%