PHIBRO ANIMAL HEALTH CORP
Form 10-Q
February 06, 2017
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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, 2016
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 January 30, 2017, there were 18,529,489 shares of the registrant's Class A common stock, par value $0.0001 per share, and 20,887,811 shares of the registrant's Class B common stock, par value $0.0001 per share, outstanding.

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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	2016	2015	2016	2015
	(unaudited) (in thousands, except per share amounts)			
Net sales	$ 191,598	$ 191,773	$ 379,585	$ 378,893
Cost of goods sold	128,100	130,311	255,088	258,224
Gross profit	63,498	61,462	124,497	120,669
Selling, general and administrative expenses	40,870	38,841	80,056	76,190
Operating income	22,628	22,621	44,441	44,479
Interest expense, net	3,872	3,967	7,779	7,786
Foreign currency (gains) losses, net	(548)	2,557	(214)	(2,896)
Income before income taxes	19,304	16,097	36,876	39,589
Provision (benefit) for income taxes	5,887	(14,081)	11,282	(9,342)
Net income	$ 13,417	$ 30,178	$ 25,594	$ 48,931
Net income per share				
basic	$ 0.34	$ 0.77	$ 0.65	$ 1.25
diluted	$ 0.34	$ 0.75	$ 0.64	$ 1.22
Weighted average common shares outstanding				
basic	39,411	39,163	39,409	39,128
diluted	40,002	39,978	39,954	39,995
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	2016	2015	2016	2015
	(unaudited) (in thousands)			
Net income	$ 13,417	$ 30,178	$ 25,594	$ 48,931
Change in fair value of derivative instruments	270	1,909	304	(2,994)
Foreign currency translation adjustment	(2,296)	2,014	(3,189)	(19,715)
Unrecognized net pension gains (losses)	4,671	508	11,840	892
(Provision) benefit for income taxes	(1,894)	(1,371)	(4,644)	2,315
Other comprehensive income (loss)	751	3,060	4,311	(19,502)
Comprehensive income (loss)	$ 14,168	$ 33,238	$ 29,905	$ 29,429

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, 2016	June 30, 2016
	(unaudited)	
	(in thousands, except share and per share amounts)	
ASSETS		
Cash and cash equivalents	$ 39,220	$ 33,605
Accounts receivable, net	124,131	123,790
Inventories, net	158,819	167,691
Other current assets	16,839	17,745
Total current assets	339,009	342,831
Property, plant and equipment, net	127,180	127,323
Intangibles, net	57,134	60,095
Goodwill	21,121	21,121
Other assets	47,841	56,465
Total assets	$ 592,285	$ 607,835
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current portion of long-term debt	$ 2,901	$ 2,907
Accounts payable	54,826	60,167
Accrued expenses and other current liabilities	45,602	45,703
Total current liabilities	103,329	108,777
Revolving credit facility	48,500	69,000
Long-term debt	277,132	278,265
Other liabilities	50,711	61,313
Total liabilities	479,672	517,355
Commitments and contingencies (Note 8)		
Common stock, par value $0.0001 per share; 300,000,000 Class A shares authorized, 18,529,095 and 18,519,757 shares issued and outstanding at December 31, 2016, and June 30, 2016, respectively; 30,000,000 Class B shares authorized, 20,887,811 shares issued and outstanding at December 31, 2016, and June 30, 2016	4	4
Preferred stock, par value $0.0001 per share; 16,000,000 shares authorized, no shares issued and outstanding	—	—
Paid-in capital	118,409	118,299
Retained earnings	51,674	33,962
Accumulated other comprehensive income (loss)	(57,474)	(61,785)
Total stockholders' equity	112,613	90,480
Total liabilities and stockholders' equity	$ 592,285	$ 607,835

