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ACETO CORP  
Form 10-K  
September 12, 2006

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

FORM 10-K

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

FOR THE FISCAL YEAR ENDED JUNE 30, 2006  
Commission file number 000-04217  
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ACETO CORPORATION  
(Exact name of registrant as specified in its charter)

New York ----- (State or other jurisdiction of incorporation or organization)	11-1720520 ----- (I.R.S. Employer Identification Number)
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One Hollow Lane, Lake Success, NY 11042  
-----  
(Address of principal executive offices)

(516) 627-6000  
-----  
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12 (b) of the Act:

Common Stock, Par Value \$.01 Per Share ----- (Title of Class)	The NASDAQ Stock Market LLC ----- (Name of each exchange on which registered)
--	--

Securities registered pursuant to Section 12 (g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act.  
Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

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

Yes [ ] No [X]

The aggregate market value of the voting stock of the Company held by non-affiliates of the Company as of December 31, 2005 was approximately \$157,431,224.

The Registrant has 24,281,239 shares of common stock outstanding as of September 1, 2006.

Documents incorporated by reference: The information required in response to Part III of this Annual Report on Form 10-K is hereby incorporated by reference to the specified portions of the Registrant's definitive proxy statement for the annual meeting of shareholders to be held on December 7, 2006.

### ACETO CORPORATION AND SUBSIDIARIES FORM 10-K FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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## PART I

### CAUTIONARY STATEMENT RELATING TO THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K and the information incorporated by reference includes "forward-looking statements" within the meaning of section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend those forward looking-statements to be covered by the safe harbor provisions for forward-looking statements. All statements regarding our expected financial position and operating results, our business strategy, our financing plans and the outcome of any contingencies are forward-looking statements. Any such forward-looking statements are based on current expectations, estimates, and projections about our industry and our business. Words such as "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates," or variations of those words and similar expressions are intended to identify such forward-looking statements. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those stated in or implied by any forward-looking statements. Factors that could cause actual results to differ materially from forward-looking statements include, but are not limited to, unforeseen environmental liabilities, international military conflicts, the mix of products sold and their profit margins, order cancellation or a reduction in orders from customers, the nature and pricing of competing products, the availability and pricing of key raw materials, dependence on key members of management, risks of entering into new European markets, and economic and political conditions in the United States and abroad.

### NOTE REGARDING DOLLAR AMOUNTS

In this Annual Report, all dollar amounts are expressed in thousands, except share prices and per-share amounts.

## ITEM 1. BUSINESS

### GENERAL

Aceto Corporation, together with its consolidated subsidiaries, are referred to herein collectively as "Aceto" "Company", "we", "us", and "our" unless the content indicates otherwise. Aceto was incorporated in 1947 in the State of New York. We are a global distributor of chemically-derived pharmaceuticals, biopharmaceuticals, specialty chemicals and agrochemicals. Our business is organized along product lines into three segments: Health Sciences, Chemicals &

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Colorants and Agrochemicals.

Our Health Sciences division includes active ingredients for generic pharmaceuticals, vitamins, and nutritional supplements, as well as products used in preparing pharmaceuticals, primarily by major innovative drug companies, and biopharmaceuticals.

The products in our Chemicals & Colorants division include a variety of specialty chemicals used in plastics, resins, adhesives, coatings, food, flavor additives, fragrances, cosmetics, metal finishing, electronics, air-conditioning systems and many other areas. Dye and pigment intermediates are used in the color-producing industries such as textiles, inks, paper, and coatings. Organic intermediates are used in the production of agrochemicals.

Our Agrochemicals division includes herbicides, fungicides and insecticides, as well as a sprout inhibitor for potatoes.

Our presence in China, Germany, France, the Netherlands, Singapore, India, Poland, Hong Kong, the United Kingdom and the United States, along with warehouses worldwide, enable us to respond quickly to demands from customers worldwide, assuring that a consistent, high-quality supply of pharmaceutical, biopharmaceutical, specialty chemicals and agrochemicals is readily accessible. We are able to offer our customers competitive pricing, continuity of supply, and quality control. Our 59 years of experience, our reputation for reliability and stability, and our long-term relationships with our suppliers have fostered loyalty among our customers.

We remain confident about our short- and long-term business prospects. In the short-term, we anticipate continued organic growth, entering the developing biopharmaceutical market, globalization of our Chemicals & Colorants business, expansion of our agrochemical segment by acquisition of product lines, continued enhancement of our sourcing operations in China and India, and steady improvement of our regulatory capabilities.

We believe that our track record of continuous product introductions demonstrates that Aceto has come to be recognized by the worldwide generic pharmaceutical industry as an important, reliable supplier. Our long-term plans involve seeking

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strategic acquisitions that enhance our earnings, forming alliances with partners that add to our capabilities, and establishing significant business operations in Eastern Europe.

Information concerning revenue and gross profit attributable to each of our reportable segments is found in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation", and in Note 20 to the Consolidated Financial Statements, Part II, Item 8, "Financial Statements and Supplementary Data."

### PRODUCTS AND CUSTOMERS

During the fiscal years ended June 30, 2006 and 2005, approximately 67% and 68%, respectively, of our purchases were from Asia and approximately 21% and 22%, respectively, were from Europe.

Our customers are located throughout the United States, Europe and Asia. They include a wide range of companies in the industrial chemical, agricultural, and health science industries, and range from small trading companies to Fortune 500 companies. During fiscal years 2006 and 2005, sales made to customers in the

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United States totaled \$157,329 and \$160,123, respectively. Sales made to customers outside the United States during fiscal years 2006 and 2005 totaled \$139,801 and \$153,258, respectively, of which, approximately 53% and 65%, respectively, were to customers located in Europe.

The chemical industry is highly competitive. We compete by offering high-quality products produced around the world by both large and small manufacturers at attractive prices. Because of our long relationship with many suppliers as well as our sourcing offices in China and India, we are able to ensure that any given product is manufactured at a facility that is appropriate for that product. For the most part, we store our inventory of chemicals in public warehouses strategically located throughout the United States, Europe, and Asia, and we can therefore fill orders rapidly from inventory. We have developed ready access to key purchasing, research, and technical executives of our customers and suppliers. This allows us to ensure that when necessary, sourcing decisions can be made quickly.

No single product or customer accounted for as much as 10% of net sales in fiscal years 2006, 2005 or 2004. No single supplier accounted for as much as 10% of purchases in fiscal 2006. Two suppliers accounted for approximately 13% and 12% of purchases in fiscal year 2005, one supplier accounted for approximately 10% of purchases in fiscal year 2004.

We hold no patents, licenses, franchises or concessions that we consider material to our operations.

Our subsidiary Aceto Agricultural Chemicals Corp. ("Aceto Agricultural") markets, and contracts for the manufacture of, certain agricultural chemicals that are subject to the Federal Insecticide, Fungicide and Rodenticide Act ("FIFRA"). Under FIFRA, companies that wish to market pesticides must provide test data to the Environmental Protection Agency ("EPA") to register, obtain and maintain approved labels for those pesticides. The EPA requires that follow-on registrants of these products, on a basis prescribed in the FIFRA regulations, compensate the initial registrant for the cost of producing the necessary test data. Follow-on registrants do not themselves generate or contract for the data. However, when FIFRA requirements mandate that new test data be generated to enable all registrants to continue marketing a pesticide product, often both the initial and follow-on registrants establish a task force to jointly undertake, and pay for, the testing effort. We are currently a member of two such task force groups and historically, our payments have been in the range of \$250 - \$500 per year. We may be required to make such additional payments in the future.

Compliance with federal, state and local environmental regulations has not had a material effect on our capital expenditures and competitive position. Our subsidiary, Arsynco, Inc., a New Jersey corporation ("Arsynco") has environmental remediation obligations in connection with its former manufacturing facility in Carlstadt, New Jersey, which was closed in 1993 and is currently held for sale. During fiscal 2006, based on continued monitoring of the contamination at the site and the current proposed plan of remediation, Arsynco received an estimate from an environmental consultant stating that the costs of remediation could be between \$5,400 and \$6,900. As of June 30, 2006 a liability of \$5,400 is included in the accompanying consolidated balance sheet. In accordance with Emerging Issues Task Force (EITF) Issue 90-8, "Capitalization of Costs to Treat Environmental Contamination" management believes that the majority of costs incurred to remediate the site will be capitalized in preparing the property which is currently classified as held for sale. An appraisal of the fair value of the property by a third-party appraiser supports this assumption. As of June 30, 2005, a liability of \$1,195 was included in the accompanying consolidated balance sheet. It is possible that the assumptions underlying our estimates will be found to be incorrect, in which case the liability could be significantly greater than currently estimated and could have

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a material adverse effect on our financial condition, operating results and cash flows.

In March 2006, also related to the former manufacturing facility in Carlstadt, New Jersey, Arsynco received notice from the Environmental Protection Agency (EPA) of its status as a potentially responsible party ("PRP") under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) for a site described as the Berry's

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Creek Study Area. Arsynco is one of over 150 PRP's which have potential liability for the required investigation and remediation of the site. The estimate of the potential liability is not quantifiable for a number of reasons, including the difficulty in determining the extent of contamination and the length of time remediation may require. In addition, any estimate of liability must also consider the number of other PRP's and their financial strength. Since an amount of the liability can not be reasonably estimated at this time, no accrual is recorded for these potential future costs. The impact of the resolution of this matter on the Company's results of operations in a particular reporting period is not known. Management currently believes, however, that the ultimate outcome of this matter will not have a material adverse effect on the Company's financial condition or liquidity.

### HISTORICAL BUSINESS ACQUISITIONS

We completed two significant transactions in fiscal year 2004. These transactions are consistent with our strategy of seeking strategic acquisitions that enhance earnings and forming alliances with partners that add to our capabilities.

On December 31, 2003, through our wholly owned subsidiary Aceto Holding GmbH ("Aceto Holding"), we acquired all of the capital stock of Pharma Waldhof Beteiligungs GmbH ("Pharma Waldhof") and all of the partnership interest of Pharma Waldhof GmbH & Co. KG. Pharma Waldhof is the general partner of Pharma Waldhof GmbH & Co. KG.

Based in Dusseldorf, Germany, Pharma Waldhof GmbH distributes biologically and chemically derived Active Pharmaceutical Ingredients, or "APIs," used in therapeutic and diagnostic products. It is a worldwide provider of a biologically derived API used in a widely used diagnostic and therapeutic heart medication. Its primary customers include worldwide ethical and generic pharmaceutical companies.

We continued the business of Pharma Waldhof and successfully integrated that business into our business during the second half of fiscal year 2004.

On November 25, 2003, our wholly owned subsidiary Aceto Agricultural formed a joint venture with Nufarm Americas Inc. ("Nufarm"), a subsidiary of Australia-based Nufarm Limited. Each company owns 50% of the joint venture, which is named S.R.F.A., LLC.

Aceto Agricultural and Nufarm have been issued an EPA label for Butoxone(R), an herbicide used on peanuts, soybeans and alfalfa. Aceto Agricultural previously marketed this herbicide under a different label (2,4DB). Aceto Agricultural and Nufarm now market the herbicide in the United States solely under the Butoxone(R) label, which has greater market penetration than 2,4DB. Nufarm continues to formulate the product for the joint venture. S.R.F.A. commenced operations in April 2004. In accordance with FASB Interpretation 46R, "Consolidation of Variable Interest Entities" (FIN 46R), the financial statements of S.R.F.A. are included in the consolidated financial statements of

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Aceto.

This joint venture reflects our strategy for expanding our agrochemical business, which is to partner with large agrochemical manufacturers and distributors to capitalize on the rapid consolidation of the industry. Due to this consolidation, there remain a limited number of significant manufacturers of crop-protection products. We believe this consolidation trend will continue, forcing the large distributors to find alternative sources. We will look to Asian producers to meet our needs in this area.

### EMPLOYEES

At June 30, 2006, we had 216 employees, none of whom were covered by a collective bargaining agreement.

### ITEM 1A. RISK FACTORS

You should carefully consider the following risk factors and other information included in this Annual Report. The risks and uncertainties described below are not the only ones we face. Additionally, risks and uncertainties not currently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risk factors occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

IF WE ARE UNABLE TO COMPETE EFFECTIVELY WITH OUR COMPETITORS, MANY OF WHICH HAVE GREATER MARKET PRESENCE AND RESOURCES THAN US, OUR PROFITABILITY AND FINANCIAL CONDITION WILL BE ADVERSELY AFFECTED.

Our financial condition and operating results are directly related to our ability to compete in the intensely competitive worldwide chemical market. We face intense competition from global and regional distributors of chemical products, many of which are large chemical manufacturers as well as distributors. Many of these companies have substantially greater

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resources than us, including greater financial, marketing and distribution resources. We cannot assure you that we will be able to compete successfully with any of these companies. In addition, increased competition could result in price reductions, reduced margins and loss of market share for our services, all of which would adversely affect our business, results of operations and financial condition.

WE MAY INCUR SIGNIFICANT UNINSURED ENVIRONMENTAL AND OTHER LIABILITIES INHERENT IN THE CHEMICAL DISTRIBUTION INDUSTRY THAT WOULD HAVE A NEGATIVE EFFECT ON OUR FINANCIAL CONDITION.

The business of distributing chemicals is subject to regulation by numerous federal, state, local, and foreign governmental authorities. These regulations impose liability for loss of life, damage to property and equipment, pollution and other environmental damage that may occur in our business. Many of these regulations provide for substantial fines and remediation costs in the event of chemical spills, explosions and pollution. While we believe that we are in substantial compliance with all current laws and regulations, we can give no assurance that we will not incur material liabilities that exceed our insurance coverage or that such insurance will remain available on terms and at rates acceptable to us. Additionally, if existing environmental and other regulations are changed, or additional laws or regulations are passed, the cost of complying with those laws may be substantial, thereby adversely affecting our financial performance.

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Our subsidiary, Arsynco, has environmental remediation obligations in connection with its former manufacturing facility in Carlstadt, New Jersey. Estimates of how much it would cost to remediate environmental contamination at this site have increased since the facility was closed in 1993. If the actual costs are significantly greater than estimated, it could have a material adverse effect on our financial condition, operating results and cash flows.

In March 2006, also related to its former manufacturing facility in Carlstadt, New Jersey, Arsynco received notice from the Environmental Protection Agency (EPA) of its status as a potentially responsible party ("PRP") under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) for a site described as the Berry's Creek Study Area. Arsynco is one of over 150 PRP's which have potential liability for the required investigation and remediation of the site. The estimate of the potential liability is not quantifiable for a number of reasons, including the difficulty in determining the extent of contamination and the length of time remediation may require. In addition, any estimate of liability must also consider the number of other potentially responsible parties and their financial strength. Since an amount of the liability can not be reasonably estimated at this time, no accrual is recorded for these potential future costs. The impact of the resolution of this matter on the Company's results of operations in a particular reporting period is not known. However, management believes that the ultimate outcome of this matter will not have a material adverse effect on the Company's financial condition or liquidity.

ASSESSMENTS BY VARIOUS TAX AUTHORITIES MAY BE MATERIALLY DIFFERENT THAN THE AMOUNTS WE HAVE PROVIDED FOR IN OUR CONSOLIDATED FINANCIAL STATEMENTS.

We are regularly audited by federal, state, and foreign tax authorities. From time to time, these audits may result in proposed assessments. While we believe that we have adequately provided for any such assessments, future settlements may be materially different than we have provided for and thereby adversely affect our earnings and cash flows.

We operate in various tax jurisdictions, and although we believe that we have provided for income and other taxes in accordance with the relevant regulations, if the applicable regulations were ultimately interpreted differently by a taxing authority, we may be exposed to additional tax liabilities.

OUR ACQUISITION STRATEGY IS SUBJECT TO A NUMBER OF INHERENT RISKS, INCLUDING THE RISK THAT OUR ACQUISITIONS MAY NOT BE SUCCESSFUL.

We continually seek to expand our business through acquisitions of other companies that complement our own and through joint ventures, licensing agreements and other arrangements. Any decision regarding strategic alternatives would be subject to inherent risks, and we cannot guarantee that we will be able to identify the appropriate opportunities, successfully negotiate economically beneficial terms, successfully integrate any acquired business, retain key employees, or achieve the anticipated synergies or benefits of the strategic alternative selected. Acquisitions can require significant capital resources and divert our management's attention from our existing business. Additionally, we may issue additional shares in connection with a strategic transaction, thereby diluting the holdings of our existing common shareholders, incur debt or assume liabilities, become subject to litigation, or consume cash, thereby reducing the amount of cash available for other purposes.

ANY ACQUISITION THAT WE MAKE COULD RESULT IN A SUBSTANTIAL CHARGE TO OUR EARNINGS.



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We have previously incurred charges to our earnings in connection with acquisitions, and may continue to experience charges to our earnings for any acquisitions that we make, including large and immediate write-offs of acquired assets, or impairment charges. These costs may also include substantial severance and other closure costs associated with eliminating duplicate or discontinued products, employees, operations and facilities. These charges could have a material adverse effect on our results of operations for particular quarterly periods and they could possibly have an adverse impact on the market price of our common stock.

OUR REVENUE STREAM IS DIFFICULT TO PREDICT.

Our revenue stream is difficult to predict because it is primarily generated as customers place orders and customers can change their requirements or cancel orders. Many of our sales orders are short-term and may be cancelled at any time. As a result, much of our revenue is not recurring from period to period, which contributes to the variability of our results from period to period. We believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance.

OUR OPERATING RESULTS MAY FLUCTUATE IN FUTURE QUARTERS, WHICH MAY ADVERSELY AFFECT THE TRADING PRICE OF OUR COMMON STOCK.

Our operating results will fluctuate on a quarterly basis as a result of a number of factors, including the timing of contracts, the delay or cancellation of a contract, and changes in government regulations. Any one of these factors could have a significant impact on our quarterly results. In some quarters, our revenue and operating results may fall below the expectations of securities analysts and investors, which would likely cause the trading price of our common stock to decline.

FAILURE TO OBTAIN PRODUCTS FROM OUTSIDE MANUFACTURERS COULD ADVERSELY AFFECT OUR ABILITY TO FULFILL SALES ORDERS TO OUR CUSTOMERS.

We rely on outside manufacturers to supply products for resale to our customers. Manufacturing problems may occur with these and other outside sources. If such problems occur, we cannot ensure that we will be able to deliver our products to our customers profitably or on time.