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	2016	2015
	(unaudited) (in thousands)	
OPERATING ACTIVITIES		
Net income	$ 25,594	$ 48,931
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	12,762	10,822
Amortization of debt issuance costs and debt discount	508	484
Acquisition-related accrued compensation	840	840
Acquisition-related accrued interest	855	689
Pension settlement cost	1,702	—
Deferred income taxes	3,736	(21,615)
Foreign currency (gains) losses, net	293	(2,790)
Other	310	149
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,583)	(6,885)
Inventories, net	7,017	(12,794)
Other current assets	919	(309)
Other assets	(512)	(3,343)
Accounts payable	(4,667)	(4,842)
Accrued expenses and other liabilities	(41)	(3,733)
Net cash provided (used) by operating activities	47,733	5,604
INVESTING ACTIVITIES		
Capital expenditures	(10,564)	(17,653)
Other, net	(201)	263
Net cash provided (used) by investing activities	(10,765)	(17,390)
FINANCING ACTIVITIES		
Revolving credit facility borrowings	73,000	100,500
Revolving credit facility repayments	(93,500)	(83,500)
Payments of long-term debt, capital leases and other	(2,776)	(2,466)
Proceeds from common shares issued	110	2,078
Dividends paid	(7,882)	(7,827)
Net cash provided (used) by financing activities	(31,048)	8,785
Effect of exchange rate changes on cash	(305)	(843)
Net increase (decrease) in cash and cash equivalents	5,615	(3,844)
Cash and cash equivalents at beginning of period	33,605	29,216
Cash and cash equivalents at end of period	$ 39,220	$ 25,372

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," and similar expressions refer to Phibro and its subsidiaries.

The unaudited consolidated financial information for the three and six months ended December 31, 2016 and 2015, 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, 2016 (the "Annual Report"), filed with the Securities and Exchange Commission on August 29, 2016 (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, 2016, 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 ("GAAP"). 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.
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, 2016, there have been no material changes to any of the significant accounting policies contained therein, except for the application of Accounting Standards Update ("ASU") 2015-03, Interest—Imputation of Interest (Subtopic 835-30), as of July 1, 2016. Prior periods have been adjusted to reflect the retrospective application of this guidance. For further discussion, see "—New Accounting Standards."

Revisions of Previously Issued Financial Statements

During the three months ended June 30, 2016, the Company determined that amortization expense related to product-related intangible assets should be recorded in cost of goods sold rather than in selling, general and administrative expense within the consolidated statement of operations. The Company has revised its prior period financial statements, to correct the classification of amortization expense to increase cost of goods sold and reduce gross profit and selling, general and administrative expenses by $954 and $1,907 for the three and six months ended December 31, 2015, respectively. These revisions had no impact on the Company's previously reported net income (loss) or cash flows. The Company evaluated the impact of the revisions on prior periods, assessing materiality quantitatively and qualitatively, and concluded the errors were not material to any previously issued financial statements.

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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

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. For the three and six months ended December 31, 2016 and 2015, 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	2016	2015	2016	2015
Net income	$ 13,417	$ 30,178	$ 25,594	$ 48,931
Weighted average number of shares – basic	39,411	39,163	39,409	39,128
Dilutive effect of stock options	591	815	545	867
Weighted average number of shares – diluted	40,002	39,978	39,954	39,995
Net income per share				
basic	$ 0.34	$ 0.77	$ 0.65	$ 1.25
diluted	$ 0.34	$ 0.75	$ 0.64	$ 1.22

Dividends

We declared and paid quarterly cash dividends of $0.10 per share, totaling $3,941 and $7,882, during the three and six months ended December 31, 2016, respectively, to holders of our Class A common stock and Class B common stock.

New Accounting Standards

Financial Accounting Standards Board (“FASB”) ASU 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, supersedes the current guidance by establishing a one-step goodwill impairment test. This new guidance requires an entity to compare the fair value of a reporting unit to its carrying amount, and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value. This ASU is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early application is permitted for goodwill impairment tests performed after January 1, 2017. We will apply this guidance when performing our next goodwill impairment test. We do not expect adoption of this guidance to have a material effect on our consolidated financial statements.

ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, provides specific guidance for the classification of certain transactions within the statement of cash flows. The issues addressed by this guidance include, but are not limited to, debt prepayments or debt extinguishment costs, contingent consideration payments made after a business combination and proceeds from the settlement of insurance claims. This ASU is effective for annual reporting periods beginning after December 15, 2017. Early application is permitted, as long as all provisions under the guidance are applied simultaneously. The provisions of this guidance are to be applied using a retrospective transition approach. We do not expect adoption of this guidance to have a material effect on our consolidated financial statements.

ASU 2016-02, Leases (Topic 842), supersedes the current lease accounting guidance and requires an entity to recognize assets and liabilities for both financing and operating leases on the balance sheet and requires additional qualitative and quantitative disclosures regarding leasing arrangements. This ASU is effective for annual reporting periods beginning after December 15, 2018. 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 years. We do not expect adoption of this guidance to have a material effect on our consolidated financial statements.

ASU 2015-05, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40) provides guidance regarding the treatment of cloud computing arrangements and if an arrangement includes a software license. We adopted this guidance during the three months ended September 30, 2016, and it had no material impact on our consolidated financial statements.

ASU 2015-03, Interest—Imputation of Interest (Subtopic 835-30), requires debt issuance costs to be presented as a reduction of the related liability. These costs were previously included in other assets. Debt issuance costs associated with line-of-credit arrangements may continue to be recognized in other assets. We adopted this guidance during the three months ended September 30, 2016, and applied the guidance retrospectively. Debt issuance costs of $2,538 as of June 30, 2016, have been presented as a reduction in long-term debt on our consolidated balance sheets.

ASU 2014-15, Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern (Subtopic 205-40), requires management to assess an entity’s ability to continue as a going concern within one year after the issuance date of the financial statements, and to provide related footnote disclosures in certain circumstances. Management will need to consider relevant conditions that are known and reasonably knowable at the issuance date. Substantial doubt exists if it is probable that the entity will be unable to meet its obligations within one year after the issuance date. Under the new standard, the definition of substantial doubt incorporates a likelihood threshold of “probable” similar to the current use of that term in GAAP for loss contingencies. ASU 2014-15 will be effective for annual periods ending after December 15, 2016, and for annual periods and interim periods thereafter. We do not expect adoption of this guidance to 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. ASU 2015-14, Deferral of the Effective Date, amended ASU 2014-09, resulting in a one-year deferral of the effective date. ASU 2016-08, Principal versus Agent Considerations; ASU 2016-10, Identifying Performance Obligations and Licensing; and ASU 2016-12, Narrow-Scope Improvements and Practical Expedients also amended ASU 2014-09. The amendments are effective concurrent with the effective date for ASU 2014-09 for annual periods beginning after December 15, 2017, and interim periods within those years. We are evaluating the impact of adoption of this guidance on our consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

3.
Statements of Operations—Additional Information

	Three Months		Six Months	
For the Periods Ended December 31	2016	2015	2016	2015
Interest expense, net				
Term B loan	$ 2,866	$ 2,927	$ 5,771	$ 5,862
Revolving credit facility	731	342	1,686	602
Amortization of debt issuance costs and debt discount	255	242	508	484
Acquisition-related accrued interest	462	344	855	689
Other	47	169	128	255
Interest expense	4,361	4,024	8,948	7,892
Interest (income)	(489)	(57)	(1,169)	(106)
	$ 3,872	$ 3,967	$ 7,779	$ 7,786
Depreciation and amortization				
Depreciation of property, plant and equipment	$ 4,952	$ 4,075	$ 9,683	$ 8,186
Amortization of intangible assets	1,434	1,260	2,962	2,519
Amortization of other assets	58	58	117	117
	$ 6,444	$ 5,393	$ 12,762	$ 10,822

The provision (benefit) for income taxes for the three and six months ended December 31, 2015, included a benefit of $18,787 due to the reversal of the valuation allowance we previously had recorded against domestic deferred tax assets. Based on continued domestic profitability, we concluded that 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.
4.
Balance Sheets—Additional Information

As of	December 31, 2016	June 30, 2016
Inventories		
Raw materials	$ 56,299	$ 51,369
Work-in-process	9,455	8,074
Finished goods	93,065	108,248
	$ 158,819	$ 167,691

Goodwill balances did not change during the six months ended December 31, 2016.
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 $4,094 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

As of	December 31, 2016	June 30, 2016
Accrued expenses and other current liabilities		
Employee related	$ 21,011	$ 21,712
Commissions and rebates	4,572	3,722
Insurance related	1,617	1,780
Professional fees	3,930	3,573
Income and other taxes	3,007	1,910
Deferred consideration on acquisitions	—	1,250
Other	11,465	11,756
	$ 45,602	$ 45,703