OUR POTENTIAL LIABILITY ARISING FROM OUR COMMITMENT TO INDEMNIFY OUR DIRECTORS, OFFICERS AND EMPLOYEES COULD ADVERSELY AFFECT OUR EARNINGS AND FINANCIAL CONDITION.

We have committed in our bylaws to indemnify our directors, officers and employees against the reasonable expenses incurred by these persons in connection with an action brought against him or her in such capacity, except in matters as to which he or she is adjudged to have breached a duty to us. The maximum potential amount of future payments we could be required to make under this provision is unlimited. While we have a "director and officer" insurance policy that covers a portion of this potential exposure, we may be adversely affected if we are required to pay damages or incur legal costs in connection with a claim above our insurance limits.

OUR BUSINESS MAY BE ADVERSELY AFFECTED BY TERRORIST ACTIVITIES.

Our business depends on the free flow of products and services through the channels of commerce. Instability due to military, terrorist, political and economic actions in other countries could materially disrupt our overseas operations and export sales. In fiscal years 2006 and 2005, approximately 47% and 49%, respectively, of our revenues were attributable to operations conducted abroad and to export sales. In addition, in fiscal year 2006, approximately 67%

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and 21% of our purchases came from Europe and Asia, respectively. In addition, in certain countries where we currently operate or export, intend to operate or export, or intend to expand our operations, we could be subject to other political, military and economic uncertainties, including labor unrest, restrictions on transfers of funds and unexpected changes in regulatory environments.

FLUCTUATIONS IN FOREIGN CURRENCY EXCHANGE RATES MAY ADVERSELY AFFECT OUR RESULTS OF OPERATIONS AND FINANCIAL CONDITION.

A substantial portion of our revenue is denominated in currencies other than the U.S. dollar because certain of our foreign subsidiaries operate in their local currencies. Our results of operations and financial condition may therefore be adversely affected by fluctuations in the exchange rate between foreign currencies and the U.S. dollar.

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WE RELY HEAVILY ON KEY EXECUTIVES FOR OUR FINANCIAL PERFORMANCE.

Our financial performance is highly dependent upon the efforts and abilities of our key executives. The loss of the services of any of our key executives could therefore have a material adverse effect upon our financial position and operating results. None of our key executives has an employment agreement with us and we do not maintain "key-man" insurance on any of our key executives.

VIOLATIONS OF CGMP AND OTHER GOVERNMENT REGULATIONS COULD HAVE A MATERIAL ADVERSE AFFECT ON OUR BUSINESS, FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

All facilities and manufacturing techniques used to manufacture products for clinical use or for commercial sale in the United States must be operated in conformity with current Good Manufacturing Practices ("cGMP") regulations as required by the FDA. Our facilities are subject to scheduled periodic regulatory and customer inspections to ensure compliance with cGMP and other requirements applicable to such products. A finding that we had materially violated these requirements could result in one or more regulatory sanctions, loss of a customer contract, disqualification of data for client submissions to regulatory authorities and a mandated closing of our facilities, which in turn could have a material adverse effect on our business, financial condition and results of operations.

LITIGATION MAY HARM OUR BUSINESS AND OUR MANAGEMENT AND FINANCIAL RESOURCES.

Substantial, complex or extended litigation could cause us to incur large expenditures and could distract our management. For example, lawsuits by employees, stockholders, collaborators, distributors, customers, or end-users of our products or services could be very costly and substantially disrupt our business. Disputes from time to time with such companies or individuals are not uncommon, and we cannot assure you that we will always be able to resolve such disputes out of court or on favorable terms.

THE MARKET PRICE OF OUR STOCK COULD BE VOLATILE.

The market price of our common stock has been subject to volatility and may continue to be volatile in the future, due to a variety of factors, including:

- o quarterly fluctuations in our operating income and earnings per share results
- o technological innovations or new product introductions by us or our competitors
- o economic conditions

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- o disputes concerning patents or proprietary rights
- o changes in earnings estimates and market growth rate projections by market research analysts
- o sales of common stock by existing security holders
- o loss of key personnel
- o securities class actions or other litigation

The market price for our common stock may also be affected by our ability to meet analysts' expectations. Any failure to meet such expectations, even slightly, could have an adverse effect on the market price of our common stock. In addition, the stock market is subject to extreme price and volume fluctuations. This volatility has had a significant effect on the market prices of securities issued by many companies for reasons unrelated to the operating performance of these companies.

INCIDENTS RELATED TO HAZARDOUS MATERIALS COULD ADVERSELY AFFECT OUR BUSINESS.

Portions of our operations require the controlled use of hazardous materials. Although we are diligent in designing and implementing safety procedures to comply with the standards prescribed by federal, state, and local regulations, the risk of accidental contamination of property or injury to individuals from these materials cannot be completely eliminated. In the event of such an incident, we could be liable for any damages that result, which could adversely affect our business.

THERE ARE INHERENT UNCERTAINTIES INVOLVED IN ESTIMATES, JUDGMENTS AND ASSUMPTIONS USED IN PREPARING FINANCIAL STATEMENTS IN ACCORDANCE WITH U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES. ANY CHANGES IN THE ESTIMATES, JUDGMENTS AND ASSUMPTIONS WE USE COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR FINANCIAL POSITION AND RESULTS OF OPERATIONS.

The consolidated financial statements included in the periodic reports we file with the SEC are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). Preparing financial statements in accordance with GAAP involves

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making estimates, judgments and assumptions that affect reported amounts of assets, liabilities, revenues, expenses and income. Estimates, judgments and assumptions are inherently subject to change, and any such changes could result in corresponding changes to the reported amounts.

FAILURE TO MAINTAIN EFFECTIVE INTERNAL CONTROLS IN ACCORDANCE WITH SECTION 404 OF THE SARBANES-OXLEY ACT COULD HAVE AN ADVERSE EFFECT ON OUR BUSINESS AND STOCK PRICE.

Section 404 of the Sarbanes-Oxley Act requires us to evaluate annually the effectiveness of our internal controls over financial reporting as of the end of each fiscal year and to include a management report assessing the effectiveness of our internal controls over financial reporting in our annual report. Section 404 also requires our independent registered public accounting firm to attest to, and report on, management's assessment of our internal controls over financial reporting. If we fail to maintain the adequacy of our internal controls, we cannot assure you that we will be able to conclude in the future that we have effective internal controls over financial reporting. If we fail to maintain effective internal controls, we might be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission or NASDAQ. Any such action could adversely affect our financial results and the market price of our common stock and may also result in delayed filings with the Securities and Exchange Commission.

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### AVAILABLE INFORMATION

We file annual, quarterly, and current reports, proxy statements, and other information with the U.S. Securities and Exchange Commission. You may read and copy any document we file at the SEC's public reference room at Room 1024, 450 Fifth Street, NW, Washington, D.C. 20549. You may call the SEC at 1-800-SEC-0330 for information on the public reference room. The SEC maintains a website that contains annual, quarterly, and current reports, proxy statements, and other information that issuers (including Aceto) file electronically with the SEC. The SEC's website is [WWW.SEC.GOV](http://WWW.SEC.GOV).

Our website is [WWW.ACETO.COM](http://WWW.ACETO.COM). We make available free of charge through our Internet site, via a link to the SEC's website at [WWW.SEC.GOV](http://WWW.SEC.GOV), our annual reports on Form 10-K; quarterly reports on Form 10-Q; current reports on Form 8-K; Forms 3, 4 and 5 filed on behalf of our directors and executive officers; and any amendments to those reports and forms. We make these filings available as soon as reasonably practicable after they are electronically filed with, or furnished to, the SEC. The information on our website is not incorporated by reference into this Annual Report.

### ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

### ITEM 2. PROPERTIES

Our general headquarters and main sales office occupy approximately 26,000 gross square feet of leased space in an office building in Lake Success, New York. The lease expires in April 2011.

Arsynco's former manufacturing facility is located on a 12-acre parcel in Carlstadt, New Jersey, that it owns. This parcel contains one building with approximately 5,000 gross square feet of office space.

In November 2004, we purchased approximately 1,300 gross square meters of office space located in Shanghai, China for our sales offices and investment purposes.

We also lease office space in Hamburg, Germany; Dusseldorf, Germany; Heemskerk, the Netherlands; Paris, France; Lyon, France; Singapore; Warsaw, Poland and Mumbai, India. These offices are used for sales and administrative purposes.

We believe that our properties are generally well maintained, in good condition and adequate for our present needs.

### ITEM 3. LEGAL PROCEEDINGS.

We are subject to various claims that have arisen in the normal course of business. We do not know what impact the final resolution of these matters will have on our results of operations in a particular reporting period. We believe, however, that the ultimate outcome of such matters will not have a material adverse effect on our financial condition or liquidity.

In March 2006, Arsynco received notice from the Environmental Protection Agency (EPA) of its status as a potentially responsible party ("PRP") under the Comprehensive Environmental Response, Compensation and Liability Act

(CERCLA) for a site described as the Berry's Creek Study Area. Arsynco is one of over 150 PRP's which have potential liability for the required investigation and

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remediation of the site. The estimate of the potential liability is not quantifiable for a number of reasons, including the difficulty in determining the extent of contamination and the length of time remediation may require. In addition, any estimate of liability must also consider the number of other potentially responsible parties and their financial strength. Since an amount of the liability can not be reasonably estimated at this time, no accrual is recorded for these potential future costs. The impact of the resolution of this matter on the Company's results of operations in a particular reporting period is not known. However, management currently believes that the ultimate outcome of this matter will not have a material adverse effect on the Company's financial condition or liquidity.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matter was submitted to a vote of our security holders during the fourth quarter of the fiscal year covered by this Annual Report.

## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Our common stock is traded on the NASDAQ Stock Market LLC using the symbol "ACET." The following table states the fiscal year 2006 and 2005 high and low sales prices of our common stock as reported by the NASDAQ Stock Market LLC for the periods indicated, adjusted for a 3-for-2 stock split, effected in the form of a dividend, paid in January 2005.

	HIGH	LOW
FISCAL YEAR 2006		
First Quarter	\$ 8.20	\$ 5.49
Second Quarter	6.96	5.64
Third Quarter	7.70	6.44
Fourth Quarter	8.36	6.33
FISCAL YEAR 2005		
First Quarter	\$11.84	\$ 8.99
Second Quarter	13.33	8.79
Third Quarter	13.19	7.36
Fourth Quarter	8.05	6.53

Cash dividends of \$0.075 per common share were paid in January and June of fiscal years 2006 and 2005. Cash dividends of \$0.056 per common share were paid in January and June of fiscal year 2004. Our revolving credit facility restricts the payment of cash dividends to \$4,500 per year.

As of September 1, 2006, there were 530 holders of record of our common stock.

22,006 shares were held by the nominee of the Depository Trust Company, the country's principal central depository. For purposes of determining the number of owners of our common stock, those shares are considered to be owned by one holder. Additional individual holdings in street name result in a sizable number of beneficial owners being represented on our records as owned by various banks and stockbrokers.

The following table states certain information with respect to our equity compensation plans at June 30, 2006:

	Number of securities to	Weighted-average	Number remainin
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Plan category	be issued upon exercise of outstanding options	exercise price of outstanding options	future equity c
Equity compensation plans approved by security holders	2,743	\$ 7.62	
Equity compensation plans not approved by security holders	-	-	
Total	2,743	\$ 7.62	

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## ITEM 6. SELECTED FINANCIAL DATA (In thousands, except per-share amounts)

Fiscal Years Ended June 30,	2006	2005	2004 (1)	2003
Net sales	\$297,130	\$313,381	\$296,359	\$269,961
Operating income	11,973	11,540	16,118	13,027
Income from continuing operations	9,264	10,625	13,111	9,522
Net income (2)	9,237	10,015	13,067	7,595
At Year End				
Working capital	\$104,707	\$ 94,249	\$ 86,420	\$ 72,208
Total assets	166,592	149,028	149,697	123,519
Long-term liabilities	15,140	3,982	2,877	1,043
Shareholders' equity	115,053	107,655	100,266	84,569
Per Diluted Common Share (3)				
Income from continuing operations	\$ 0.38	\$ 0.43	\$ 0.53	\$ 0.40
Net income	\$ 0.38	\$ 0.41	\$ 0.53	\$ 0.32
Cash dividends	\$ 0.15	\$ 0.15	\$ 0.11	\$ 0.10

- (1) Includes the acquisition of Pharma Waldhof on December 31, 2003, as more fully described in Item 1.
- (2) Fiscal 2003 net income includes a \$1,873 (\$0.08 per diluted common share) charge for a cumulative effect of an accounting change resulting from an impairment of goodwill.
- (3) Adjusted for stock splits, effected in the form of dividends, as appropriate.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

### EXECUTIVE SUMMARY

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We are reporting a \$433 increase in operating profit to \$11,973 for the year ended June 30, 2006 as compared to \$11,540 for the prior year. This increase in operating profit was achieved, despite a highly competitive environment, primarily through maintaining our profit margin and our successful management of selling, general and administrative costs, which decreased \$2,775 in fiscal 2006 as compared to fiscal 2005. Net sales for fiscal 2006 were \$297,130, a decrease of \$16,251 from fiscal 2005. This decline in net sales also negatively impacted our gross profit, which decreased \$2,342 to \$50,759 for fiscal 2006. Our net income decreased to \$9,237, or \$0.38 per diluted share, a decrease of \$778 compared to fiscal year 2005.

Our financial position as of June 30, 2006, remains strong, as we had cash and short-term investments of \$37,041, working capital of \$104,707, no long-term debt and shareholders' equity of \$115,053.

Our business is separated into three principal segments: Health Sciences, Chemicals & Colorants and Agrochemicals.

The Health Sciences segment is our largest segment both in sales and gross profits. This segment is comprised of APIs, pharmaceutical intermediates, diagnostic chemicals, biopharmaceuticals and nutritional supplements. We typically partner with both customers and suppliers years in advance of a drug coming off patent to provide the generic equivalent.

We have a pipeline of new and second source generic products poised to reach commercial levels over the coming years as the patents on existing drugs expire, both in the United States and Europe. In addition, as new members join the European Union, primarily from Eastern Europe, they become subject to the same regulatory standards as their Western European counterparts. Given our regulatory expertise, we believe that this represents an opportunity for us, and we believe we are well positioned to take advantage of that opportunity.

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The Chemicals & Colorants segment supplies chemicals used in the color-producing industries such as the textiles, ink, paper and coatings industries, as well as chemicals used in plastic, resins, adhesives, coatings, food, flavor additives, and the production of agrochemicals. Our customers for these products are predominantly located in the United States, and we purchase the products primarily from manufacturers located in China and Western Europe.

The Agrochemicals segment, while relatively small in terms of sales, is our most profitable in terms of gross margin percentages. This segment sells herbicides, pesticides, and other agricultural chemicals to customers primarily located in the United States and Western Europe. Our joint venture with Nufarm, which markets Butoxone (R), is expected to increase our market share of the peanut, soybean and alfalfa herbicide markets.

We formerly also reported under the Institutional Sanitary Supplies segment, which included cleaning solutions, fragrances and deodorants for commercial and industrial customers. This former segment was successfully divested from our ongoing business during fiscal 2006.

Our main strengths are sourcing, regulatory support and quality control. We are currently the largest buyer of pharmaceutical and specialty chemicals for export from China, purchasing from over 500 different factories.

In this section, we explain our general financial condition and results of operations, including the following:

- o factors that affect our business

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- o our earnings and costs in the periods presented
- o changes in earnings and costs between periods
- o sources of earnings
- o the impact of these factors on our overall financial condition

As you read this section, refer to the accompanying consolidated statements of income, which present the results of our operations for the three years ended June 30, 2006. We analyze and explain the differences between periods in the specific line items of the consolidated statements of income.

### CRITICAL ACCOUNTING ESTIMATES AND POLICIES

This discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. In preparing these financial statements, we were required to make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We regularly evaluate our estimates including those related to allowances for bad debts, inventories, goodwill and intangible assets, environmental and other contingencies, and income taxes. We base our estimates on various factors, including historical experience, advice from outside subject-matter experts, and various assumptions that we believe to be reasonable under the circumstances, which together form the basis for our making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We believe the following critical accounting policies affected our more significant judgments and estimates used in preparing these consolidated financial statements.

### REVENUE RECOGNITION

We recognize revenue from sales of any product when it is shipped and title and risk of loss pass to the customer. We have no acceptance or other post-shipment obligations and we do not offer product warranties or services to our customers.

Sales are recorded net of returns of damaged goods from customers, which historically have been immaterial, and sales incentives offered to customers. Sales incentives consist primarily of volume incentive rebates. We record volume incentive rebates as the underlying revenue transactions that result in progress by the customer in earning the rebate are recorded, in accordance with Emerging Issues Task Force (EITF) 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)."

### ALLOWANCE FOR DOUBTFUL ACCOUNTS

We maintain allowances for doubtful accounts relating to estimated losses resulting from customers being unable to make required payments. Allowances for doubtful accounts are based on historical experience and known factors regarding

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specific customers and the industries in which those customers operate. If the financial condition of our customers were to deteriorate, resulting in their ability to make payments being impaired, additional allowances would be required.

### INVENTORIES

Inventories, which consist principally of finished goods, are stated at the



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lower of cost (first-in first-out method) or market. We write down our inventories for estimated excess and obsolete goods by an amount equal to the difference between the carrying cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions. A significant sudden increase in demand for our products could result in a short-term increase in the cost of inventory purchases, while a significant decrease in demand could result in an increase in the excess inventory quantities on-hand. Additionally, we may overestimate or underestimate the demand for our products which would result in our understating or overstating, respectively, the write-down required for excess and obsolete inventory. Although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand could have a significant impact on the value of our inventory and reported operating results.

### GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is calculated as the excess of the cost of purchased businesses over the value of their underlying net assets. Other intangible assets principally consist of customer relationships, trademarks, EPA registration, patent license and covenants not to compete. Goodwill and other intangible assets that have an indefinite life are not amortized.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," we test goodwill and other intangible assets for impairment on at least an annual basis. To determine the fair value of these intangible assets, we use many assumptions and estimates that directly impact the results of the testing. In making these assumptions and estimates, we use industry-accepted valuation models and set criteria that are reviewed and approved by various levels of management. Additionally, we use as necessary, an outside valuation firm to help us evaluate recorded goodwill. If our estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets.

### ENVIRONMENTAL AND OTHER CONTINGENCIES

We establish accrued liabilities for environmental matters and other contingencies when it is probable that a liability has been incurred and the amount of the liability can reasonably be estimated. If the contingency is resolved for an amount greater or less than the accrual, or our share of the contingency increases or decreases, or other assumptions relevant to the development of the estimate were to change, we would recognize an additional expense or benefit in income in the period that the determination was made.

### TAXES

We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." SFAS No. 109 establishes financial accounting and reporting standards for the effects of income taxes that result from an enterprise's activities during the current and preceding years. It requires an asset-and-liability approach to financial accounting and reporting of income taxes.

As of June 30, 2006, we had current net deferred tax assets of \$2,533 and non-current net deferred tax assets of \$4,027. These net deferred tax assets have been recorded based on our projecting that we will have sufficient future earnings to realize these assets, and the net deferred tax assets have been provided for at currently enacted income tax rates. If we determine that we will not be able to realize a deferred tax asset, an adjustment to the deferred tax asset will result in a reduction of net income at that time.

Deferred taxes have not been provided on undistributed earnings of foreign subsidiaries since substantially all of these earnings are expected to be

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permanently reinvested in our foreign operations. A deferred tax liability will be recognized when we expect that we will recover those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. Determination of the amount of the unrecognized U.S. income tax liability is not practical because of the complexities of the hypothetical calculation. In addition, unrecognized foreign tax credit carryforwards would be available to reduce a portion of such U.S. tax liability.

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### STOCK-BASED COMPENSATION

With the adoption of SFAS No. 123(R) on July 1, 2005, we are required to record the fair value of stock-based compensation awards as an expense. In order to determine the fair value of stock options on the date of grant, we apply the Black-Scholes option-pricing model, including an estimate of forfeitures. Inherent in this model are assumptions related to expected stock-price volatility, option term, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions that are based on factual data derived from public sources, the expected stock-price volatility and option term assumptions require a greater level of judgment which makes them critical accounting estimates.

We use an expected stock-price volatility assumption that is based on the historical daily price changes of the underlying stock which are obtained from public data sources. For stock option grants issued during fiscal 2006, we used an expected stock-price volatility of 50% based upon the historical volatility at the time of issuance. With regard to the weighted-average option term assumption, for stock option grants issued during fiscal 2006, we used an expected option term assumption of 5.5 years as determined under the "simplified" method prescribed in SEC Staff Accounting Bulletin ("SAB") No. 107.

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### RESULTS OF OPERATIONS

FISCAL YEAR ENDED JUNE 30, 2006 COMPARED TO FISCAL YEAR ENDED JUNE 30, 2005

			NET SALES BY SEGMENT		
			Year ended June 30,		
	2006		2005		Com Over
Segment	Net Sales	% of Total	Net Sales	% of Total	\$ Change
Health Sciences	\$166,695	56.1%	\$184,560	58.9%	\$ (17,865)
Chemicals & Colorants	110,701	37.3	104,744	33.4	5,957
Agrochemicals	19,734	6.6	20,031	6.4	(297)
Institutional Sanitary Supplies	-	-	4,046	1.3	(4,046)
Net sales	\$297,130	100.0%	\$313,381	100.0%	\$ (16,251)

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## GROSS PROFIT BY SEGMENT Year ended June 30,

Segment	2006		2005		Com Ove
	Gross Profit	% of Sales	Gross Profit	% of Sales	\$ Change
Health Sciences	\$ 32,283	19.4%	\$ 32,869	17.8%	\$ (586)
Chemicals & Colorants	16,975	15.3	17,224	16.4	(249)
Agrochemicals	4,760	24.1	6,719	33.5	(1,959)
Institutional Sanitary Supplies	-	-	696	17.2	(696)
Segment gross profit	54,018	18.2	57,508	18.3	(3,490)
Freight and storage costs (1)	(3,259)	(1.1)	(4,407)	(1.4)	1,148
Gross profit	\$ 50,759	17.1%	\$ 53,101	16.9%	\$ (2,342)

(1) Represents certain freight and storage costs that are not allocated to a segment.

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## NET SALES

Net sales decreased \$16,251, or 5.2%, to \$297,130 for the year ended June 30, 2006, compared with \$313,381 for the prior year. We reported sales decreases in our Health Sciences and Agrochemicals segments, which were partially offset by a sales increase in our Chemicals & Colorants segment.

## HEALTH SCIENCES

Net sales for the Health Sciences segment decreased by \$17,865 for the year ended June 30, 2006, to \$166,695, which represents a 9.7% decrease over net sales of \$184,560 for the prior year. The sales decrease from the prior period is directly attributable to the loss of foreign business of \$16,716 from two previously launched APIs due to increased competition. The fiscal 2006 results, net of the two lost APIs, include a sales reduction of \$2,243 from our foreign operations which was partially offset by a sales increase of \$1,162 from our domestic operations over the prior fiscal year.

## CHEMICALS & COLORANTS

Net sales for the Chemicals & Colorants segment were \$110,701 for the year ended June 30, 2006, compared to \$104,744 for the prior year. This increase of \$5,957, or 5.7%, over the prior period is primarily attributable to an increase in the agricultural intermediate, food, beverage and cosmetics and coatings product groups of \$7,650 as compared to fiscal 2005. Our chemical business is diverse in terms of products, customers and consuming markets. One customer within our color-pigment and pigment-intermediate business purchased \$3,515 less product during fiscal 2006 as their contract had expired. This reduction was more than offset by an increase over the prior period in domestic sales of our diverse chemical and colorants offerings. In addition, net sales includes a \$1,783 increase relating to our former CDC business, primarily from sales of the

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Anti-Clog product we retained.

### AGROCHEMICALS

Net sales for the Agrochemicals segment decreased to \$19,734 for the year ended June 30, 2006, a decrease of \$297, or 1.5%, over net sales of \$20,031 for the prior year. This decline over the prior year was primarily due to dry weather conditions shortening the agricultural selling season, for our second largest product.

### GROSS PROFIT

Gross profit by segment before unallocated cost of sales (primarily storage and certain freight costs) decreased \$3,490 to \$54,018 (18.2% of net sales) for the year ended June 30, 2006, as compared to \$57,508 (18.3% of net sales) for the prior year.

### HEALTH SCIENCES

Health Sciences' gross profit of \$32,283 for the year ended June 30, 2006, was \$586 or 1.8% lower than the prior year. This decrease in gross profit was directly attributable to the loss of business on two larger previously-launched APIs in Asia of \$2,373 due to significant competitive pressures as well as a decrease in our foreign business, net of the two APIs, of \$499. This lost gross profit was partially offset by an increase in gross profit from sales increases from our domestic business of \$1,087 over the prior fiscal year. The gross margin increased to 19.4% in fiscal 2006 compared to a gross margin of 17.8% for the prior fiscal year due primarily to a shift in the product mix of net sales to higher margin products during the 2006 fiscal year.

### CHEMICALS & COLORANTS

Gross profit for the year ended June 30, 2006, decreased by \$249, or 1.4%, over the prior year. Gross margin decreased from 16.4% in fiscal 2005 to 15.3% in fiscal 2006. Decreases in categories such as organic chemicals and chemical intermediates in terms of both volume and margins were the primary reasons for these decreases. In addition, the decrease in gross margin percentage was partly attributable to an increased allocation of certain freight and storage costs.

### AGROCHEMICALS

Gross profit for the Agrochemicals segment decreased to \$4,760 for the year ended June 30, 2006, versus \$6,719 for the prior year, a decrease of \$1,959 or 29.2%. Gross margin decreased from 33.5% in fiscal 2005 to 24.1% in fiscal 2006. The primary cause of the decrease was lower royalty payments from our foreign customers of \$652 and lower gross margins on

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our second highest volume product compared to the prior fiscal year of \$416. The gross profits and margins were also negatively affected by higher costs associated with maintaining our EPA registered products and increased rebate expenses of \$339.

### UNALLOCATED FREIGHT AND STORAGE COSTS

Unallocated cost of sales decreased \$1,148, to \$3,259 in fiscal 2006, compared to \$4,407 in the prior year, representing a 26.0% decrease. The lower costs were mainly a result of decreased sales and shipments to customers. In addition, certain system improvements allow previously unallocated costs to be identifiable and included in a particular segment.

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### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses ("SG&A") decreased \$2,775, or 6.7%, to \$38,786 for the year ended June 30, 2006 compared to \$41,561 for the prior year. As a percentage of sales, SG&A remained stable at 13.1% for fiscal 2006 versus 13.3% for fiscal 2005. The decrease in SG&A was primarily due to a \$1,405 decrease in expenses for our former CDC business, reduced legal fees of \$878, a reduction in audit and Sarbanes-Oxley compliance costs of \$428 and reduced sales and marketing related expenses of \$638. These expense reductions were partially offset by a \$537 charge for a settlement of legal claims against one of our subsidiaries.

### OPERATING INCOME

Fiscal 2006 operating income was \$11,973 compared to \$11,540 in the prior year, an increase of \$433 or 3.8%. This increase was due to the \$2,775 decrease in SG&A expenses, which was partially offset by the overall decrease in gross profit of \$2,342.

### INTEREST AND OTHER INCOME (EXPENSE)

Interest and other income was \$1,412 for fiscal 2006, which represents a 6.9% increase from \$1,321 in fiscal 2005. The increase is primarily attributable to an increase of \$208 in interest income, a government subsidy paid annually for doing business in a free trade zone in Shanghai, China of \$104, proceeds from credit insurance of \$211 and the sale of distribution rights for a particular product in certain European countries of \$133, partially offset by a net loss on foreign currency of \$537.

### PROVISION FOR INCOME TAXES

The effective tax rate for fiscal 2006 increased to 30.1% from 16.9% for fiscal 2005. The effective tax rate for fiscal 2005 included the recognition of certain deferred tax assets for foreign net operating loss carryforwards, which previously were fully offset by a valuation allowance in the amount of \$1,263. Excluding the recognition of the deferred tax assets, the effective tax rate for fiscal 2005 would have been 26.8%. The increase in the effective tax rate relates primarily to increased earnings in foreign tax jurisdictions with higher tax rates, primarily Germany.

### DISCONTINUED OPERATIONS

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," the results of operations for one of the subsidiaries forming part of the Institutional Sanitary Supplies segment have been recorded as discontinued operations in the accompanying consolidated statements of income. The net loss from discontinued operations was \$27, \$610 and \$44 for the fiscal years ended 2006, 2005 and 2004, respectively. The net loss from discontinued operations for the fiscal year ended 2005 includes a non-cash write-down of goodwill, net of an income tax benefit, of \$570.

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### RESULTS OF OPERATIONS

FISCAL YEAR ENDED JUNE 30, 2005 COMPARED TO FISCAL YEAR ENDED JUNE 30, 2004

NET SALES BY SEGMENT

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Year ended June 30,

Segment	2005		2004		Compa Over/ (
	Net Sales	% of Total	Net Sales	% of Total	\$ Change
Health Sciences	\$184,560	58.9%	\$180,701	61.0%	\$ 3,859
Chemicals & Colorants	104,744	33.4	94,395	31.8	10,349
Agrochemicals	20,031	6.4	16,898	5.7	3,133
Institutional Sanitary Supplies	4,046	1.3	4,365	1.5	(319)
Net sales	\$313,381	100.0%	\$296,359	100.0%	\$ 17,022

GROSS PROFIT BY SEGMENT  
Year ended June 30,

Segment	2005		2004		Compa Over/ (
	Gross Profit	% of Sales	Gross Profit	% of Sales	\$ Change
Health Sciences	\$ 32,869	17.8%	\$ 33,821	18.7%	\$ (952)
Chemicals & Colorants	17,224	16.4	15,303	16.2	1,921
Agrochemicals	6,719	33.5	5,503	32.6	1,216
Institutional Sanitary Supplies	696	17.2	1,288	29.5	(592)
Segment gross profit	57,508	18.3	55,915	18.9	1,593
Freight and storage costs (1)	(4,407)	(1.4)	(3,503)	(1.2)	(904)
Gross profit	\$ 53,101	16.9%	\$ 52,412	17.7%	\$ 689

(1) Represents certain freight and storage costs that are not allocated to a segment.

NET SALES

Net sales increased \$17,022, or 5.7%, to \$313,381 for the year ended June 30, 2005, compared with \$296,359 for the prior year. We reported sales increases in our three largest segments, as explained below.

HEALTH SCIENCES

Net sales for the Health Sciences segment increased by \$3,859 for the year ended June 30, 2005, to \$184,560, which represents a 2.1% increase over net sales of

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\$180,701 for the prior year. Several factors contributed to the net increase in net sales in the Health Sciences segment. The Pharma Walldorf business, which we acquired on December 31, 2003, contributed \$5,354 towards the sales increase. Domestic sales of Health Science products increased \$7,942 during fiscal year 2005 as compared to the prior year, partly due to sales of pharmaceutical intermediates increasing by \$4,649, or 75.1% compared to the prior year. The large increase in sales of pharmaceutical intermediates reflects the change in attitude by some of the larger pharmaceutical companies towards securing a second, lower-cost supplier in Asia. We believe that sales of this product line will continue to increase. The European and Asian market (excluding Pharma Walldorf) recorded a net decrease in sales of \$9,437 as compared to the prior year. Contributing to the net decline in Asian sales was the \$16,923 decrease in sales of two previously launched APIs due to increased competition. This decrease was partially offset by a \$5,867 increase in sales of two relatively new products over last year.

### CHEMICALS & COLORANTS

Net sales for the Chemicals & Colorants segment was \$104,744 for the year ended June 30, 2005, compared to \$94,395 for the prior year. This increase of \$10,349, or 11.0%, over the prior year is partially attributable to a steady increase in the number of products being offered by our foreign subsidiaries. Sales of Chemicals & Colorants products by our foreign subsidiaries for the year ended June 30, 2005, showed an increase of \$4,681 over the prior year. Our chemical business is diverse in terms of products, customers and consuming markets. One customer within our color-pigment and pigment-intermediate business purchased \$5,010 less product during fiscal year 2005. This reduction was more than offset by a \$10,678 increase over the prior year in domestic sales of our industrial chemical offerings, in particular products with increased sales were polymer additives, agricultural intermediates, and coatings.

### AGROCHEMICALS

Net sales for the Agrochemical segment increased to \$20,031 for the year ended June 30, 2005, an increase of \$3,133, or 18.5%, over net sales of \$16,898 for the prior year. The increase in net sales was attributable to higher sales of our two highest-volume products.

### GROSS PROFIT

Gross profit by segment before unallocated cost of sales (primarily storage and certain freight costs) increased \$1,593 to \$57,508 (18.3% of net sales) for the year ended June 30, 2005, as compared to \$55,915 (18.9% of net sales) for the prior year.

### HEALTH SCIENCES

Health Sciences' gross profit of \$32,869 for the year ended June 30, 2005, was \$952 or 2.8% lower than the prior year. The gross margin decreased to 17.8% compared to a gross margin of 18.7% for the prior year. This decrease is primarily attributed to the lower-than-normal API gross margin of 8% realized on a relaunched antibiotic and a shift in product mix to pharmaceutical intermediates, which generally have lower margins than APIs. Additionally, two of our larger previously-launched APIs in Europe and Asia have experienced significant pricing pressures, which further affected our gross profit and gross margin. We expect pricing pressures on previously launched APIs to continue in the short-term.

### CHEMICALS & COLORANTS

Gross profit for the year ended June 30, 2005, increased by \$1,921, or 12.6%, over the prior year. Gross profit for fiscal year 2004 included a favorable

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adjustment of \$450 due to the reversal of an accrual for the estimated loss of a purchase contract. Excluding this adjustment, gross profit would have increased by \$2,371, or 16.0%. Excluding the adjustment, the segment would have shown improved margins of 16.4% versus 15.7% for the prior year. Contributions from categories such as

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polymer additives, agricultural intermediates and coatings, in addition to improved sales volume and margins in the European markets, were the primary reasons for this improvement. The increase in gross margin percentage was caused by a decrease in sales to one major customer whose sales had generated lower margins than usual, along with an improvement in margins across other categories due to changes in product mix and, in some cases, improved product pricing.

### AGROCHEMICALS

Gross profit for the Agrochemicals segment increased to \$6,719 for the year ended June 30, 2005, versus \$5,503 for the prior year, an increase of \$1,216 or 22.1%. This increase resulted from a large increase in sales of our two highest volume products, improved royalty income of one existing product, and a price increase in another product.

Unallocated cost of sales increased \$904, to \$4,407 in fiscal 2005, compared to \$3,503 in the prior year, representing a 25.8% increase. The higher costs were mainly a result of higher freight costs due to rising fuel surcharges and increased sales and shipments to customers.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses ("SG&A") increased \$5,267, or 14.5%, to \$41,561 for the year ended June 30, 2005 compared to \$36,294 for the prior year. As a percentage of sales, SG&A increased to 13.3% for fiscal 2005 versus 12.2% for fiscal 2004. This increase was primarily due to the inclusion of \$1,131 of expenses of Pharma Waldhof, which was acquired in December 2003, additional increases in costs of \$762 for new business-development initiatives (including new personnel), an asset impairment charge of \$619 relating to our Institutional Sanitary Supplies segment, additional legal fees in our Agricultural business of \$322, increased fees associated with the planning and pre-implementation efforts of a new enterprise-resource-planning, or "ERP," system of \$382, an increase in fees relating to our audit services and compliance with our obligations under section 404 of the Sarbanes-Oxley Act of \$754, and increased compensation and related fringe-benefit costs of \$1,242.

### OPERATING INCOME

In fiscal year 2005 operating income was \$11,540 compared to \$16,118 in the prior year, a decrease of \$4,578 or 28.4%. This decrease was due to the \$5,267 increase in SG&A expenses, which was partially offset by the overall increase in gross profit of \$689.

### INTEREST AND OTHER INCOME (EXPENSE)

Interest and other income of \$1,321 for fiscal year 2005 represents a slight decrease from \$1,334 in fiscal 2004. The decrease is primarily attributable to a reduction in miscellaneous income of \$234, which was partially offset by a decrease of \$143 for minority interest and an increase in the government subsidy we receive for doing business in a free-trade zone in Shanghai, China in the amount of \$62.

### PROVISION FOR INCOME TAXES



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The effective tax rate for fiscal year 2005 decreased to 16.9% from 24.4% for fiscal year 2004. The decrease in the effective tax rate was primarily due to recognition of certain deferred tax assets for foreign net operating loss carryforwards, which previously were fully offset by a valuation allowance in the amount of \$1,263, partially offset by increased earnings in foreign tax jurisdictions with higher tax rates, primarily Germany.

### DISCONTINUED OPERATIONS

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," the results of operations for one of the subsidiaries forming part of the Institutional Sanitary Supplies segment have been recorded as discontinued operations in the accompanying consolidated statements of income. The net loss from discontinued operations was \$610, \$44 and \$54 for the fiscal years ended 2005, 2004 and 2003, respectively. The net loss from discontinued operations for the fiscal year ended 2005 includes a non-cash write-down of goodwill, net of an income tax benefit, of \$570.

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### LIQUIDITY AND CAPITAL RESOURCES

#### CASH FLOWS

At June 30, 2006, we had \$33,732 in cash, \$3,309 in short-term investments and no outstanding bank loans. Working capital was \$104,907 at June 30, 2006, versus \$94,249 at June 30, 2005.

Our cash position at June 30, 2006, increased \$13,782 from the amount at June 30, 2005. Operating activities provided cash of \$16,154, primarily from net income of \$9,237 and a decrease in inventory of \$4,909.

Investing activities provided cash of \$1,261, primarily as a result of proceeds from the sale of investments of \$1,739. This was partially offset by \$551 of expenditures for property and equipment. We expect capital expenditures will be between \$1,000 and \$1,500 during fiscal 2007.

Financing activities used cash of \$4,009 primarily as a result of payments of cash dividends of \$3,637 and payments for purchases of treasury stock of \$581.

#### CREDIT FACILITIES

We have available credit facilities with certain foreign financial institutions. These facilities provide us with a line of credit of \$18,512, which was not utilized as of June 30, 2006. We are not subject to any financial covenants under these arrangements.

We have a revolving credit agreement with a financial institution that expires June 30, 2007, and provides for available credit of \$10,000. At June 30, 2006, we had utilized \$1,349 in letters of credit, leaving \$8,651 of this facility unused. Under the credit agreement, we may obtain credit through direct borrowings and letters of credit. Our obligations under the credit agreement are guaranteed by certain of our subsidiaries and are secured by 65% of the capital of certain of our non-domestic subsidiaries. There is no borrowing base on the credit agreement. Interest under the credit agreement is at LIBOR plus 1.50%. The credit agreement contains several covenants requiring, among other things, minimum levels of debt service and tangible net worth. We are also subject to certain restrictive debt covenants, including covenants governing liens, limitations on indebtedness, limitations on cash dividends, guarantees, sale of assets, sales of receivables, and loans and investments. We were in compliance

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with all covenants at June 30, 2006.

### WORKING CAPITAL OUTLOOK

Working capital was \$104,707 at June 30, 2006, versus \$94,249 at June 30, 2005. The increase in working capital was primarily attributable to net income during the year. We continually evaluate possible acquisitions of or investments in businesses that are complementary to our own, and such transactions may require the use of cash. We believe that our cash, other liquid assets, operating cash flows, borrowing capacity and access to the equity capital markets, taken together, provide adequate resources to fund ongoing operating expenditures and the anticipated continuation of semi-annual cash dividends for the next twelve months. We may obtain additional credit facilities to enhance our liquidity.

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### OFF-BALANCE SHEET ARRANGEMENTS AND COMMITMENTS AND CONTINGENCIES

We have no material financial commitments other than those under operating lease agreements, letters of credit and unconditional purchase obligations. We have certain contractual cash obligations and other commercial commitments that will affect our short and long-term liquidity. At June 30, 2006, we had no significant obligations for capital expenditures. At June 30, 2006, contractual cash obligations and other commercial commitments were as follows:

		Payments Due and/or Amount of Commitment (Expiration Per Period) -----			
	Total -----	Less than 1 Year -----	1-3 Years -----	4-5 Years -----	After 5 Years -----
Operating leases	\$ 6,159	\$ 1,550	\$ 2,641	\$ 1,897	\$ 71
Commercial letters of credit	1,349	1,349	-	-	-
Standby letters of credit	153	153	-	-	-
Unconditional purchase obligations	58,137	58,137	-	-	-
	-----	-----	-----	-----	-----
Total	\$65,798	\$61,189	\$ 2,641	\$ 1,897	\$ 71
	=====	=====	=====	=====	=====

Other significant commitments and contingencies include the following:

- One of our subsidiaries markets certain agricultural chemicals which are subject to the Federal Insecticide, Fungicide and Rodenticide Act ("FIFRA"). FIFRA requires that test data be provided to the Environmental Protection Agency ("EPA") to register, obtain and maintain approved labels for pesticide products. The EPA requires that follow-on registrants of these products compensate the initial registrant for the cost of

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producing the necessary test data on a basis prescribed in the FIFRA regulations. Follow-on registrants do not themselves generate or contract for the data. However, when FIFRA requirements mandate that new test data be generated to enable all registrants to continue marketing a pesticide product, often both the initial and follow-on registrants establish a task force to jointly undertake the testing effort. We are presently a member of two such task force groups and historically, our payments have been in the range of \$250 - \$500 per year. We may be required to make additional payments in the future.

2. We, together with our subsidiaries, are subject to pending and threatened legal proceedings that have arisen in the normal course of business. We do not know how the final resolution of these matters will affect our results of operations in a particular reporting period. Our management is of the opinion, however, that the ultimate outcome of such matters will not have a material adverse effect upon our financial condition or liquidity.

In March 2006, our subsidiary, Arsynco, received notice from the Environmental Protection Agency (EPA) of its status as a potentially responsible party ("PRP") under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) for a site described as the Berry's Creek Study Area. Arsynco is one of over 150 PRP's which have potential liability for the required investigation and remediation of the site. The estimate of the potential liability is not quantifiable for a number of reasons, including the difficulty in determining the extent of contamination and the length of time remediation may require. In addition, any estimate of liability must also consider the number of other PRP's and their financial strength. Since an amount of the liability can not be reasonably estimated at this time, no accrual is recorded for these potential future costs. The impact of the resolution of this matter on the Company's results of operations in a particular reporting period is not known. However, management believes that the ultimate outcome of this matter will not have a material adverse effect on the Company's financial condition or liquidity.

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### RELATED PARTY TRANSACTIONS

Certain of our directors are affiliated with law firms that serve as our legal counsel on various corporate matters. During fiscal years 2006, 2005 and 2004, we incurred legal fees of \$315, \$215 and \$310, respectively, for services rendered to the Company by those law firms. We believe that the fees charged by those firms were at rates comparable to rates obtainable from other firms for similar services.

### IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS

In June 2005, the Financial Accounting Standards Board ("FASB") issued SFAS No. 154, "Accounting Changes and Error Corrections", a replacement of APB Opinion No. 20, Accounting Changes, and FASB SFAS No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS No. 154 applies to all voluntary changes in accounting principles and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS No. 154 also

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requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Earlier application is permitted for accounting changes and corrections of errors occurring in fiscal years beginning after June 1, 2005. SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the date of SFAS No. 154. We do not believe that adoption of SFAS No. 154 will have a material impact on our financial statements.

In June 2006, the FASB issued FIN No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109 "Accounting for Income Taxes." It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. The Company will be required to adopt this interpretation in the first quarter of fiscal 2008. Management is currently evaluating the requirements of FIN No. 48 and has not yet determined the impact on the consolidated financial statements.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### MARKET RISK SENSITIVE INSTRUMENTS

The market risk inherent in our market-risk-sensitive instruments and positions is the potential loss arising from adverse changes in investment market prices, foreign currency exchange-rates and interest rates.

#### INVESTMENT MARKET PRICE RISK

We had short-term investments of \$3,309 at June 30, 2006. Those short-term investments consisted of government and agency securities, corporate bonds and corporate equity securities, and they were recorded at fair value and had exposure to price risk. If this risk is estimated as the potential loss in fair value resulting from a hypothetical 10% adverse change in prices quoted by stock exchanges, the effect of that risk would be \$331 as of June 30, 2006. Actual results may differ.

#### FOREIGN CURRENCY EXCHANGE RISK

In order to reduce the risk of foreign currency exchange rate fluctuations, we hedge some of our transactions denominated in a currency other than the functional currencies applicable to each of our various entities. The instruments used for hedging are short-term foreign currency contracts (futures). The changes in market value of such contracts have a high correlation to price changes in the currency of the related hedged transactions. At June 30, 2006, we had foreign currency contracts outstanding that had a notional amount of \$12,389. The difference between the fair market value of the foreign currency contracts and the related commitments at inception and the fair market value of the contracts and the related commitments at June 30, 2006, was not material.

In addition, we enter into cross currency interest rate swaps to reduce foreign currency exposure on inter-company transactions. In June 2004 we entered into a one-year cross currency interest rate swap transaction, which expired in June 2005 when the underlying inter-company loan was repaid, and in May 2003 we entered into a five-year cross currency

interest rate swap transaction, both for the purpose of hedging fixed-interest-rate, foreign-currency-denominated cash flows under inter-company loans. Under the terms of these derivative financial instruments, U.S. dollar fixed principal and interest payments to be received under inter-company loans will be swapped for Euro denominated fixed principal and interest payments. The change in fair value of the swaps from date of purchase to June 30, 2006, was \$(236). The gains or losses on the inter-company loans due to changes in foreign currency rates will be offset by the gains or losses on the swap in the accompanying consolidated statements of income. Since our interest rate swaps qualify as hedging activities, the change in their fair value, amounting to \$42 and \$49 in fiscal 2006 and 2005, respectively, is recorded in accumulated other comprehensive income (loss) included in the accompanying consolidated balance sheets.

We are subject to risk from changes in foreign exchange rates for our subsidiaries that use a foreign currency as their functional currency and are translated into U.S. dollars. These changes result in cumulative translation adjustments, which are included in accumulated other comprehensive income (loss). On June 30, 2006, we had translation exposure to various foreign currencies, with the most significant being the Euro and the Chinese Renminbi. The potential loss as of June 30, 2006, resulting from a hypothetical 10% adverse change in quoted foreign currency exchange rates amounted to \$7,941. Actual results may differ.

#### INTEREST RATE RISK

Due to our financing, investing and cash-management activities, we are subject to market risk from exposure to changes in interest rates. We utilize a balanced mix of debt maturities along with both fixed-rate and variable-rate debt to manage our exposure to changes in interest rates. Our financial instrument holdings at year-end were analyzed to determine their sensitivity to interest rate changes. In this sensitivity analysis, we used the same change in interest rate for all maturities. All other factors were held constant. If there were an adverse change in interest rates of 10%, the expected effect on net income related to our financial instruments would be immaterial. However, there can be no assurances that interest rates will not significantly affect our results of operations.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The financial statements and supplementary data required by this Item 8 are set forth at the end of this report.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

As previously reported on Form 8-K dated November 29, 2005, the Company decided to change accountants. There were no disagreements with predecessor accountants.

#### ITEM 9A. CONTROLS AND PROCEDURES

##### EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As required by Securities and Exchange Commission rules, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this annual report. This evaluation was carried out under the supervision and with the participation of our management, including our principal executive officer and principal

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financial officer. Based on this evaluation, these officers have concluded that the design and operation of our disclosure controls and procedures are effective. There were no significant changes to our internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation.

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

### MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as that term is defined in Rule 13a-15(f) under the Exchange Act. Under the supervision and with the participation of our management, including our principal executive and principal financial officers, we assessed, as of June 30, 2006, the effectiveness of our internal control over financial reporting. This assessment was based on criteria established in the

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framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our assessment using those criteria, management concluded that our internal control over financial reporting as of June 30, 2006, was effective.

Our assessment of the effectiveness of our internal control over financial reporting as of June 30, 2006, has been audited by BDO Seidman LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

### CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During fiscal 2006, our U.S. operations successfully implemented a new Enterprise Resource Planning ("ERP") system. We expect this ERP system to further advance our control environment by automating manual processes, improving management visibility and standardizing processes as its full capabilities are utilized. Compensating internal controls were strengthened and additional management reviews were established during the transitional period to ensure the overall system of internal control continued to operate effectively. There were no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the three months ended June 30, 2006 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### LIMITATIONS ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Internal control over financial reporting is defined as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

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- o pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;
- o provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles and that our receipts and expenditures are being made only in accordance with authorization of our management and directors; and
- o provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that the benefits of controls must be considered relative to their costs. Because of the inherent limitations in any control system, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Also, projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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The Board of Directors and Shareholders  
Aceto Corporation:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Aceto Corporation and subsidiaries maintained effective internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Aceto Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective

internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe

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that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Aceto Corporation maintained effective internal control over financial reporting as of June 30, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also in our opinion, Aceto Corporation maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control--Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Aceto Corporation as of June 30, 2006 and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for the year then ended, and our report dated September 6, 2006, expressed an unqualified opinion on those consolidated financial statements.

/s/ BDO Seidman, LLP

Melville, New York  
September 6, 2006

### ITEM 9B. OTHER INFORMATION

None.

## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Incorporated herein by reference to our definitive proxy statement with respect to our annual meeting of shareholders scheduled to be held on December 7, 2006.

### ITEM 11. EXECUTIVE COMPENSATION



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Incorporated herein by reference to our definitive proxy statement with respect to our annual meeting of shareholders scheduled to be held on December 7, 2006.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Incorporated herein by reference to our definitive proxy statement with respect to our annual meeting of shareholders scheduled to be held on December 7, 2006.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Incorporated herein by reference to our definitive proxy statement with respect to our annual meeting of shareholders scheduled to be held on December 7, 2006.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Incorporated herein by reference to our definitive proxy statement with respect to our annual meeting of shareholders scheduled to be held on December 7, 2006.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The financial statements listed in the Index to Consolidated Financial Statements are filed as part of this Annual Report.

(b) Exhibits

The Exhibits required by this Item 15 are listed in the Exhibit Index set forth at the end of this Annual Report.

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## ACETO CORPORATION AND SUBSIDIARIES INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

### Reports of Independent Registered Public Accounting Firms

#### Consolidated financial statements:

Consolidated balance sheets as of June 30, 2006 and 2005

Consolidated statements of income for the years ended June 30, 2006, 2005 and 2004

Consolidated statements of cash flows for the years ended June 30, 2006, 2005 and 2004

Consolidated statements of shareholders' equity and comprehensive income for the years ended June 30, 2006, 2005 and 2004

Notes to consolidated financial statements

#### Schedules:

II - Valuation and qualifying accounts

All other schedules are omitted because they are not required or the information required is given in the consolidated financial statements

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or notes thereto.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders  
Aceto Corporation:

We have audited the accompanying consolidated balance sheet of Aceto Corporation and subsidiaries as of June 30, 2006 and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for the year then ended. In connection with our audit of the consolidated financial statements, we have also audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial statement schedule are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and financial statement schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial presentation of the financial statements and the financial statement schedule. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Aceto Corporation and subsidiaries at June 30, 2006, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the financial statement schedule presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Aceto Corporation and subsidiaries' internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated September 6, 2006 expressed an unqualified opinion.

/s/ BDO Seidman, LLP

Melville, New York  
September 6, 2006

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Report of Independent Registered Public Accounting Firm

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The Board of Directors and Stockholders  
Aceto Corporation:

We have audited the accompanying consolidated balance sheet of Aceto Corporation and subsidiaries as of June 30, 2005 and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for each of the years in the two-year period ended June 30, 2005. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule as listed in the accompanying index for each of the years in the two-year period ended June 30, 2005. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Aceto Corporation and subsidiaries as of June 30, 2005, and the results of their operations and their cash flows for each of the years in the two-year period ended June 30, 2005, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG LLP

Melville, New York  
September 8, 2005

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ACETO CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
AS OF JUNE 30, 2006 AND 2005  
(in thousands, except per-share amounts)

### ASSETS

#### Current assets:

Cash and cash equivalents

20  
-----

\$ 33

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Investments	3
Trade receivables: less allowance for doubtful accounts (2006, \$416; 2005, \$427)	50
Other receivables	1
Inventory	47
Prepaid expenses and other current assets	1
Assets held for sale	
Deferred income tax asset, net	3
	-----
Total current assets	141
Long-term notes receivable	
Property and equipment, net	4
Property held for sale	4
Goodwill	1
Intangible assets, net	3
Deferred income tax asset, net	7
Other assets	2
	-----
TOTAL ASSETS	\$ 166 =====
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Accounts payable	\$ 24
Short term bank loans	
Note payable - related party	
Accrued expenses	10
Deferred income tax liability	
Liabilities relating to assets held for sale	
	-----
Total current liabilities	36
Long-term liabilities	6
Environmental remediation liability	5
Deferred income tax liability	3
Minority interest	
	-----
Total liabilities	51
Commitments and contingencies (Note 17)	
Shareholders' equity:	
Common stock, \$.01 par value, 40,000 shares authorized; 25,644 shares issued; 24,278 and 24,282 shares outstanding at June 30, 2006 and 2005, respectively	
Capital in excess of par value	56
Retained earnings	68
Treasury stock, at cost, 1,366 and 1,362 shares at June 30, 2006 and 2005, respectively	(13)
Accumulated other comprehensive income	2
	-----
Total shareholders' equity	115 -----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 166 =====

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See accompanying notes to consolidated financial statements.

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## ACETO CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME FOR THE YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (in thousands, except per-share amounts)

	2006	2005
	-----	-----
Net sales	\$ 297,130	\$ 313,38
Cost of sales	246,371	260,28
	-----	-----
Gross profit	50,759	53,10
Selling, general and administrative expenses	38,786	41,56
	-----	-----
Operating income	11,973	11,54
Other income (expense):		
Interest expense	(127)	(7
Interest and other income, net	1,412	1,32
	-----	-----
	1,285	1,24
	-----	-----
Income from continuing operations before income taxes	13,258	12,78
Provision for income taxes	3,994	2,16
	-----	-----
Income from continuing operations	9,264	10,62
Loss from discontinued operations, net of income taxes (Note 3)	(27)	(61
	-----	-----
Net income	\$ 9,237	\$ 10,01
	=====	=====
Basic income per common share:		
Income from continuing operations	\$ 0.38	\$ 0.4
Loss from discontinued operations	-	(0.0
	-----	-----
Net income	\$ 0.38	\$ 0.4
Diluted income per common share:		
Income from continuing operations	\$ 0.38	\$ 0.4
Loss from discontinued operations	-	(0.0
	-----	-----
Net income	\$ 0.38	\$ 0.4
Weighted average shares outstanding:		
Basic	24,267	24,19
Diluted	24,590	24,67

See accompanying notes to consolidated financial statements.

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## ACETO CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (in thousands)

	2006	
	-----	
Operating activities:		
Net income	\$ 9,237	\$
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,558	
Goodwill impairment charge relating to discontinued operations	-	
Gain on sale of assets	-	
Provision for doubtful accounts	38	
Non-cash stock compensation	278	
Income tax benefit on exercise of stock options	-	
Deferred income taxes	1,134	
Changes in assets and liabilities:		
Investments - trading securities	20	
Trade accounts receivable	(227)	
Other receivables	129	
Income taxes receivable	-	
Inventory	4,909	
Prepaid expenses and other current assets	(182)	
Other assets	(719)	
Accounts payable	(3,962)	
Accrued expenses and other liabilities	3,941	
	-----	
Net cash provided by (used in) operating activities	16,154	
	-----	
Investing activities:		
Purchases of investments	-	
Proceeds from sale of investments	1,739	
Payments received on notes receivable	73	
Acquisition of Pharma Walldorf, net of cash acquired	-	
Purchases of property and equipment	(551)	
	-----	
Net cash provided by (used in) investing activities	1,261	
	-----	
Financing activities:		
Proceeds from exercise of stock options	250	
Excess income tax benefit on exercise of stock options	85	
Payment of note payable - related party	-	
Payment of cash dividends	(3,637)	
Payments for purchases of treasury stock	(581)	
Borrowings (repayments) of short-term bank loans	(126)	
	-----	
Net cash used in financing activities	(4,009)	
	-----	
Effect of foreign exchange rate changes on cash	376	
	-----	

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Net increase (decrease) in cash and cash equivalents	13,782
Cash and cash equivalents at beginning of period	19,950
	-----
Cash and cash equivalents at end of period	\$ 33,732
	=====

See accompanying notes to consolidated financial statements.

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## ACETO CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE FOR THE YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (in thousands, except per-share amounts)

	COMMON SHARES	STOCK AMOUNT	CAPITAL IN EXCESS OF PAR VALUE	RETAINED EARNINGS	TREAS SHARES
Balance at June 30, 2003	25,644	\$ 256	\$ 56,967	\$ 46,142	(2,007)
Net income	-	-	-	13,067	-
Other comprehensive income:					
Change in fair value of cross currency interest rate swaps	-	-	-	-	-
Foreign currency translation adjustments	-	-	-	-	-
Comprehensive income:					
Stock issued pursuant to employee stock incentive plans	-	-	50	-	19
Cash dividends (\$0.11 per share)	-	-	-	(2,719)	-
Exercise of stock options	-	-	(1,438)	-	462
Tax benefit from exercise of stock options	-	-	1,532	-	-
Balance at June 30, 2004	25,644	256	57,111	56,490	(1,526)
Net income	-	-	-	10,015	-
Other comprehensive income:					
Change in fair value of cross currency interest rate swap	-	-	-	-	-
Foreign currency translation adjustments	-	-	-	-	-
Unrealized loss on available for sale investments	-	-	-	-	-
Additional minimum pension liability	-	-	-	-	-
Comprehensive income					
Stock issued pursuant to employee stock incentive plans	-	-	(74)	-	41
Cash dividends (\$0.15 per share)	-	-	-	(3,641)	-
Exercise of stock options	-	-	(276)	-	123
Tax benefit from exercise of stock					

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options	-	-	142	-	-
Balance at June 30, 2005	25,644	256	56,903	62,864	(1,362)
Net income	-	-	-	9,237	-
Other comprehensive income:					
Change in fair value of cross currency interest rate swap	-	-	-	-	-
Foreign currency translation adjustments	-	-	-	-	-
Unrealized loss on available for sale investments	-	-	-	-	-
Additional minimum pension liability	-	-	-	-	-
Comprehensive income					
Stock issued pursuant to employee stock incentive plans	-	-	(66)	-	20
Cash dividends (\$0.15 per share)	-	-	-	(3,637)	-
Amortization of unearned compensation	-	-	188	-	-
Purchases of treasury stock	-	-	-	-	(96)
Exercise of stock options	-	-	(419)	-	72
Tax benefit from exercise of stock options	-	-	85	-	-
Balance at June 30, 2006	25,644	\$ 256	\$ 56,691	\$ 68,464	(1,366)

See accompanying notes to consolidated financial statements.

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## ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

### (1) DESCRIPTION OF BUSINESS

Aceto Corporation and subsidiaries ("Aceto" or the "Company") is primarily engaged in the marketing, sale and distribution of biopharmaceuticals, chemically-derived pharmaceuticals, agrochemicals and specialty chemicals used principally as raw materials in the agricultural, color, pharmaceutical, surface coating/ink and general chemical consuming industries. Most of the chemicals distributed by the Company are purchased from companies located outside the United States. The Company's customers are primarily located throughout the United States, Europe and Asia.

### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the financial statements of the Company and its wholly-owned subsidiaries. In addition, the financial statements of S.R.F.A. LLC, a joint-venture entity which is 50% owned by the Company and commenced operations in April 2004, are included in the consolidated financial statements in accordance with FASB Interpretation 46R, "Consolidation of Variable Interest Entities" (FIN 46R). All significant inter-company balances and transactions are eliminated in consolidation.



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### USE OF ESTIMATES

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses reported in those financial statements and the disclosure of contingent assets and liabilities at the date of the financial statements. These judgments can be subjective and complex, and consequently actual results could differ from those estimates and assumptions. The Company's most critical accounting policies relate to revenue recognition; allowance for doubtful accounts; inventory; goodwill and other intangible assets; environmental matters; pension benefits; income taxes; and other contingencies.

### CASH EQUIVALENTS

The Company considers all highly liquid debt instruments with original maturities at the time of purchase of three months or less to be cash equivalents.

### INVESTMENTS

The Company classifies investments in marketable securities as trading, available-for-sale or held-to-maturity at the time of purchase and periodically re-evaluates such classifications. Trading securities are carried at fair value, with unrealized holding gains and losses included in earnings. Held-to-maturity securities are recorded at cost and are adjusted for the amortization or accretion of premiums or discounts over the life of the related security. Unrealized holding gains and losses on available-for-sale securities are excluded from earnings and are reported as a separate component of accumulated other comprehensive income (loss) until realized. In determining realized gains and losses, the cost of securities sold is based on the specific identification method. Interest and dividends on the investments are accrued at the balance sheet date.

### INVENTORIES

Inventories, which consist principally of finished goods, are stated at the lower of cost (first-in first-out method) or market. The Company writes down its inventories for estimated excess and obsolete goods by an amount equal to the difference between the carrying cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions.

### ENVIRONMENTAL AND OTHER CONTINGENCIES

The Company establishes accrued liabilities for environmental matters and other contingencies when it is probable that a liability has been incurred and the amount of the liability is reasonably estimable. If the contingency is resolved for an amount greater or less than the accrual, or the Company's share of the contingency increases or decreases, or other

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Company would recognize an additional expense or benefit in the consolidated statements of income in the period such determination was made.

### PENSION BENEFITS

In connection with certain historical acquisitions in Germany, the Company assumed defined benefit pension plans covering certain employees who meet certain eligibility requirements. The net pension benefit obligations recorded and the related periodic costs are based on, among other things, assumptions of the discount rate, estimated return on plan assets, salary increases and the mortality of participants. The obligation for these claims and the related periodic costs are measured using actuarial techniques and assumptions. Actuarial gains and losses are deferred and amortized over future periods. The Company's plans are funded in conformity with the funding requirements of applicable government regulations.

### ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of accumulated other comprehensive income as of June 30, 2006 and 2005 are as follows:

	2006	2005
	-----	-----
Fair value of cross currency interest rate swaps	\$ (236)	\$ (278)
Cumulative foreign currency translation adjustments	3,170	1,488
Unrealized loss on available for sale investments	(94)	(52)
Additional minimum pension liability	-	(21)
	-----	-----
Total	\$ 2,840	\$ 1,137
	=====	=====

The currency translation adjustments are not adjusted for income taxes as they relate to indefinite investments in non-US subsidiaries.

### COMMON STOCK

On May 4, 2005, the Board of Directors of the Company authorized the extension of the Company's stock repurchase program for an additional three years, expiring in May 2008. Under the stock repurchase program, the Company is authorized to purchase up to an additional 4,147 shares of common stock, in open market or private transactions, at prices not to exceed the market value of the common stock at the time of such purchase.

On December 2, 2004, the Board of Directors of the Company declared a 3-for-2 stock split, effected in the form of a dividend, that was paid January 10, 2005 to shareholders of record on December 24, 2004. The Company transferred \$80 to common stock from capital in excess of par value, representing the aggregate par value of the 8,073 shares issued.

On December 4, 2003, the shareholders of the Company approved an increase in the Company's authorized common stock to 40,000 shares. In addition, the Board of Directors of the Company declared a 3-for-2 stock split, effected in the form of a dividend that was paid January 2, 2004, to shareholders of record on December 17, 2003. The Company transferred \$53 to common stock from capital in excess of par value, representing the aggregate par value of the shares issued.

All references to the number of common shares and the per common share amounts have been restated to give retroactive effect to the above stock splits for all periods presented.

### STOCK OPTIONS

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Prior to July 1, 2005, the Company accounted for stock-based employee compensation under the intrinsic value method as outlined in the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations while disclosing pro-forma net income and net income per share as if the fair value method had been applied in accordance with Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation." Under the intrinsic value method, no compensation expense was recognized if the exercise price of the Company's employee stock options equaled or exceeded the market price of the underlying stock on the date of grant. Since the Company had issued all stock option grants with exercise prices equal to, or greater than, the market value of the common stock on the date of grant, through June 30, 2005 no compensation cost was recognized in the consolidated statements of income.

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

Effective July 1, 2005, the Company adopted SFAS No. 123(R), "Share-based Payment." SFAS No. 123(R) replaces SFAS No. 123 and supersedes APB Opinion No. 25. SFAS 123(R) requires that all stock-based compensation be recognized as an expense in the financial statements and that such costs be measured at the fair value of the award. This statement was adopted using the modified prospective method, which requires the Company to recognize compensation expense on a prospective basis. Therefore, prior period financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based payment awards, expense is also recognized to reflect the cost associated with the remaining vesting period of awards that had been included in pro-forma disclosures in prior periods. Since all options outstanding as of June 30, 2005 were fully vested, there was no compensation expense recognized for those options in the consolidated statements of income for the three years ended June 30, 2006. In addition, the Company elected to use the "short-cut" method to calculate the historical pool of windfall tax benefits upon adoption of SFAS 123(R), which resulted in no historical pool of windfall tax benefits.

In order to determine the fair value of stock options on the date of grant, the Company uses the Black-Scholes option-pricing model, including an estimate of forfeiture rates. Inherent in this model are assumptions related to expected stock-price volatility, option term, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions that are based on factual data derived from public sources, the expected stock-price volatility and option term assumptions require a greater level of judgment.

The Company uses an expected stock-price volatility assumption that is based on the historical daily price changes of the underlying stock which are obtained from public data sources. For stock option grants issued during fiscal 2006, an expected stock-price volatility of 50% was used based upon the historical volatility at the time of issuance. With regard to the weighted-average option term assumption, for stock option grants issued during fiscal 2006, an expected option term assumption of 5.5 years was used as determined under the "simplified" method prescribed in SEC Staff Accounting Bulletin ("SAB") No. 107.

SFAS 123(R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows. Prior to the adoption of SFAS 123(R), the Company presented all tax benefits related to stock-based

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compensation as an operating cash inflow. The Company's policy is to satisfy stock-based compensation awards with treasury shares.

The following table illustrates the effect on net income and net income per common share as if the Company had measured the compensation cost for the Company's stock option programs under the fair value method for the fiscal years ended June 30, 2005 and 2004:

	2005 -----	2004 -----
Net income - as reported	\$ 10,015	\$ 13,067
Add: Stock-based compensation included in reported net income	329	190
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(4,643)	(1,366)
	-----	-----
Net income - pro forma	\$ 5,701 =====	\$ 11,891 =====
Net income per share:		
Basic - as reported	\$ 0.41	\$ 0.55
Basic - pro forma	\$ 0.24	\$ 0.50
Diluted - as reported	\$ 0.41	\$ 0.53
Diluted - pro forma	\$ 0.23	\$ 0.49

Stock-based employee compensation expense under the fair value method for the fiscal year ended June 30, 2005, includes \$6,046, which represents the entire fair value of 1,322 options granted to employees and 61 options granted to directors in

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

September 2004, all of which had an exercise price equal to or greater than the market value of the common stock on the date of grant, as those options were vested as of their date of grant.

#### REVENUE RECOGNITION

The Company recognizes revenue from product sales at the time of shipment and passage of title and risk of loss to the customer. The Company has no acceptance or other post-shipment obligations and does not offer product warranties or services to its customers.

Sales are recorded net of returns of damaged goods from customers, which historically have been immaterial, and sales incentives offered to customers. The Company's sales incentives consist primarily of volume incentive rebates. The Company records such volume incentive rebates as the underlying revenue transactions that result in progress by the customer in earning the rebate are

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recorded, in accordance with Emerging Issues Task Force (EITF) 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)."

### SHIPPING AND HANDLING FEES AND COSTS

All amounts billed to a customer in a sales transaction related to shipping and handling represent revenues earned and are included in net sales. The costs incurred by the Company for shipping and handling are reported as a component of cost of sales. Cost of sales also includes inbound freight, receiving, inspection, warehousing, distribution network, and customs and duty costs.

### NET INCOME PER COMMON SHARE

Basic income per common share is based on the weighted average number of common shares outstanding during the period. Diluted income per common share includes the dilutive effect of potential common shares outstanding. The Company's only potential common shares outstanding are stock options, which resulted in a dilutive effect of 323, 472 and 604 shares for the years ended June 30, 2006, 2005 and 2004, respectively. There were 986, 1,651 and 6 stock options outstanding as of June 30, 2006, 2005 and 2004, respectively, that were not included in the calculation of diluted income per common share for the years ended June 30, 2006, 2005 and 2004, respectively because their effect would have been anti-dilutive.

### INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

### PROPERTY AND EQUIPMENT

Property and equipment are stated at cost and are depreciated using the straight line method over the estimated useful lives of the related asset. Expenditures for improvements that extend the useful life of an asset are capitalized. Ordinary repairs and maintenance are expensed as incurred. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any related gains or losses are included in income.

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The components of property and equipment were as follows:

	June 30, 2006	June 30, 2005
--	---------------	---------------

Estim		
Lif		

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Machinery and equipment	\$ 741	\$ 1,412	
Leasehold improvements	322	787	Short
Computer equipment and software	3,523	3,312	life o
Furniture and fixtures	952	1,010	
Automobiles	423	425	
Building	3,015	3,015	
	-----	-----	
	\$ 8,976	\$ 9,961	
Accumulated depreciation and amortization	4,168	4,744	
	-----	-----	
	\$ 4,808	\$ 5,217	
	=====	=====	

Property held for sale represents land and land improvements of \$4,531 and \$326 at June 30, 2006 and 2005, respectively. During fiscal 2006 the Company recorded an additional \$4,205 to partially recognize the increase in the fair value of the land and land improvements to the extent of additional environmental remediation cost estimates in accordance with EITF 90-8 "Capitalization of Costs to Treat Environmental Contamination".

Depreciation and amortization of property and equipment amounted to \$731, \$749, and \$706 for the years ended June 30, 2006, 2005, and 2004, respectively.

## GOODWILL AND OTHER INTANGIBLES

Goodwill is calculated as the excess of the cost of purchased businesses over the fair value of their underlying net assets. Other intangible assets principally consist of customer relationships, trademarks, purchased customer lists and covenants not to compete. Goodwill and other intangible assets that have an indefinite life are not amortized.

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," the Company tests goodwill and other intangible assets for impairment on at least an annual basis. Goodwill impairment exists if the net book value of a reporting unit exceeds its estimated fair value. The impairment testing is performed in two steps: (i) the Company determines impairment by comparing the fair value of a reporting unit with its carrying value, and (ii) if there is an impairment, the Company measures the amount of impairment loss by comparing the implied fair value of goodwill with the carrying amount of that goodwill. To determine the fair value of these intangible assets, the Company uses many assumptions and estimates that directly impact the results of the testing. In making these assumptions and estimates, the Company uses industry accepted valuation models and set criteria that are reviewed and approved by various levels of management. Additionally, the Company utilizes the assistance of an outside valuation firm, as necessary, to help evaluate recorded goodwill.

## IMPAIRMENT OF LONG-LIVED ASSETS AND LONG-LIVED ASSETS TO BE DISPOSED OF

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. Recoverability of assets held for sale is measured by comparing the carrying amount of the assets to their estimated fair value. If such assets are considered to be impaired, the impairment to be recognized is measured by the

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amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

### ACCOUNTING FOR DERIVATIVES AND HEDGING ACTIVITIES

The Company accounts for derivatives and hedging activities under the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended, which establishes accounting and reporting guidelines for

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

derivative instruments and hedging activities. SFAS No. 133 requires the recognition of all derivative financial instruments as either assets or liabilities in the statement of financial condition and measurement of those instruments at fair value. Changes in the fair values of those derivatives are reported in earnings or other comprehensive income depending on the designation of the derivative and whether it qualifies for hedge accounting. The accounting for gains and losses associated with changes in the fair value of a derivative and the effect on the consolidated financial statements depends on its hedge designation and whether the hedge is highly effective in achieving offsetting changes in the fair value or cash flows of the asset or liability hedged. Under the provisions of SFAS No. 133, the method that is used for assessing the effectiveness of a hedging derivative, as well as the measurement approach for determining the ineffective aspects of the hedge, is established at the inception of the hedged instrument.

For derivatives designated as fair value hedges, changes in fair value are recognized in earnings. If the fair value hedge is fully effective, the change in fair value of the hedged item attributable to the hedged risk is adjusted to fair value and is also recognized in earnings. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge are recorded in other comprehensive income to the extent that the derivative is effective as a hedge, until earnings are affected by the variability in cash flows of the designated hedged item.

The Company enters into cross currency interest rate swaps to reduce foreign currency exposure on inter-company transactions. The gains or losses on the inter-company loans due to changes in foreign currency rates will be offset by the gains or losses on the swap in the statements of income. Since the Company's interest rate swaps qualify as cash flow hedging activities, the change in their fair value is recorded in accumulated other comprehensive income.

The Company operates internationally, therefore its earnings, cash flows and financial positions are exposed to foreign currency risk from foreign-currency-denominated receivables and payables, which, in the U.S., have been denominated in various foreign currencies, including Euros, British Pounds, Japanese Yen, Singapore Dollars and Chinese Renminbi and at certain foreign subsidiaries in U.S. dollars and other non-local currencies.

Management believes it is prudent to minimize the risk caused by foreign currency fluctuation. Management minimizes the currency risk on its foreign currency receivables and payables by purchasing future foreign currency contracts (futures) with one of its financial institutions. Futures are traded

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on regulated U.S. and international exchanges and represent commitments to purchase or sell a particular foreign currency at a future date and at a specific price. Since futures are purchased for the exact amount of the foreign currency receivable or for the exact amount of foreign currency needed to pay for specific purchase orders, and the futures mature on the due date of the related foreign currency vendor invoices or customer receivables, the Company believes that it eliminates all risks relating to foreign currency fluctuation. The Company takes delivery of all futures to pay suppliers in the appropriate currency. The gains or losses for the changes in the fair value of the foreign currency contracts are recorded in cost of sales (sales) and offset the gains or losses associated with the impact of changes in foreign exchange rates on trade payables (receivables) denominated in foreign currencies. Senior management and members of the financial department continually monitor foreign currency risks and the use of this derivative instrument.

### FOREIGN CURRENCY

The functional currency of the Company's foreign subsidiaries is the applicable local currency. The translation of the applicable foreign currencies into U.S. dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for revenue and expense accounts and cash flows using average rates of exchange prevailing during the year. Adjustments resulting from the translation of foreign currency financial statements are accumulated in a separate component of stockholders' equity.

### REVISION TO STATEMENT OF CASH FLOWS AND RECLASSIFICATIONS

Certain reclassifications have been made to the prior period consolidated financial statements to conform to the current year presentation. In addition, the Company has revised its statement of cash flows for the years ended June 30, 2005 and 2004 to combine cash flows from discontinued operations of \$6 and \$34, respectively, with cash flows from continuing operations within each major category. The Company previously reported cash flows from discontinued operations as a single line item in the statement of cash flows.

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### (3) SALE OF INSTITUTIONAL SANITARY SUPPLIES SEGMENT

During June 2005, the Company entered into an agreement to sell the majority of the product lines formulated and marketed by CDC Products Corp. ("CDC"), which is one of the two subsidiaries forming part of the Institutional Sanitary Supplies segment. The sale of certain product lines of CDC was completed on August 24, 2005 for \$75 and a note receivable of \$44 due in April 2006, which resulted in a pre-tax gain of \$66, included in other income in the statement of income for the year ended June 30, 2006. The Company recorded an asset impairment charge relating to CDC of \$619 included in selling, general and administrative expenses in the consolidated statement of income for the year ended June 30, 2005. Excluded from the sale of CDC's product lines was Anti-Clog, an EPA-registered biocide that has a unique delivery system and is used in commercial air-conditioning systems. Beginning in July 2005, the operating results of the Anti-Clog product, which are not material, are included in the Chemicals & Colorants segment.



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On September 6, 2005, the Company completed the sale of certain assets of Magnum Research Corp. for \$81, the remaining subsidiary forming part of the Institutional Sanitary Supplies segment, the operating results of which are included in discontinued operations in the consolidated statements of income. In December 2005, the Company exited the leased space previously occupied by CDC and Magnum Research Corp. In June 2006, the Company negotiated a lease termination with its landlord which resulted in a pre-tax charge of \$378 included in selling, general and administrative expenses for the year ended June 30, 2006.

Assets held for sale of the disposal group included in the accompanying consolidated balance sheet as of June 30, 2005, consist of current assets (primarily accounts receivable and inventory) of \$217, and goodwill of \$25. Liabilities related to the assets held for sale reported in the accompanying consolidated balance sheet as of June 30, 2005, consist of accounts payable and accrued expenses of \$46.

Operating results of discontinued operations for the fiscal years ended June 30, 2006, 2005 and 2004 were as follows:

	2006	2005	2004
	-----	-----	-----
Net sales	\$ 154	\$ 1,314	\$ 1,359
	-----	-----	-----
Loss from operations of discontinued business	(44)	(64)	(74)
Benefit for income taxes	17	24	30
Non-cash impairment charge	-	(920)	-
Benefit for income taxes	-	350	-
	-----	-----	-----
Loss from discontinued operations	\$ (27)	\$ (610)	\$ (44)
	=====	=====	=====

#### (4) BUSINESS ACQUISITIONS AND JOINT VENTURE

##### PHARMA WALDHOF

On December 31, 2003, the Company, through its wholly owned subsidiary Aceto Holding GmbH ("Aceto Holding"), acquired from Corange Deutschland Holding GmbH ("Corange"), all of the capital stock of Pharma Waldhof Beteiligungs GmbH ("Pharma Waldhof"), and all of the partnership interest of Pharma Waldhof GmbH & Co. KG. Pharma Waldhof is the general partner of Pharma Waldhof GmbH & Co. KG.

Based in Dusseldorf, Germany, Pharma Waldhof GmbH distributes biologically and chemically derived active pharmaceutical ingredients (APIs) used in therapeutic and diagnostic products. It is a worldwide provider of a patent-protected, biologically derived API used for a widely used diagnostic and therapeutic heart medication. Its primary customers include worldwide ethical and generic pharmaceutical companies.

The Company paid \$30 for the capital stock of Pharma Waldhof and \$2,970 for the partnership interest of Pharma Waldhof GmbH & Co. KG. Additionally, the share purchase agreement stated that the Company is required to pay Corange an

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## ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

amount equal to certain acquired assets less certain acquired liabilities, originally estimated to be \$321. Further negotiations between Aceto and Corange regarding this provision of the share purchase agreement took place in April 2004, and as a result the Company paid Corange \$1,844 for those assets less those liabilities.

The Company accounted for the transaction under the purchase method of accounting for business combinations. The purchase price was allocated to the acquired assets and assumed liabilities based on the fair values as of the date of the acquisition. The excess of the purchase price paid, including acquisition costs, over the fair value of the net identifiable assets acquired represented goodwill.

The purchase price was allocated as follows:

Goodwill	\$ 806
Accounts receivable	937
Inventory	1,961
Identifiable intangible assets	3,847
Cash	387
Other receivables	308
Fixed assets	11
	-----
Total assets	8,257
Less liabilities assumed	(3,238)
	-----
Purchase price, including acquisition costs	\$ 5,019
	=====

The following unaudited pro forma financial information presents a summary of the Company's consolidated results of operations for the year ended June 30, 2004, assuming the Pharma Waldhof acquisition had taken place as of July 1, 2003:

	2004
	-----
Net sales	\$ 300,913
Net income	\$ 14,032
Net income per common share:	
Basic	\$ 0.59
Diluted	\$ 0.57

The unaudited pro forma financial information has been prepared for comparative purposes only and reflects the addition of the historical unaudited results of Pharma Waldhof through the date of acquisition. The pro forma financial information includes adjustments to the Company's historical results to reflect reduced interest income generated from cash that was used for the acquisition, depreciation and amortization expenses and related income tax adjustments. The pro forma information does not purport to be indicative of operating results that would have been achieved had the acquisition taken place on the date indicated or the results that may be obtained in the future.

SCHWEIZERHALL PHARMA

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On March 26, 2001, the Company acquired (i) the distribution business of the Schweizerhall Pharma division of Schweizerhall Holding AG ("Schweizerhall Holding"), a Switzerland corporation and (ii) certain assets relating to the Pharmaceutical Ingredients business of Schweizerhall, Inc., a New Jersey corporation and a wholly owned subsidiary of Schweizerhall Holding AG (collectively, "Schweizerhall Pharma"). The Schweizerhall Pharma purchase agreement detailed an additional payment to be made to Schweizerhall Holding should the Company realize certain tax savings due to the utilization of certain tax benefits of Schweizerhall Holding GmbH. Such payment would be 50% of the net tax savings received by the Company.

S.R.F.A.

In November 2003, the Company formed a joint venture with Nufarm Americas, Inc. (Nufarm), a subsidiary of Australia-based Nufarm Limited. Each company owns 50% of the joint venture, named S.R.F.A., LLC, that was established to distribute Butoxone(R), an herbicide product for which the Company and Nufarm have acquired an EPA label. Nufarm will continue to formulate Butoxone(R) for the joint venture. S.R.F.A. commenced operations in April 2004. In accordance with

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

FIN 46R, the Company determined that it is the primary beneficiary of the joint venture since it has assumed the majority of the economic risks and rewards of the entity. In June 2004, Nufarm and the Company each loaned \$1,000 to S.R.F.A., with those loans being evidenced by demand notes that bear interest at 3.0% per annum. During fiscal 2005, S.R.F.A. repaid \$500 of principal to each of Nufarm and the Company. The amounts due Nufarm at June 30, 2006 and 2005 are included as a note payable in the accompanying consolidated balance sheets. Minority interest in the net earnings of S.R.F.A. of \$61, \$14 and \$157 was included in interest and other income, net in the accompanying consolidated statements of income for fiscal 2006, 2005 and 2004, respectively.

#### (5) INVESTMENTS

A summary of short-term investments were as follows:

	June 30, 2006		June 30, 2005
	Fair Value	Cost Basis	Fair Value
Trading Securities			
Corporate equity securities	\$ 697	\$ 152	\$ 657
Available for Sale Securities			
Corporate bonds	\$ 1,167	\$ 1,210	\$ 1,194
Government and agency securities	\$ 1,445	\$ 1,501	\$ 3,217

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\$ 3,309

=====

\$ 5,068

=====

The gains on trading securities were \$40, \$110 and \$111 for fiscal 2006, 2005 and 2004, respectively.

## (6) NOTES RECEIVABLE

The Company has five notes receivable with outstanding balances aggregating \$624 and \$697 at June 30, 2006 and June 30, 2005, respectively, which have arisen from sales of property. The notes are either secured by a first mortgage on the real property sold or collateralized by a security interest in the asset sold. The notes range in length from four to eighteen years and earn interest at a fixed rate. The range of fixed rates on the notes is 4.0% to 9.0%. Included in current assets are notes receivable due within one year totaling \$67 and \$73 at June 30, 2006 and 2005, respectively.

## (7) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill of \$1,755 and \$1,720 as of June 30, 2006 and June 30, 2005, respectively, relates to the Health Sciences segment. Goodwill at June 30, 2005 also includes \$25 related to the subsidiary included in the discontinued institutional sanitary supplies segment, and is included in assets held for sale at June 30, 2005. Goodwill in the Health Sciences segment was \$6,838 at June 30, 2003, which during fiscal 2004 was increased by \$806 for the acquisition of Pharma Waldhof and \$59 for foreign currency translation adjustments and decreased by \$5,469 for the recognition of acquired tax benefits, net of related accrued liabilities, resulting in goodwill of \$2,234 at June 30, 2004, which during fiscal 2005 decreased by \$514 for the utilization and recognition of deferred tax assets for acquired foreign net operating loss carryforwards, resulting in goodwill of \$1,720 at June 30, 2005

Intangible assets subject to amortization as of June 30, 2006 and 2005 were as follows:

	Gross Carrying Value	Accumulated Amortization	Net Boo Value
	-----	-----	-----
June 30, 2006			
-----			
Customer relationships	\$ 2,755	\$ 984	\$ 1,771
Customer lists	600	600	-
Patent license	838	57	781
EPA registrations	265	3	262
Non-compete agreements	230	115	115
	-----	-----	-----
	\$ 4,688	\$ 1,759	\$ 2,929
	=====	=====	=====

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June 30, 2005  
-----

Customer relationships	\$ 2,648	\$ 567	\$ 2,081
Customer lists	600	510	90
Non-compete agreements	641	486	155
	-----	-----	-----
	\$ 3,889	\$ 1,563	\$ 2,326
	=====	=====	=====

The estimated useful lives of customer relationships, customer lists, patent license, EPA registrations and non-compete agreements are 7 years, 5 years, 11 years, 10 years and 3-5 years, respectively.

As of June 30, 2006 and June 30, 2005, the Company also had \$860 and \$827, respectively, of intangible assets pertaining to trademarks which have indefinite lives and are not subject to amortization.

In fiscal 2006, changes in goodwill and trademarks are attributable to foreign currency exchange rates used to translate the financial statements of foreign subsidiaries

Amortization expense for intangible assets subject to amortization amounted to \$615, \$542 and \$413 for the years ended June 30, 2006, 2005 and 2004, respectively. The estimated aggregate amortization expense for intangible assets subject to amortization for each of the succeeding years ended June 30, 2007 through June 30, 2012 are as follows: 2007: \$525; 2008: \$525; 2009: \$498; 2010: \$489; 2011: \$258 and 2012 and thereafter: \$634.

## (8) ACCRUED EXPENSES

The components of accrued expenses as of June 30, 2006 and 2005 were as follows:

	2006 -----	2005 -----
Accrued compensation	\$ 2,691	\$2,566
Accrued environmental remediation costs	200	1,195
Accrued income taxes payable	2,019	425
Other accrued expenses	5,702	5,288
	-----	-----
	\$10,612	\$9,474
	=====	=====

## (9) ENVIRONMENTAL REMEDIATION

The Company has environmental remediation obligations in connection with Arsynco, Inc. ("Arsynco"), a subsidiary formerly involved in manufacturing chemicals located in Carlstadt, New Jersey, which was closed in 1993 and is currently held for sale. During fiscal 2003, the Company received an estimate that the remaining costs of the remediation could be an amount between \$1,550 and \$3,200. The remaining liability as of June 30, 2005 is \$1,195 in the accompanying consolidated balance sheet. During fiscal 2006, based on continued monitoring of the contamination at the site and the current proposed plan of remediation, the Company received an estimate from an environmental consultant stating that the costs of remediation could be between \$5,400 and \$6,900 . As of

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June 30, 2006 a liability of \$5,400 is included in the accompanying consolidated balance sheet. In accordance with Emerging Issues Task Force (EITF) Issue 90-8, "Capitalization of Costs to Treat Environmental Contamination" management believes that the majority of costs incurred to remediate the site will be capitalized in preparing the property which is currently classified as held for sale. An appraisal of the fair value of the property by a third-party appraiser supports this assumption. However, these matters, if resolved in a manner different from those assumed in current estimates, could have a material adverse effect on the Company's financial condition, operating results and cash flows when resolved in a future reporting period.

In March 2006, Arsynco received notice from the Environmental Protection Agency (EPA) of its status as a potentially responsible party ("PRP") under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) for a site described as the Berry's Creek Study Area. Arsynco is one of over 150 PRP's which have potential liability for the required investigation and remediation of the site. The estimate of the potential liability is not quantifiable for a number of reasons, including the difficulty in determining the extent of contamination and the length of time remediation may require. In addition, any estimate of liability must also consider the number of other PRP's and their financial strength. Since an amount of the liability can not be reasonably

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

estimated at this time, no accrual is recorded for these potential future costs. The impact of the resolution of this matter on the Company's results of operations in a particular reporting period is not known. However, management believes that the ultimate outcome of this matter will not have a material adverse effect on the Company's financial condition or liquidity.

#### (10) FINANCING ARRANGEMENTS

The Company has a revolving credit agreement with a financial institution that expires June 30, 2007 and provides for available credit of \$10,000. Under the credit agreement, the Company may obtain credit through direct borrowings and letters of credit. The obligations of the Company under the credit agreement are guaranteed by certain of the Company's subsidiaries and are secured by 65% of the capital of certain non-domestic subsidiaries which the Company owns. There is no borrowing base on the credit agreement. Interest under the credit agreement is at LIBOR plus 1.50%, which was 7.19%, 4.93% and 2.86% at June 30, 2006, 2005 and 2004, respectively. The credit agreement contains several financial covenants requiring, among other things, minimum levels of debt service and tangible net worth. The Company is also subject to certain restrictive debt covenants including liens, limitations on indebtedness, limitations on cash dividends, guarantees, sale of assets, sales of receivables, and loans and investments. The Company was in compliance with all covenants at June 30, 2006.

At June 30, 2006 and 2005, the Company had available lines of credit with foreign financial institutions totaling \$18,512 and \$17,792, respectively. The Company has issued a cross corporate guarantee to the foreign banks. Short term loans under these agreements bear interest at LIBOR plus 0.75%, which was 6.44%, 4.18% and 2.11% at June 30, 2006, 2005 and 2004, respectively. The Company is

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not subject to any financial covenants under these arrangements.

Under the above financing arrangements, the Company had no short-term bank loans outstanding and \$1,349 in letters of credit leaving an unused facility of \$27,163 at June 30, 2006. At June 30, 2005 the Company had \$126 in short-term bank borrowings and had utilized \$1,783 in letters of credit leaving an unused facility of \$25,883. The weighted average interest rate on short-term loans outstanding for the year ended June 30, 2005 was 5.24%.

### (11) STOCK BASED COMPENSATION PLANS

In September 2002, the Company adopted the Aceto Corporation 2002 Stock Option Plan (2002 Plan), which was ratified by the Company's shareholders in December 2002. Under the 2002 Plan, options or restricted stock to purchase up to 1,688 shares of the Company's common stock may be granted by the Company to officers, directors, employees and agents of the Company. The exercise price per share shall not be less than the market value of Aceto common stock on the date of grant and each option may not become exercisable less than six months from the date it is granted. Restricted stock may be granted to an eligible participant in lieu of a portion of any annual cash bonus earned by such participant. Such award may include additional shares of restricted stock (premium shares) greater than the portion of bonus paid in restricted stock. The restricted stock award is vested at issuance and the restrictions lapse ratably over a period of years as determined by the Board of Directors, generally three years. The premium shares vest when all the restrictions lapse, provided that the participant remains employed by the Company at that time.

In August 2003, the Company granted 368 options to employees and directors under the 2002 Plan at an exercise price of \$8.22 per share. All of these options vested in December 2004.

In December 2003, the Company granted 21 options to employees under the 2002 Plan at an exercise price of \$9.07 per share. During the remainder of fiscal 2004, the Company granted 20 options to employees at prices ranging from \$9.75 to \$10.67 per share. These options vested on the first anniversary of the date of grant.

In January 2006, the Company granted 131 options to certain employees and directors at an exercise price of 6.82 per share. The options vest on the first anniversary of the date of grant and expire ten years from the date of grant.

All options granted were at exercise prices equal to the market value of the common stock on the date of grant and expire no later than ten years from the date of grant. As of June 30, 2006, there were 145 shares of common stock available for grant as either options or restricted stock under the 2002 Plan.

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

In December 1998, the Company adopted the Aceto Corporation 1998 Omnibus Equity Award Plan (1998 Plan). In accordance with the 1998 Plan the Company's Board of Directors (Board) may grant up to 1,688 shares of common stock in the form of stock options or restricted stock to eligible participants. The exercise price per share, determined by the Board, for options granted cannot be less than the market value of the stock on the date of grant. The options vest as determined

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by the Board and expire no later than ten years from the date of grant. Restricted stock may be granted to an eligible participant in lieu of a portion of any annual cash bonus earned by such participant. Such restricted stock award may include premium shares greater than the portion of bonus paid in restricted stock. The restricted stock award is vested at issuance and the restrictions lapse ratably over a period of years as determined by the Board. The premium shares vest when the restrictions lapse, provided that the participant remains employed by the Company at that time. Under the 1998 Plan, there were 81 shares of common stock available for grant as either options or restricted stock at June 30, 2006.

Under the terms of the Company's 1980 Stock Option Plan, as amended (1980 Plan), options may be issued to officers and key employees. The exercise price per share can be greater or less than the market value of the stock on the date of grant. The options vest either immediately or over a period of years as determined by the Board of Directors and expire no later than five or ten years from the original date they are fully vested. The 1980 Plan expired September 2005. Outstanding options survive the expiration of the 1980 Plan.

In September 2004, the Company granted 1,317 options under the 1980 Plan to employees, 64 options under the 1998 Plan to directors and employees and 2 options under the 2002 Plan to employees at an exercise price of \$10.95 per share which was equal to the market value of the common stock on the date of grant. These options were vested as of their date of grant and will expire ten years from such date.

The following summarizes the shares of common stock under option for all plans at June 30, 2006, 2005 and 2004, and the activity with respect to options for the respective years then ended:

	Shares subject to option	Weighted average exercise price per share
Balance at June 30, 2003	2,167	\$ 3.54
Granted	408	8.35
Exercised	(890)	3.46
Forfeited	(53)	5.46
Balance at June 30, 2004	1,632	4.72
Granted	1,383	10.95
Exercised	(171)	5.18
Forfeited	(80)	9.62
Balance at June 30, 2005	2,764	7.65
Granted	131	6.82
Exercised	(72)	3.88
Forfeited	(80)	10.65
Balance at June 30, 2006	2,743	\$ 7.62

Options exercisable at June 30, 2006, 2005 and 2004 were 2,613, 2,764 and 1,247, respectively. The weighted average exercise price per share for options exercisable at June 30, 2006, 2005 and 2004 was \$7.65, \$7.65 and \$3.59, respectively. At June 30, 2006, outstanding options had expiration dates ranging from December 10, 2008 to January 31, 2016.

Under the 2002 Plan and the 1998 Plan, compensation expense is recorded for the



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market value of the restricted stock awards in the year the related bonus is earned and over the vesting period for the market value at the date of grant of the premium shares granted. In fiscal 2006, 2005 and 2004, restricted stock awarded and premium shares vested of 20, 41 and 19 common shares, respectively, were issued from treasury stock under employee incentive plans, which increased stockholders' equity by \$153, \$334 and \$234, respectively. The related non-cash compensation expense related to the restricted stock granted and the vesting of premium shares during the year, which are issuable only when fully vested, was \$90, \$329 and \$190 in fiscal 2006, 2005 and 2004, respectively. Additionally, non-cash compensation expense of \$188 was recorded in fiscal 2006 relating to stock option grants.

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

Summarized information about stock options outstanding and exercisable at June 30, 2006, is as follows:

Exercise Price Range	Number of Options Outstanding	Average Life (1)	Average Price (2)	Number of Options Exercisable	Average Price
-----	-----	-----	-----	-----	-----
\$2.67 - 4.28	1,038	6.86	\$3.52	1,038	\$ 3.52
6.82	130	9.50	6.82	-	-
8.21 - 10.81	348	7.18	8.39	348	8.39
10.95	1,227	8.20	10.95	1,227	10.95
	-----	-----	-----	-----	-----
	2,743	7.63	\$7.62	2,613	\$ 7.62
	=====			=====	

(1) Weighted-average contractual life remaining, in years.

(2) Weighted-average exercise price.

The following summarizes the non-vested stock options at June 30, 2006 and the activity with respect to non-vested options for the year ended June 30, 2006:

	Shares subject to option	Weighted average grant date fair value
-----	-----	-----
Non-vested at June 30, 2005	-	-
Granted	131	\$2.87
Vested	-	-
Forfeited	(1)	-
-----	-----	-----
Non-vested at June 30, 2006	130	\$2.87

Non-cash compensation expense for non-vested options at June 30, 2006 of \$188 will be expensed during fiscal 2007. The per-share weighted-average fair value of stock options granted during 2006, 2005 and 2004 was \$2.87, \$4.38 and \$3.63, respectively, on the date of the grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

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Date of Grant	Expected Volatility (%)	Expected Life (years)	Risk-free interest rate	Dividend yield
-----				
Fiscal 2006:				
-----				
January 2006	50	5.5	4.36	2.22
Fiscal 2005:				
-----				
September 2004	40	6.0	3.76	1.04
Fiscal 2004:				
-----				
August 2003	40	7.5	4.12	1.24
December 2003	40	7.5	4.02	1.69
February 2004	40	7.5	4.29	1.12
March 2004	40	7.5	4.29	1.16
June 2004	40	6.0	4.00	1.06

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## ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

### (12) INTEREST AND OTHER INCOME

Interest and other income during fiscal 2006, 2005 and 2004 was comprised of the following:

	2006	2005	2004
	-----	-----	-----
Dividends	\$ 133	\$ 86	\$ 83
Interest	590	459	491
Net gain (loss) on investments	29	117	111
Foreign government subsidies received	561	457	395
Minority interest	(61)	(14)	(157)
Foreign currency gains (losses)	(354)	182	143
Insurance recovery	191	-	-
Miscellaneous	323	34	268
	-----	-----	-----
	\$ 1,412	\$ 1,321	\$ 1,334
	=====	=====	=====

### (13) INCOME TAXES

The components of income from continuing operations before the provision for income taxes are as follows:

2006	2005	2004
-----	-----	-----

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Domestic operations	\$ 1,981	\$ (332)	\$ 4,015
Foreign operations	11,277	13,120	13,336
	-----	-----	-----
	\$ 13,258	\$ 12,788	\$ 17,351
	=====	=====	=====

The components of the provision for income taxes are as follows:

	2006	2005	2004
	-----	-----	-----
Federal:			
Current	\$ 105	\$ 293	\$ 1,355
Deferred	335	(692)	(22)
State and local:			
Current	187	126	119
Deferred	126	(184)	(4)
Foreign:			
Current	2,568	1,023	1,399
Deferred	673	1,597	1,393
	-----	-----	-----
	\$ 3,994	\$ 2,163	\$ 4,240
	=====	=====	=====

Income taxes payable, which is included in accrued expenses, was \$2,019 and \$425 at June 30, 2006 and 2005, respectively.

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## ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

The tax effects of temporary differences that give rise to the deferred tax assets and liabilities at June 30, 2006 and 2005 are presented below:

	2006	2005
	-----	-----
Deferred tax assets:		
Accrued environmental remediation liabilities not currently deductible	\$ 461	\$ 473
Accrued deferred compensation	1,159	969
Additional inventoried costs for tax purposes	124	162
Allowance for doubtful accounts receivable	116	125
Depreciation and amortization	223	89
Other	53	48
Impairment charges	585	556
Domestic net operating loss carryforwards	376	961
Foreign net operating loss carryforwards	10,695	5,280
	-----	-----
Total gross deferred tax assets	13,792	8,663
Valuation allowances	(2,450)	(1,753)
	-----	-----
	11,342	6,910

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	-----	-----
Deferred tax liabilities:		
Foreign deferred tax liabilities	(4,192)	-
Unrealized gain on investments	(207)	(192)
Goodwill	(383)	(312)
	-----	-----
Total gross deferred tax liabilities	(4,782)	(504)
	-----	-----
Net deferred tax assets	\$ 6,560	\$ 6,406
	=====	=====

The following table shows the current and non current deferred tax assets (liabilities) at June 30, 2006 and 2005:

	2006	2005
	-----	-----
Current deferred tax assets, net	\$ 3,396	\$ 2,780
Non-current deferred tax assets, net	7,356	3,626
Current deferred tax liabilities	(863)	-
Non current deferred tax liabilities	(3,329)	-
	-----	-----
Net deferred tax assets	\$ 6,560	\$ 6,406
	=====	=====

The net change in the total valuation allowance for the year ended June 30, 2006 was an increase of \$697. This increase was primarily attributable to an additional valuation allowance recorded for net operating loss carryforwards generated in certain foreign jurisdictions. The net change in the total valuation allowance for the year ended June 30, 2005 was a decrease of \$1,712, resulting primarily from the utilization of, or establishing deferred tax assets for the projected utilization of, certain foreign net operating loss carryforwards for which a full valuation allowance was previously established, partially offset by a valuation allowance recorded for net operating loss carryforwards generated in certain other foreign jurisdictions. A valuation allowance is provided when it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. The Company has established valuation allowances primarily for net operating loss carryforwards in certain foreign countries. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets are not expected to be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which net operating loss carryforwards are utilizable and temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. In order to fully realize the net deferred tax assets recognized at June 30, 2006, the Company will need to generate future taxable income of approximately \$15,500.

Based upon the level of historical taxable income and projections for taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these

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deductible differences. There can be no assurance, however, that the Company will generate any earnings or any specific level of continuing earnings in the future. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

In fiscal 2006, the Company recorded a net tax benefit of \$199 for certain foreign net operating loss carryforwards, acquired in a prior business acquisition, which were previously offset by a valuation allowance. This amount is net of a liability to the seller. In fiscal 2005, the Company recorded a tax benefit of \$1,777 for certain foreign net operating loss carryforwards which were previously offset by a valuation allowance, of which \$514 eliminated the remaining related goodwill and \$1,263 reduced income tax expense. In fiscal 2004, primarily as a result of the acquisition of Pharma Waldhof, the Company recognized certain tax benefits that were previously unrecognized in the amount of \$1,310.

Deferred taxes have not been provided on undistributed earnings of foreign subsidiaries amounting to approximately \$49,640 at June 30, 2006 since substantially all of these earnings are expected to be permanently reinvested in foreign operations. A deferred tax liability will be recognized when the Company expects that it will recover these undistributed earnings in a taxable manner, such as through the receipt of dividends or sale of the investments. Determination of the amount of unrecognized deferred U.S. income tax liabilities is not practical to calculate because of the complexity of this hypothetical calculation. In addition, unrecognized foreign tax credit carryforwards would be available to reduce a portion of such U.S. tax liability.

We operate in various tax jurisdictions, and although we believe that we have provided for income and other taxes in accordance with the relevant regulations, if the applicable regulations were ultimately interpreted differently by a taxing authority, we may be exposed to additional tax liabilities.

A reconciliation of the statutory federal income tax rate and the effective tax rate for continuing operations for the fiscal years ended June 30, 2006, 2005 and 2004 follows:

	2006	2005	2004
	----	----	----
Federal statutory tax rate	34.0%	34.0%	34.0%
State and local taxes, net of federal income tax benefit	1.0	(0.5)	0.7
Increase (reduction) in valuation allowance	5.3	(9.9)	-
Foreign tax rate differential	(9.1)	(5.6)	(9.7)
Other	(1.1)	(1.1)	(0.6)
	-----	-----	-----
Effective tax rate	30.1%	16.9%	24.4%
	=====	=====	=====

At June 30, 2006, the Company had U.S. federal net operating loss carryforwards of \$334 which are available to offset future U.S. federal taxable income and which expire in 2025. In addition, at June 30, 2006, the Company had foreign net operating loss carryforwards of approximately \$23,000 which are available to offset future foreign taxable income and which have no expiration date.

(14) SUPPLEMENTAL CASH FLOW INFORMATION

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Cash paid for interest and income taxes during fiscal 2006, 2005 and 2004 was as follows:

	2006	2005	2004
	-----	-----	-----
Interest	\$ 129	\$ 151	\$ 101
Income taxes, net of refunds	\$ 797	\$ 195	\$1,135

### (15) RETIREMENT PLANS

#### DEFINED CONTRIBUTION PLANS

The Company has defined contribution retirement plans in which certain employees are eligible to participate. The Company's annual contribution per employee, which is at management's discretion, is based on a percentage of the

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employee's compensation. The Company's provisions for contributions amounted to \$1,148, \$1,161 and \$1,101 in fiscal 2006, 2005 and 2004, respectively.

#### DEFINED BENEFIT PLANS

The Company sponsors certain defined benefit pension plans covering certain employees of its German subsidiaries who meet the plan's eligibility requirements. The accrued pension liability as of June 30, 2006 was \$755. The accrued pension liability recorded as of June 30, 2005 amounted to \$679, which includes \$21 of an additional minimum pension liability, net of unrecognized prior service cost and tax recorded in other comprehensive income. Net periodic pension costs, which consists principally of interest cost and service cost was \$87 in fiscal 2006, \$84 in fiscal 2005 and insignificant in fiscal 2004. The Company's plans are funded in conformity with the funding requirements of the applicable government regulations. An assumed weighted average discount rate of 4.2%, 4.6% and 5.5% and a compensation increase rate of 3.3%, 3.0% and 3.3% were used in determining the actuarial present value of benefit obligations as of June 30, 2006, 2005 and 2004, respectively.

#### DEFERRED COMPENSATION PLANS

To comply with the requirements of the American Jobs Creation Act of 2004, as of December 2004, the Company froze its non-qualified Supplemental Executive Retirement Plan (the "Frozen Plan") and has not allowed any further deferrals or contributions to the Frozen Plan after December 31, 2004. All of the earned benefits of the participants in the Frozen Plan as of December 31, 2004, will be preserved under the existing plan provisions.

On March 14, 2005, the Company's Board of Directors adopted the Aceto Corporation Supplemental Executive Deferred Compensation Plan (the "Plan"). The Plan is a non-qualified deferred compensation plan intended to provide certain qualified executives with supplemental benefits beyond the Company's 401(k)

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plan, as well as to permit additional deferrals of a portion of their compensation. The Plan is intended to comply with the provisions of section 409A of the Internal Revenue Code of 1986, as amended, and is designed to provide comparable benefits to those under the Frozen Plan. Substantially all compensation deferred under the Plan, as well as Company contributions, is held by the Company in a grantor trust, which is considered an asset of the Company. The assets held by the grantor trust are in life insurance policies.

As of June 30, 2006 and 2005, the Company recorded a liability under the Plans of \$2,937 and \$2,430, respectively, (included in long-term liabilities) and an asset (included in other assets) of \$2,556 and \$2,087, respectively, primarily representing the cash surrender value of policies owned by the Company.

### (16) FINANCIAL INSTRUMENTS

#### DERIVATIVE FINANCIAL INSTRUMENTS

At June 30, 2006 and 2005 the Company had future foreign currency contracts that have a notional amount of \$12,389 and \$11,456, respectively. Unrealized gains on hedging activities at the end of fiscal 2006 amounted to \$171 and are included in the consolidated statement of income. The contracts have varying maturities of less than one year. At June 30, 2006 and 2005, the Company had not hedged open purchase commitments denominated in foreign currencies of approximately \$21 and \$125, respectively.

The Company is exposed to credit losses in the event of non-performance by the financial institutions, who are the counter parties, on its future foreign currency contracts. The Company anticipates, however, that the financial institutions will be able to fully satisfy their obligations under the contracts. The Company does not obtain collateral to support financial instruments, but monitors the credit standing of the financial institutions.

In addition, the Company enters into cross currency interest rate swaps to reduce foreign currency exposure on inter-company transactions. In June 2004, a foreign subsidiary of the Company entered into a one-year cross currency interest rate swap transaction, which expired in June 2005 when the underlying inter-company loan was repaid, and in May 2003 the foreign subsidiary entered into a five-year cross currency interest rate swap transaction, both for the purpose of hedging fixed-interest-rate, foreign-currency-denominated cash flows under inter-company loans. Under the terms of these derivative financial instruments, U.S. dollar fixed principal and interest payments to be received under inter-company loans will be swapped for EURO denominated fixed principal and interest payments. The change in fair value of the swaps from the date

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of purchase to June 30, 2006, was \$(236). The gains or losses on the inter-company loans due to changes in foreign currency rates will be offset by the gains or losses on the swap in the statements of income. Since the Company's interest rate swaps qualify as hedging activities, the change in their fair value, amounting to \$42, \$49 and \$(210) in 2006, 2005 and 2004, respectively, is recorded in accumulated other comprehensive income.

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### OFF-BALANCE SHEET RISK

Commercial letters of credit are issued by the Company during the ordinary course of business through major banks as requested by certain suppliers. The Company had open letters of credit of approximately \$1,349 and \$1,783 as of June 30, 2006 and 2005, respectively. The terms of these letters of credit are all less than one year. No material loss is anticipated due to non-performance by the counter parties to these agreements.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying values of all financial instruments classified as a current asset or current liability are deemed to approximate fair value because of the short maturity of these instruments. The fair value of foreign currency contracts (used for hedging purposes) was estimated by obtaining quotes from brokers and the difference between the fair value and contract value as of June 30, 2005 was not material. The difference between the fair value of long-term notes receivable and their carrying value at both June 30, 2006 and 2005 was not material. The fair value of the Company's notes receivable was based upon current rates offered for similar financial instruments to the Company.

### BUSINESS AND CREDIT CONCENTRATION

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of trade receivables. The Company's customers are dispersed across many industries and are located throughout the United States as well as in Mexico, Brazil, Malaysia, France, Canada, Germany, Australia, the United Kingdom, the Netherlands and other countries. The Company estimates an allowance for doubtful accounts based upon the credit worthiness of its customers as well as general economic conditions. Consequently, an adverse change in those factors could affect the Company's estimate of this allowance. The Company as a policy does not require collateral from its customers. At June 30, 2006 and 2005, no single customer accounted for as much as 10% of net trade accounts receivable.

No single product or customer accounted for as much as 10% of net sales in fiscal 2006, 2005 or 2004. Two suppliers accounted for 13% and 12% of purchases in fiscal 2005 and one supplier accounted for approximately 10% in fiscal 2004.

During the fiscal years ended June 30, 2006, 2005 and 2004, approximately 67%, 68% and 59%, respectively, of the Company's purchases came from Asia and approximately 21%, 22% and 29%, respectively, came from Europe.

The Company maintains operations located outside of the United States. Net assets located in Europe and Asia approximated \$23,444 and \$28,165, respectively at June 30, 2006. Net assets located in Europe and Asia approximated \$18,120 and \$24,700, respectively at June 30, 2005.

### (17) COMMITMENTS AND CONTINGENCIES

As of June 30, 2006, the Company has outstanding purchase obligations totaling \$58,137 with suppliers to the Company's domestic and foreign operations to acquire certain products for resale to third party customers.

The Company and its subsidiaries are subject to various claims which have arisen in the normal course of business. The impact of the final resolution of these matters on the Company's results of operations in a particular reporting period is not known. Management is of the opinion, however, that the ultimate outcome of such matters will not have a material adverse effect upon the Company's financial condition or liquidity.

The Company has environmental remediation obligations in connection with



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Arsynco's former manufacturing facility located in Carlstadt, New Jersey, which was closed in 1993 and is currently held for sale. During fiscal 2006, based on continued monitoring of the contamination at the site and the current proposed plan of remediation, the Company received an estimate from an environmental consultant stating that the costs of remediation could be between \$5,400 and \$6,900. As of June 30, 2006 a liability of \$5,400 is included in the accompanying consolidated balance sheet. However, these matters, if resolved in a

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

manner different from those assumed in current estimates, could have a material adverse effect on the Company's financial condition, operating results and cash flows when resolved in a future reporting period.

In March 2006, Arsynco received notice from the Environmental Protection Agency (EPA) of its status as a potentially responsible party ("PRP") under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) for a site described as the Berry's Creek Study Area. Arsynco is one of over 150 PRP's which have potential liability for the required investigation and remediation of the site. The estimate of the potential liability is not quantifiable for a number of reasons, including the difficulty in determining the extent of contamination and the length of time remediation may require. In addition, any estimate of liability must also consider the number of other PRP's and their financial strength. Since an amount of the liability can not be reasonably estimated at this time, no accrual is recorded for these potential future costs. The impact of the resolution of this matter on the Company's results of operations in a particular reporting period is not known. However, management believes that the ultimate outcome of this matter will not have a material adverse effect on the Company's financial condition or liquidity.

One of the Company's subsidiaries was a defendant in a legal action alleging patent infringement. The patent in question covered a particular method of applying one of the products in the Company's Agrochemicals segment. In September 2005, shortly before a trial was expected to begin, the parties agreed to a settlement. Under the terms of the settlement agreement, the Company was obligated to pay \$1,375, of which \$625 was paid in December 2005 and the remaining \$750 will be paid in equal installments over the next five years. As a result of the settlement, the company recorded an intangible asset of \$838 for the patent license, which will be amortized over its remaining life of 11 years, and a charge of \$537, included in SG&A expense, for the fiscal year ended June 30, 2006.

A subsidiary of the Company markets certain agricultural chemicals which are subject to the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA). FIFRA requires that test data be provided to the Environmental Protection Agency (EPA) to register, obtain and maintain approved labels for pesticide products. The EPA requires that follow-on registrants of these products compensate the initial registrant for the cost of producing the necessary test data on a basis prescribed in the FIFRA regulations. Follow-on registrants do not themselves generate or contract for the data. However, when FIFRA requirements mandate that new test data be generated to enable all registrants to continue marketing a pesticide product, often both the initial and follow-on registrants establish a task force to jointly undertake the testing effort. The Company is presently a

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member of two such task force groups and historically, our payments have been in the range of \$250 - \$500 per year. The Company may be required to make additional payments in the future.

In fiscal 2002 a vendor made allegations that the Company breached a purchase contract. As a result, the Company recorded a liability during fiscal 2003 of \$450. During fiscal 2004, the Company received a favorable court ruling and the liability was reversed accordingly.

The Company leases office facilities in the United States, the Netherlands, Germany, France, China and Singapore expiring at various dates between December 2006 and April 2011. In addition, a domestic subsidiary leases a manufacturing facility under an operating lease expiring November 2009.

At June 30, 2006, the future minimum lease payments for each of the five succeeding years and in the aggregate are as follows:

Fiscal year	Amount
-----	-----
2007	\$1,550
2008	1,376
2009	1,265
2010	1,070
2011	827
Thereafter	71
	-----
	\$6,159
	=====

Total rental expense amounted to \$1,354, \$1,665 and \$1,673 for fiscal 2006, 2005 and 2004, respectively.

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### ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

In June 2006, The Company negotiated a lease termination with its landlord for the facility previously occupied by CDC and Magnum. In connection with the lease termination, the landlord and a third party entered into a long-term lease for which the Company guaranteed the rental payments by the third party through September 30, 2009. The aggregate future rental payments of the third party that are guaranteed by the Company are \$925 and the fair value of this guarantee is deemed to be insignificant.

#### (18) RELATED PARTY TRANSACTIONS

Certain directors of the Company are affiliated with law firms that serve as legal counsel to the Company on various corporate matters. During fiscal 2006, 2005 and 2004, the Company incurred legal fees of \$315, \$215 and \$310, respectively, for services rendered to the Company by those law firms.

#### (19) IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS

In June 2005, the Financial Accounting Standards Board ("FASB") issued SFAS No. 154, "Accounting Changes and Error Corrections," a replacement of APB Opinion No. 20, Accounting Changes, and FASB SFAS No. 3, Reporting Accounting Changes in

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Interim Financial Statements. SFAS No. 154 applies to all voluntary changes in accounting principles, and changes the requirements for accounting for and reporting of a change in accounting principle. SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. SFAS No. 154 also requires that a change in method of depreciation, amortization, or depletion for long-lived, non-financial assets be accounted for as a change in accounting estimate that is affected by a change in accounting principle. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. Earlier application is permitted for accounting changes and corrections of errors occurring in fiscal years beginning after June 1, 2005. SFAS No. 154 does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the date of SFAS No. 154. The Company does not believe that adoption of SFAS No. 154 will have a material impact on its financial statements.

In June 2006, the FASB issued FIN No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109 "Accounting for Income Taxes." It prescribes a recognition threshold and measurement attribute for financial statement disclosure of tax positions taken or expected to be taken on a tax return. This interpretation is effective for fiscal years beginning after December 15, 2006. The Company will be required to adopt this interpretation in the first quarter of fiscal 2008. Management is currently evaluating the requirements of FIN No. 48 and has not yet determined the impact on the consolidated financial statements.

### (20) SEGMENT INFORMATION

The Company's four reportable segments, organized by product, are as follows:

- o Health Sciences - includes the active ingredients for generic pharmaceuticals, vitamins, and nutritional supplements, as well as products used in preparing pharmaceuticals, primarily by major innovative drug companies, and biopharmaceuticals.
- o Chemicals & Colorants - products include a variety of specialty chemicals used in plastics, resins, adhesives, coatings, food, flavor additives, fragrances, cosmetics, metal finishing, electronics and many other areas; dye and pigment intermediates used in the color-producing industries such as textiles, inks, paper, and coatings; intermediates used in the production of agrochemicals.
- o Agrochemicals - products include herbicides, fungicides and insecticides, as well as a sprout inhibitor for potatoes.
- o Institutional Sanitary Supplies - products include cleaning solutions, fragrances, and deodorants for commercial and industrial customers.

During June 2005, the Company entered into an agreement to sell the majority of the product lines formulated and marketed by CDC Products Corp. ("CDC"), which is one of the two subsidiaries forming part of the Institutional Sanitary Supplies segment. The sale of CDC was completed on August 24, 2005. Excluded from the sale of CDC's product lines was Anti-

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Clog, an EPA-registered biocide that has a unique delivery system and is used in commercial air-conditioning systems. Beginning in July 2005, the operating results of the Anti-Clog product, which are not material, are included in the Chemicals & Colorants segment. On September 6, 2005, the Company completed the sale of certain assets of Magnum Research Corp., the remaining subsidiary forming part of the Institutional Sanitary Supplies segment, the operating results of which are included in discontinued operations in the consolidated statements of income.

Certain freight and storage costs are not allocated to the segments as such costs are managed on an entity-wide basis, and the information to reasonably allocate such costs is not readily available.

The Company does not allocate assets by segment. The Company's chief operating decision maker evaluates performance of the segments based on net sales and gross profit. The Company does not allocate assets by segment because the chief operating decision maker does not review the assets by segment to assess the segments' performance, as the assets are managed on an entity-wide basis.

	Health Sciences -----	Chemicals & Colorants -----	Agrochemicals -----	Institutional Sanitary Supplies -----
2006				
----				
Net sales	\$ 166,695	\$ 110,701	\$ 19,734	
Gross profit	32,283	16,975	4,760	
Unallocated cost of sales (1)				
Net gross profit				
2005				
----				
Net sales	\$ 184,560	\$ 104,744	\$ 20,031	\$ 4,046
Gross profit	32,869	17,224	6,719	69
Unallocated cost of sales (1)				
Net gross profit				
2004				
----				
Net sales	\$ 180,701	\$ 94,395	\$ 16,898	\$ 4,361
Gross profit	33,821	15,303	5,503	1,286
Unallocated cost of sales (1)				
Net gross profit				

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(1) Represents certain freight and storage costs that are not allocated to a segment.

Net sales by source country for the years ended June 30, 2006, 2005 and 2004 and long-lived assets by location as of June 30, 2006 and 2005 were as follows:

	Net Sales			Gross Profit		
	2006	2005	2004	2006	2005	2004
United States	\$184,197	\$183,397	\$166,973	\$ 30,149	\$ 29,129	\$ 30,122
Germany	56,464	63,518	51,659	14,311	13,041	11,147
Netherlands	10,095	8,018	9,127	1,791	1,686	1,586
France	15,543	12,609	11,522	1,808	1,561	1,368
Asia-Pacific	30,831	45,839	57,078	2,700	7,684	8,189
Total	\$297,130	\$313,381	\$296,359	\$ 50,759	\$ 53,101	\$ 52,412
	=====	=====	=====	=====	=====	=====

Export sales from the United States to foreign countries amounted to \$29,152, \$26,111 and \$20,487 for the fiscal years ended June 30, 2006, 2005 and 2004, respectively.

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## ACETO CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2006, 2005 AND 2004 (IN THOUSANDS, EXCEPT PER-SHARE AMOUNTS)

### (21) UNAUDITED QUARTERLY FINANCIAL DATA

The following is a summary of the unaudited quarterly results of operations for the years ended June 30, 2006 and 2005.

	For the quarter ended			
	September 30, 2005	December 31, 2005	March 31, 2006	June 30, 2006
FISCAL YEAR ENDED JUNE 30, 2006				
Net sales	\$74,993	\$69,467	\$80,846	\$71,824
Gross profit	12,503	11,468	13,444	13,344
Net income	1,974	1,547	2,751	2,965
Net income per diluted share	\$ 0.08	\$ 0.06	\$ 0.11	\$ 0.12
	For the quarter ended			
	September 30, 2004	December 31, 2004	March 31, 2005	June 30, 2005
FISCAL YEAR ENDED JUNE 30, 2005				

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Net sales	\$80,449	\$76,738	\$82,512	\$73,682
Gross profit	13,515	13,282	14,249	12,055
Net income (1)	3,375	1,952	1,895	2,793
Net income per diluted share	\$ 0.14	\$ 0.08	\$ 0.08	\$ 0.11

(1) Net income for the quarter ended June 30, 2005 includes a benefit for income taxes of \$1,263 relating to the reduction of valuation allowances for the utilization of and establishment of deferred tax assets for foreign net operating loss carryforwards (see Note 13).

The net income per common share calculation for each of the quarters is based on the weighted average number of shares outstanding in each period. Therefore, the sum of the quarters in a year does not necessarily equal the year's net income per common share.

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## ACETO CORPORATION AND SUBSIDIARIES

### VALUATION AND QUALIFYING ACCOUNTS

For the years ended June 30, 2006, 2005 and 2004  
(dollars in thousands)

Description	Balance at beginning of year	Charged to costs and expenses	Charged to other accounts	Ded
Year ended June 30, 2006				
Allowance for doubtful accounts	\$ 427	\$ 38	-	\$ 4
	=====	=====		=====
Year ended June 30, 2005				
Allowance for doubtful accounts	\$1,033	\$343	-	\$94
	=====	=====		=====
Year ended June 30, 2004				
Allowance for doubtful accounts	\$ 939	\$520	-	\$42
	=====	=====		=====

(a) Specific accounts written off as uncollectible.

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## EXHIBIT INDEX

- 3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 4(a)(iii) to Registration Statement No. 2-70623 on Form S-8 (S-8 2-70623)).
- 3.2 Certificate of Amendment dated November 21, 1985 to Restated Certificate of Incorporation (incorporated by reference to

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Exhibit 3(ii) to the Company's annual report on Form 10-K for the fiscal year ended June 30, 1986).

- 3.3 Amended and restated by-laws of Aceto Corporation, effective as of February 2, 2005 (incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K dated February 2, 2005).
- 10.1 Aceto Corporation 401(k) Retirement Plan, effective August 1, 1997, as amended and restated as of July 1, 2002 (incorporated by reference to Exhibit 10.1 to the Company's annual report on Form 10-K for the fiscal year ended June 30, 2004).
- 10.2 Supplemental Executive Retirement Plan, as amended and restated, effective June 30, 2004 and frozen as of December 31, 2004 (incorporated by reference to Exhibit 10.2 to the Company's annual report on Form 10-K for the fiscal year ended June 30, 2004).
- 10.3 Aceto Corporation Stock Option Plan (as Amended and Restated effective as of September 19, 1990) (and as further Amended effective June 9, 1992) (incorporated by reference to Exhibit 10(v)(b) to the Company's annual report on Form 10-K for the fiscal year ended June 30, 1992).
- 10.4 1998 Aceto Corporation Omnibus Equity Award Plan (incorporated by reference to Exhibit 10(v) to the Company's annual report on Form 10-K for the fiscal year ended June 30, 1999).
- 10.5 Aceto Corporation 2002 Stock Option Plan (incorporated by reference to Exhibit 4(i) to Registration Statement No. 333-110653 on Form S-8).
- 10.6 Lease between Aceto Corporation and M. Parisi & Son Construction Co., Inc. for office space at One Hollow Lane, Lake Success, NY dated April 28, 2000 (incorporated by reference to Exhibit 10(vi) to the Company's annual report on Form 10-K for the fiscal year ended June 30, 2000).
- 10.7 Lease between Aceto Corporation and M. Parisi & Son Construction Co., Inc. for office space at One Hollow Lane, Lake Success, NY dated April 28, 2000 (incorporated by reference to Exhibit 10(vi)(b) to the Company's annual report on Form 10-K for the year ended June 30, 2000).
- 10.8 Lease between CDC Products Corp. and Seaboard Estates for manufacturing and office space at 1801 Falmouth Avenue, New Hyde Park, NY dated October 31, 1999 (incorporated by reference to Exhibit 10(vi)(c) to the Company's annual report on Form 10-K for the year ended June 30, 2000).
- 10.9 Stock Purchase Agreement among Windham Family Limited Partnership, Peter H. Kliegman, CDC Products Corp. and Aceto Corporation (incorporated by reference to Exhibit 10(vii) to the Company's annual report on Form 10-K for the year ended June 30, 1999).
- 10.10 Asset Purchase Agreement among Magnum Research Corporation, CDC Products Corp., Roy Gross and Aceto Corporation (incorporated by reference to Exhibit 10 (viii) to the Company's annual report on Form 10-K for the year ended June 30, 2000).

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- 10.11 Asset Purchase Agreement between Schweizerhall, Inc. and Aceto Corporation (incorporated by reference to Exhibit 10(ix) to the Company's annual report on Form 10-K for the year ended June 30, 2000).
- 10.12 Purchase and Sale Agreement among Schweizerhall Holding AG, Chemische Fabrik Schweizerhall, Schweizerhall, Inc., Aceto Corporation and Aceto Holding B.V., I.O. (incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K dated April 4, 2001).
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- 10.13 Loan Guarantee between Aceto Corporation and subsidiaries and Deutsche Bank AG dated March 22, 2001 (incorporated by reference to Exhibit 10.13 to the Company's annual report on Form 10-K for the year ended June 30, 2001).
- 10.14 Credit Agreement between Aceto Corporation and subsidiaries and JPMorgan Chase Bank dated May 10, 2002 (incorporated by reference to Exhibit 10.13 to the Company's annual report on Form 10-K for the year ended June 30, 2002).
- 10.15 Amendment and Waiver to Credit Agreement between Aceto Corporation and subsidiaries and JPMorgan Chase Bank dated June 29, 2004 (incorporated by reference to Exhibit 10.15 to the Company's annual report on Form 10-K for the year ended June 30, 2004).
- 10.16 Waiver to Credit Agreement between Aceto Corporation and subsidiaries and JPMorgan Chase Bank dated August 31, 2004 (incorporated by reference to Exhibit 10.16 to the Company's annual report on Form 10-K for the year ended June 30, 2004).
- 10.17 Share Purchase Agreement dated as of December 12, 2003 between Aceto Holding GmbH and Corange Deutschland Holding GmbH (incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K dated December 31, 2003).
- 10.18 Aceto Corporation Supplemental Executive Deferred Compensation Plan, effective March 14, 2005 (incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K dated March 14, 2005).
- 10.19 Form of purchase agreement between Shanghai Zhongjin Real Estate Development Company Limited and Aceto (Hong Kong) Limited dated November 10, 2004 (incorporated by reference to Exhibit 10.1 to the Company's quarterly report on Form 10-Q for the quarter ended December 31, 2004).
- 21.1\* Subsidiaries of the Company.
- 23.1\* Consent of BDO Seidman LLP.
- 23.2\* Consent of KPMG LLP.
- 31.1\* Certification by President and CEO Leonard S. Schwartz pursuant to U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2\* Certification by CFO Douglas Roth pursuant to U.S.C. Section



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1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1\* Certification by President and CEO Leonard S. Schwartz pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2\* Certification by CFO Douglas Roth pursuant to U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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\*Filed herewith

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### SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ACETO CORPORATION

By /s/ Leonard S. Schwartz

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Leonard S. Schwartz  
Chairman, President and  
Chief Executive Officer

Date: September 7, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Signatures -----	Title -----	Date ----
/s/ Leonard S. Schwartz ----- Leonard S. Schwartz	Chairman, President and Chief Executive Officer (Principal Executive Officer)	09-07-06
/s/ Douglas Roth ----- Douglas Roth	Secretary/Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)	09-07-06
/s/ Stanley Fischer ----- Stanley Fischer	Director	09-07-06
/s/ Robert Wiesen -----	Director	09-07-06

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Robert Wiesen

/s/ Ira S. Kallem ----- Ira S. Kallem	Director	09-07-06
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/s/ Albert L. Eilender ----- Albert L. Eilender	Director	09-07-06
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/s/ Hans C. Noetzli ----- Hans C. Noetzli	Director	09-07-06
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/s/ William Britton ----- William Britton	Director	09-07-06
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