As of	December 31, 2016	June 30, 2016
Accumulated other comprehensive income (loss)		
Derivative instruments	$ 2,959	$ 2,655
Foreign currency translation adjustment	(45,093)	(41,904)
Unrecognized net pension gains (losses)	(19,137)	(30,977)
(Provision) benefit for income taxes on derivative instruments	(1,664)	(1,548)
(Provision) benefit for incomes taxes on long-term intercompany investments	8,166	8,166
(Provision) benefit for income taxes on pension gains (losses)	(2,705)	1,823
	$ (57,474)	$ (61,785)

5. Debt

Revolving Credit Facility and Term B Loan

We have a revolving credit facility (the "Revolver"), where we can borrow up to $200,000, subject to the terms of the agreement, and a term B loan (the "Term B Loan," and together with the Revolver, the "Credit Facilities"). The Revolver, as amended, has applicable margins equal to 2.50%, 2.75% or 3.00%, in the case of LIBOR loans and 1.50%, 1.75% or 2.00%, in the case of base rate loans; the applicable margins are based on the First Lien Net Leverage Ratio. The Term B Loan has applicable margins equal to 3.00% with regards to LIBOR loans and 2.00% regarding base rate loans. The LIBOR rate on the Term B Loan is subject to a floor of 1.00%.

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, 2016, we were in compliance with the covenants of the Credit Facilities.

As of December 31, 2016, we had $48,500 in borrowings under the Revolver and had outstanding letters of credit of $14,518 leaving $136,982 available for borrowings and letters of credit under the Revolver. We obtain letters of credit in connection with certain regulatory and insurance obligations and other contractual obligations. The tenors of these letters of credit are all one year or less.

The weighted-average interest rates for the Revolver and Term B Loan were 3.30% and 4.00%, respectively, for the six months ended December 31, 2016.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Long-Term Debt

As of	December 31, 2016	June 30, 2016
Term B Loan due April 2021	$ 282,750	$ 284,200
Capitalized lease obligations	1	7
	282,751	284,207
Unamortized debt issuance costs and debt discount	(2,718)	(3,035)
Less: current maturities	(2,901)	(2,907)
	$ 277,132	$ 278,265

6.
Related Party Transactions

Certain relatives of Jack C. Bendheim provided services to us as employees or consultants and received aggregate compensation and benefits of $445 and $1,047 during the three and six months ended December 31, 2016, respectively, and $428 and $1,127 during the three and six months ended December 31, 2015, respectively. Mr. Bendheim has sole authority to vote shares of our stock owned by BFI Co., LLC, an investment vehicle of the Bendheim family.

7.
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.

In July 2016, we amended our domestic noncontributory defined benefit pension plan to eliminate credit for future service and compensation increases, effective as of September 30, 2016. The amendment resulted in a curtailment of the pension plan. During the three months ended September 30, 2016, we recorded a pension curtailment gain of $6,822 in other comprehensive income and an offsetting reduction in the liability for pension benefits included in other liabilities. We also modified the 401(k) retirement savings plan, effective October 1, 2016, to include, for all domestic employees, a non-elective Company contribution of 3% of compensation and an additional discretionary contribution of up to 4% of compensation, depending on the employee's age and years of service.

Separately, we offered a lump sum settlement option to certain pension plan participants. During the three months ended December 31, 2016, we recognized a partial settlement of the pension plan with respect to the lump sum settlement, which resulted in a charge to the consolidated statement of operations of $1,702, which we recorded as a component of selling, general and administrative expenses.

Net periodic pension expense was:

	Three Months		Six Months	
For the Periods Ended December 31	2016	2015	2016	2015
Service cost – benefits earned during the period	$ 284	$ 751	$ 845	$ 1,470
Interest cost on benefit obligation	505	757	1,048	1,446
Expected return on plan assets	(843)	(846)	(1,706)	(1,588)
Amortization of net actuarial (gain) loss and prior service costs	105	508	452	892
Settlement cost	1,702	—	1,702	—
Net periodic pension expense	$ 1,753	$ 1,170	$ 2,341	$ 2,220

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8.
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 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 United States 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

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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 CERCLA, RCRA 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 the 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 $7,211 and $7,024 at December 31, 2016, and June 30, 2016, 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.

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 liability, 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.

9.
Derivatives

We monitor our exposure to foreign currency exchange rates and use derivatives (currency option contracts) 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 that 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."

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table details the Company's outstanding derivatives that are designated and effective as cash flow hedges as of December 31, 2016: