

ALBEMARLE CORP  
Form 10-Q  
August 07, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D. C. 20549

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**FORM 10-Q**

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

For Quarterly Period Ended June 30, 2006

OR

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

For Transition Period from            to            .

Commission File Number 1-12658

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**ALBEMARLE CORPORATION**

(Exact name of registrant as specified in its charter)

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**VIRGINIA**  
(State or other jurisdiction of

incorporation or organization)

**330 SOUTH FOURTH STREET**

**RICHMOND, VIRGINIA**  
(Address of principal executive offices)

**54-1692118**  
(I.R.S. Employer

Identification No.)

**23219**  
(Zip Code)

**Registrant's telephone number, including area code - (804) 788-6000**

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Number of shares of common stock, \$.01 par value, outstanding as of August 1, 2006: 47,411,282

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**ALBEMARLE CORPORATION**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited).****ALBEMARLE CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(In Thousands, Except Per-Share Amounts)****(Unaudited)**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net sales	\$ 568,797	\$ 502,754	\$ 1,176,151	\$ 1,012,719
Cost of goods sold	437,413	397,587	922,314	800,230
Gross profit	131,384	105,167	253,837	212,489
Selling, general and administrative expenses	62,202	53,669	120,055	110,695
Research and development expenses	11,198	10,342	22,643	21,322
Benefit plan curtailment gain and other special charges		(4,868)		(4,868)
Operating profit	57,984	46,024	111,139	85,340
Interest and financing expenses	(12,037)	(10,135)	(22,656)	(20,388)
Other (expenses) income, net	(2,303)	78	(1,377)	566
Income before income taxes, minority interests and equity in net income of unconsolidated investments	43,644	35,967	87,106	65,518
Income taxes	11,041	13,948	22,378	25,088
Income before minority interests and equity in net income of unconsolidated investments	32,603	22,019	64,728	40,430
Minority interests in income of consolidated subsidiaries	(394)	(1,028)	(3,619)	(2,512)
Equity in net income of unconsolidated investments	11,118	11,067	16,594	18,459
Net income	\$ 43,327	\$ 32,058	\$ 77,703	\$ 56,377
Basic earnings per-share	\$ 0.92	\$ 0.69	\$ 1.65	\$ 1.22
Diluted earnings per-share	\$ 0.89	\$ 0.67	\$ 1.60	\$ 1.19
Cash dividends declared per-share of common stock (Note 7)	\$ 0.165	\$ 0.31	\$ 0.33	\$ 0.46
Weighted-average common shares outstanding - basic	47,345	46,581	47,211	46,059

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Weighted-average common shares outstanding - diluted	48,580	47,971	48,432	47,455
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See accompanying Notes to the Condensed Consolidated Financial Statements.

**Table of Contents****ALBEMARLE CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(In Thousands)**

	<b>June 30,</b>	<b>December 31,</b>
	<b>2006</b>	<b>2005</b>
	<b>(Unaudited)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 98,995	\$ 58,570
Trade accounts receivable, less allowance for doubtful accounts (2006 - \$669; 2005 - \$663)	372,684	351,989
Other accounts receivable, less allowance for doubtful accounts (2006 - \$471; 2005 - \$350)	24,965	35,474
Inventories (Note 8)	415,719	411,023
Deferred income taxes and prepaid expenses	20,738	16,607
<b>Total current assets</b>	<b>933,101</b>	<b>873,663</b>
Property, plant and equipment, at cost	2,269,096	2,194,878
Less accumulated depreciation and amortization	1,282,606	1,228,061
Net property, plant and equipment	986,490	966,817
Prepaid pension assets	184,222	187,360
Investments	109,904	92,933
Other assets and deferred charges	23,333	32,000
Goodwill	250,986	238,425
Other intangibles, net of amortization	154,106	156,045
<b>Total assets</b>	<b>\$ 2,642,142</b>	<b>\$ 2,547,243</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 212,258	\$ 222,142
Current portion of long-term debt	51,562	57,564
Accrued expenses	124,501	118,564
Dividends payable	7,399	7,034
Income taxes payable	23,914	16,613
<b>Total current liabilities</b>	<b>419,634</b>	<b>421,917</b>
Long-term debt	748,273	775,889
Postretirement benefits	60,709	63,350
Pension benefits	55,671	51,998
Other noncurrent liabilities	113,458	109,864
Deferred income taxes	214,111	193,950
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Common stock, \$.01 par value, issued and outstanding 47,378 in 2006 and 46,750 in 2005	473	467

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Additional paid-in capital	198,986	189,887
Accumulated other comprehensive income	40,863	12,047
Retained earnings	789,964	727,874
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Total shareholders' equity	1,030,286	930,275
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<b>Total liabilities and shareholders' equity</b>	<b>\$ 2,642,142</b>	<b>\$ 2,547,243</b>
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See accompanying Notes to the Condensed Consolidated Financial Statements.

**Table of Contents****ALBEMARLE CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In Thousands)****(Unaudited)**

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash and cash equivalents at beginning of year</b>	\$ 58,570	\$ 46,390
<b>Cash flows from operating activities:</b>		
Net income	77,703	56,377
Adjustments to reconcile income to cash flows from operating activities:		
Depreciation and amortization	57,666	57,692
Stock based compensation expense	7,113	6,754
Working capital changes, net of the effects of acquisitions	(11,324)	(61,453)
Minority interests in income of consolidated subsidiaries	3,619	2,512
Equity in net income of unconsolidated investments	(16,594)	(18,459)
Dividends received from unconsolidated investments and nonmarketable securities	3,720	7,078
Decrease in prepaid pension assets	3,138	1,130
Deferred income taxes (benefit)	4,418	(4,658)
Other, net	2,350	(5,693)
<b>Net cash provided from operating activities</b>	<b>131,809</b>	<b>41,280</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(49,012)	(36,189)
Acquisitions		(7,553)
Proceeds from liquidation of unconsolidated investment and sale of nonmarketable security		1,058
Investments in and advances to unconsolidated investments and nonmarketable securities	(168)	(9,088)
Investments in marketable securities	(2,900)	496
<b>Net cash used in investing activities</b>	<b>(52,080)</b>	<b>(51,276)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from issuance of senior notes		324,665
Proceeds from issuance of common stock		147,862
Proceeds from borrowings	130,709	117,372
Proceeds from exercise of stock options	12,856	2,704
Repayments of long-term debt	(165,001)	(499,419)
Dividends paid to shareholders	(15,248)	(11,978)
Tax benefit realized from stock-based compensation arrangements	5,273	
Payment of financing costs		(2,306)
Purchases of common stock	(9,885)	
Dividends paid to minority interest	(3,600)	(1,000)
Net receipt on treasury lock agreements		196



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<b>Net cash (used in) provided from financing activities</b>	(44,896)	78,096
<b>Net effect of foreign exchange on cash and cash equivalents</b>	5,592	(16,202)
<b>Increase in cash and cash equivalents</b>	40,425	51,898
<b>Cash and cash equivalents at end of period</b>	\$ 98,995	\$ 98,288

See accompanying Notes to the Condensed Consolidated Financial Statements.

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## ALBEMARLE CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Net income	\$ 43,327	\$ 32,058	\$ 77,703	\$ 56,377
Other comprehensive income (loss), net of tax:				
Unrealized (loss) gain on securities available for sale	(31)	10	(10)	15
Unrealized gain (loss) on hedging derivatives	138	119	(632)	406
Realized (loss) on treasury lock agreements				(933)
Amortization of realized loss on treasury lock agreements	34	35	68	58
Minimum pension liability	(22)		363	
Foreign currency translation adjustment	17,637	(138)	29,027	(9,563)
Other comprehensive income (loss)	17,756	26	28,816	(10,017)
<b>Comprehensive income</b>	<b>\$ 61,083</b>	<b>\$ 32,084</b>	<b>\$ 106,519</b>	<b>\$ 46,360</b>

See accompanying Notes to the Condensed Consolidated Financial Statements.

**Table of Contents****ALBEMARLE CORPORATION AND SUBSIDIARIES****Notes to the Condensed Consolidated Financial Statements (Unaudited)**

1. In the opinion of management, the accompanying condensed consolidated financial statements of Albemarle Corporation and our wholly owned, majority owned and controlled subsidiaries (collectively, Albemarle, we, us, our, or the Company ) contain all adjustments necessary for a fair presentation, in all material respects, of our condensed consolidated financial position as of June 30, 2006 and December 31, 2005, our condensed consolidated results of operations and comprehensive income for the three-month and six-month periods ended June 30, 2006 and 2005, and our condensed consolidated cash flows for the six-month periods ended June 30, 2006 and 2005. All adjustments are of a normal and recurring nature. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, which was filed with the Securities and Exchange Commission, or the SEC, on March 15, 2006. The December 31, 2005 consolidated balance sheet data herein was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles in the United States. The results of operations for the three-month and six-month periods ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year. Certain reclassifications have been made to the accompanying consolidated financial statements and the notes thereto to conform to the current presentation.

2. Cost of goods sold includes foreign exchange transaction gains (losses) of \$1.2 million and \$1.1 million, and (\$0.7 million) and (\$1.0 million) for the three-month and six-month periods ended June 30, 2006 and 2005, respectively.

3. The three-month and six-month periods ended June 30, 2005 include a curtailment gain amounting to \$5.6 million (\$3.6 million after income taxes, or seven cents per-share) that relates to a reduction in our accumulated postretirement benefit obligation (liability) associated with a change in coverage in our unfunded postretirement health care benefits plan for active employees' future retiree medical premium payments as well as a charge of \$0.7 million (\$0.5 million after income taxes, or one cent per-share) for the potential settlement of future legal claims with respect to certain future asbestos premises liability claims.

4. Interest and financing expenses for the six-month period ended June 30, 2005 include the write-off of deferred financing expenses totaling \$1.4 million (\$0.9 million net of income taxes, or two cents per-share), associated with the 364-day bridge loan that was retired using the proceeds from our January 2005 public offering of senior notes and common stock.

5. The significant differences between the U.S. federal statutory income tax rate on pretax income and the effective income tax rate for the three-month and six-month periods ended June 30, 2006 and 2005, respectively, are as follows:

	<b>% of Income Before Income Taxes</b>			
	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Federal statutory rate	35.0%	35.0%	35.0%	35.0%
State taxes, net of federal tax benefit	0.1	0.3	0.4	0.3

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Effect of minority interests in income of consolidated subsidiaries	(1.3)	(1.0)	(1.1)	(1.3)
Extraterritorial income exclusion	(0.7)	(1.5)	(0.7)	(1.7)
Depletion	(1.1)	(1.4)	(0.8)	(1.5)
Domestic production deduction	(0.3)	(0.3)	(0.3)	(0.4)
Permanent reinvestment of foreign income	(5.2)		(5.4)	
Impacts of foreign earnings <sup>(a)</sup>	(0.9)	7.4	(1.8)	7.6
Other items, net	(0.3)	0.3	0.4	0.3
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Effective income tax rate	25.3%	38.8%	25.7%	38.3%
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

<sup>(a)</sup> The improvement in tax rate impacts of foreign earnings relates mainly to benefits from foreign tax credits associated with high taxed earnings from foreign operations.

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6. Basic and diluted earnings per-share for the three-month and six-month periods ended June 30, 2006 and 2005 are calculated as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
(In thousands, except per-share amounts)				
<b>Basic earnings per-share</b>				
Numerator:				
Income available to shareholders, as reported	\$ 43,327	\$ 32,058	\$ 77,703	\$ 56,377
Denominator:				
Average number of shares of common stock outstanding	47,345	46,581	47,211	46,059
Basic earnings per-share	\$ 0.92	\$ 0.69	\$ 1.65	\$ 1.22
<b>Diluted earnings per-share</b>				
Numerator:				
Income available to shareholders, as reported	\$ 43,327	\$ 32,058	\$ 77,703	\$ 56,377
Denominator:				
Average number of shares of common stock outstanding	47,345	46,581	47,211	46,059
Shares issuable upon exercise of stock options	1,235	1,390	1,221	1,396
Total shares	48,580	47,971	48,432	47,455
Diluted earnings per-share	\$ 0.89	\$ 0.67	\$ 1.60	\$ 1.19

7. Cash dividends declared for the six-month period ended June 30, 2006 totaled 33 cents per-share. Cash dividends declared for the three-month period ended June 30, 2006 totaled 16.5 cents per-share, and included a dividend declared on April 19, 2006 payable on July 1, 2006. Cash dividends declared for the six-month period ended June 30, 2005 totaled 46 cents per-share. Cash dividends declared for the three-month period ended June 30, 2005 totaled 31 cents per-share, and included a dividend of 15 cents per-share declared on April 19, 2005 and paid on July 1, 2005, as well as a dividend of 16 cents per-share declared on June 29, 2005 and paid on October 1, 2005.

8. The following table provides a breakdown of inventories at June 30, 2006 and December 31, 2005:

	June 30,	December 31,
	2006	2005
(In thousands)		

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Finished goods	\$ 296,819	\$ 292,158
Raw materials	70,414	72,515
Stores, supplies, and other	48,486	46,350
	<u>          </u>	<u>          </u>
Total inventories	\$ 415,719	\$ 411,023
	<u>          </u>	<u>          </u>

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9. Long-term debt consists of the following:

	June 30,	December 31,
	2006	2005
	(In thousands)	
Variable-rate bank loans	\$ 238,361	\$ 389,120
Senior notes	324,713	324,696
Foreign borrowings	204,957	89,951
Capital lease obligation	19,990	17,821
Industrial revenue bonds	11,000	11,000
Miscellaneous	814	865
<b>Total</b>	<b>799,835</b>	<b>833,453</b>
Less amounts due within one year	51,562	57,564
<b>Total long-term debt</b>	<b>\$ 748,273</b>	<b>\$ 775,889</b>

In June 2006, we amended our senior credit facilities to add certain additional subsidiary borrowers located outside the U.S. and to allow borrowings by those our foreign subsidiaries to be denominated in currencies other than the U.S. dollar. Key terms of this agreement remain unchanged.

10. The Company has the following recorded environmental liabilities primarily included in Other noncurrent liabilities at June 30, 2006 (in thousands):

Beginning balance at December 31, 2005	\$ 28,896
Additions	9
Change in estimate	(100)
Payments	(903)
Foreign exchange	1,374
<b>Ending balance at June 30, 2006</b>	<b>\$ 29,276</b>

The amounts recorded represent our future remediation and other anticipated environmental liabilities. Although it is difficult to quantify the potential financial impact of compliance with environmental protection laws, management estimates (based on the latest available information) that there is a reasonable possibility that future environmental remediation costs associated with our past operations, in excess of amounts already recorded, could be up to approximately \$12.0 million before income taxes. This amount excludes any potential liability for environmental remediation at our facility in Thann, France. See Note 13 below.

We believe that any sum we may be required to pay in connection with environmental remediation matters in excess of the amounts recorded should occur over a period of time and should not have a material adverse effect upon our results of operations, financial condition or cash flows on a consolidated annual basis although any such sum could have a material adverse impact on our results of operations, financial condition or

cash flows in a particular quarterly reporting period.



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11. Effective January 1, 2006, we revised the way we evaluate the performance of our segment results to reduce our segment income (loss) for the minority interests in income of consolidated subsidiaries. Segment income (loss) represents operating profit and equity in net income of unconsolidated investments and is reduced by minority interests in income of our consolidated subsidiaries, Stannica LLC and Jordan Bromine Company Limited. Segment results for the three-month and six-month periods ended June 30, 2005 have been reclassified to conform to the new presentation. Segment data continues to include intersegment transfers of raw materials at cost and foreign exchange transaction gains and losses, as well as allocations for certain corporate costs.

Summarized financial information concerning our reportable segments is shown in the following table. The Corporate & Other segment includes corporate-related items not allocated to the reportable segments.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
	(In thousands)			
<b>Segment net sales:</b>				
Polymer Additives	\$ 228,559	\$ 204,435	\$ 450,430	\$ 402,537
Catalysts	194,045	147,304	429,401	320,128
Fine Chemicals	146,193	151,015	296,320	290,054
<b>Total segment net sales</b>	<b>\$ 568,797</b>	<b>\$ 502,754</b>	<b>\$ 1,176,151</b>	<b>\$ 1,012,719</b>
<b>Segment income (loss):</b>				
Polymer Additives	\$ 39,240	\$ 28,347	\$ 70,460	\$ 50,661
Catalysts	29,518	24,346	54,847	49,405
Fine Chemicals	13,767	14,850	23,458	26,400
Corporate & Other	(13,817)	(11,480)	(24,651)	(25,179)
<b>Total segment income</b>	<b>68,708</b>	<b>56,063</b>	<b>124,114</b>	<b>101,287</b>
Interest and financing expenses	(12,037)	(10,135)	(22,656)	(20,388)
Other (expenses) income, net	(2,303)	78	(1,377)	566
Income taxes	(11,041)	(13,948)	(22,378)	(25,088)
<b>Net income</b>	<b>\$ 43,327</b>	<b>\$ 32,058</b>	<b>\$ 77,703</b>	<b>\$ 56,377</b>

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Segment income (loss) includes the following equity in net income of unconsolidated investments and minority interests in income of consolidated subsidiaries amounts:

	Three Months Ended June 30		Six Months Ended June 30,	
	2006	2005	2006	2005
(In thousands)				
<b>Equity in net income of unconsolidated investments:</b>				
Polymer Additives	\$ 1,349	\$ 2,793	\$ 2,469	\$ 4,573
Catalysts	9,757	5,697	14,202	10,167
Fine Chemicals		2,653		3,859
Corporate & Other	12	(76)	(77)	(140)
<b>Total equity in net income of unconsolidated investments</b>	<b>\$ 11,118</b>	<b>\$ 11,067</b>	<b>\$ 16,594</b>	<b>\$ 18,459</b>
<b>Minority interests in income of consolidated subsidiaries:</b>				
Polymer Additives	\$ (1,358)	\$ (1,028)	\$ (3,373)	\$ (2,512)
Catalysts				
Fine Chemicals	(939)		(2,149)	
Corporate & Other	1,903		1,903	
<b>Total minority interests in income of consolidated subsidiaries</b>	<b>\$ (394)</b>	<b>\$ (1,028)</b>	<b>\$ (3,619)</b>	<b>\$ (2,512)</b>

## 12. Stock Based Compensation Expense.

Effective January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123R Share-Based Payment, or SFAS 123R. Prior to January 1, 2006, we accounted for stock-based awards under the intrinsic value method, which followed the recognition and measurement principles of Accounting Principles Board Opinion ( APB ) No. 25, Accounting for Stock Issued to Employees, and related interpretations. The intrinsic value method of accounting resulted in compensation expense for restricted stock awards at fair value on date of grant based on the number of shares granted and the quoted price of our common stock at grant date and for stock options to the extent exercise prices were set below market prices on the date of grant. Compensation expense for performance unit awards was recognized based on the number of units granted and the quoted price of our common stock at the end of each quarterly reporting period until distribution. To the extent restricted stock awards and performance unit awards were forfeited prior to vesting, the corresponding previously recognized expense was reversed as an offset to operating expenses.

As of January 1, 2006, we adopted SFAS 123R using the modified prospective method, which requires measurement of compensation cost for all stock-based awards at fair value on the date of grant and recognition of compensation over the service period for awards expected to vest. The modified prospective method does not require financial amounts for the prior periods presented in this Form 10-Q to be restated to reflect the fair value method of expensing share-based compensation. The fair value of restricted stock awards and performance unit awards is determined based on the number of shares or units granted and the quoted price of our common stock at grant date, and the fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with our valuation techniques previously utilized for options in footnote disclosures required under SFAS No. 123, Accounting for Stock Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. Such value is recognized as expense over the service period (generally the vesting period of the equity grant). To the extent restricted stock awards, performance unit awards and stock options are forfeited prior to vesting, the corresponding previously recognized expense is reversed as an offset to operating expenses.

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Tax benefits resulting from stock-based compensation deductions in excess of amounts reported for financial reporting purposes were \$0.9 million and \$5.3 million for the three and six-month periods ended June 30, 2006. Prior to the adoption of SFAS 123R, cash retained as a result of tax deductions relating to stock-based compensation was presented in operating cash flows, along with other tax cash flows, in accordance with the provisions of the Emerging Issues Task Force Issue No. 00-15, Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option. SFAS 123R supersedes EITC 00-15, amends SFAS 95, Statement of Cash Flows, and requires tax benefits relating to excess stock-based compensation deductions to be prospectively presented in the statement of cash flows as financing cash inflows.

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The application of SFAS 123R had the following effect on June 30, 2006 reported amounts relative to amounts that would have been reported using the intrinsic value method under previous accounting (in thousands, except per-share amounts):

	<b>Three months Ended June 30, 2006</b>	<b>Six months Ended June 30, 2006</b>
Operating profit	\$ 1,341	\$ 1,432
Income before income taxes, minority interests and equity in net income of unconsolidated investments	1,341	1,432
Net income	855	913
Basic earnings per-share	\$ 0.02	\$ 0.02
Diluted earnings per-share	\$ 0.02	\$ 0.03
Net cash provided from operating activities	\$ (919)	\$ (5,273)
Net cash (used in) financing activities	919	5,273

The impact of SFAS 123R resulted in additional compensation expense related to stock options not fully vested as of January 1, 2006, which was more than offset by a reduction in compensation expense for outstanding performance unit awards as the fair value at grant date was lower than the fair value at the end of the reporting period.

The following table illustrates the effects on net income and earnings per-share for the three and six-month periods ended June 30, 2005 as if we had applied the fair value recognition provisions of SFAS 123 to stock-based employee awards (in thousands, except per-share amounts):

		<b>Three Months Ended June 30, 2005</b>	<b>Six Months Ended June 30, 2005</b>
Stock based compensation expense, net of taxes	as reported	\$ 2,154	\$ 4,302
	pro forma	\$ 2,272	\$ 4,623
Net income	as reported	\$ 32,058	\$ 56,377
	pro forma	\$ 31,940	\$ 56,056
Basic earnings per-share on net income	as reported	\$ 0.69	\$ 1.22
	pro forma	\$ 0.69	\$ 1.22
Diluted earnings per-share on net income	as reported	\$ 0.67	\$ 1.19
	pro forma	\$ 0.66	\$ 1.17

*Capital Stock and Incentive Plans*

*Preferred Stock*

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We have the authority to issue 15,000,000 shares of preferred stock in one or more classes or series. As of June 30, 2006, no shares of preferred stock have been issued.

### *Stock Purchases*

On January 30, 2006, we entered into Stock Purchase Agreements, with each of Floyd D. Gottwald, Jr. and John D. Gottwald, pursuant to which we agreed to purchase an aggregate of 120,000 shares of our common stock from Floyd D. Gottwald, Jr. and an aggregate of 85,655 shares of our common stock from John D. Gottwald at a price of \$43.66 per share. The purchase price was \$0.05 less than the average closing price of a share of our common stock on the New York Stock Exchange for the third through the fifth business days following the date of release to the public of our earnings for the year ended December 31, 2005. The transactions were approved by the Audit Committee of our Board of Directors.

During June 2006, we repurchased an aggregate of 19,800 shares of our common stock in open-market transactions at an average price of \$45.74 per share. At June 30, 2006, we have authorization from our Board of Directors to purchase an additional 3,649,946 shares of our common stock.

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*Incentive Plans*

At June 30, 2006, we have three existing incentive plans (1994, 1998 and 2003 plans). The plans generally provide for incentive awards payable either in cash or shares of our common stock, qualified and non-qualified stock options ( stock options ), stock appreciation rights ( SARs ), restricted stock awards and performance unit awards.

Under the 1994 plan, a maximum of 3,200,000 shares of our common stock were authorized for issuance pursuant to the exercise of stock options (232,300 outstanding at June 30, 2006), SARs, or the grant of restricted stock or performance unit awards. No further grants or awards can be made under the 1994 plan.

Under the 1998 plan, a maximum aggregate number of 3,000,000 shares of our common stock were authorized for issuance pursuant to the exercise of stock options (1,527,400 outstanding at June 30, 2006), SARs, or the grant of restricted stock or performance unit awards subject to certain limitations. The maximum aggregate number of shares that could be issued pursuant to the exercise of options is 2,600,000. No further grants or awards can be made under the 1998 plan.

Under the 2003 plan, a maximum aggregate number of 3,000,000 shares of our common stock were authorized for issuance pursuant to the exercise of stock options (375,500 outstanding at June 30, 2006), SARs, or the grant of restricted stock or performance unit awards. At June 30, 2006, 1,565,000 shares were available for issuance pursuant to grants under the 2003 plan.

Total stock-based compensation expense associated with our incentive plans for the three and six-month periods ended June 30, 2006 amounted to \$4.6 million and \$7.1 million, respectively. Total stock-based compensation expense for the three and six-month periods ended June 30, 2005 amounted to \$3.4 million and \$6.8 million, respectively. Total related recognized tax benefits for the three and six-month periods ended June 30, 2006 amounted to \$1.7 million and \$2.6 million, respectively. Total related recognized tax benefits for the three and six-month periods ended June 30, 2005 amounted to \$1.2 million and \$2.5 million, respectively.

Below is a summary of the activity in the 1994, 1998 and 2003 plans for the six-month period ended June 30, 2006:

	Shares				Weighted-
	Available	Options			Average
	for Grant	Activity	Options Price		Exercise Price
	<u>          </u>	<u>          </u>	<u>          </u>		<u>          </u>
December 31, 2005	2,239,000	2,711,150	\$ 15.94	\$36.93	\$ 24.25
Exercised		(602,450)	\$ 15.94	\$29.99	\$ 21.34
Non-qualifying stock options canceled and lapsed	9,500	(9,500)	\$ 31.38		\$ 31.38
Non-qualifying stock options granted	(36,000)	36,000	\$ 45.90	\$46.60	\$ 46.48
Performance unit awards canceled	20,000				
Performance unit awards granted	(656,500)				
Restricted stock award canceled	3,000				
Restricted stock awards granted	(14,000)				

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June 30, 2006	1,565,000	2,135,200	\$ 15.94	\$46.60	\$ 25.41
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Stock options outstanding under the three plans have been granted at prices that were equal to the market value of the stock on the date of grant and expire seven to ten years after issuance. The stock options granted become exercisable based upon either (a) growth in operating earnings as defined from the base-year earnings, (b) the increase in fair market value of our common stock, during a specified period, from the fair market value on the date of grant, or (c) at the end of a fixed period as defined in the individual agreements.

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The fair value of each option grant during the three and six-month periods ended June 30, 2006 and 2005 was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Fair values of options granted	\$ 14.77	\$ N/A	\$ 14.77	\$ 11.01
Dividend Yield <sup>(1)</sup>	2.01%	N/A	2.01%	1.97%
Volatility <sup>(2)</sup>	30.01%	N/A	30.01%	29.58%
Average expected life (in years) <sup>(3)</sup>	6	N/A	6	6
Risk-free interest rate <sup>(4)</sup>	5.31%	N/A	5.31%	4.67%

- (1) Dividend yield is the average of historical yields and those estimated over the average expected life.
- (2) The stock volatility is based on historical volatilities of our common stock.
- (3) The average expected life represents the weighted average period of time that options granted are expected to be outstanding giving consideration to vesting schedules and our historical exercise patterns.
- (4) The risk-free interest rate is based on the U.S. Treasury strip rate with stripped coupon interest for the period equal to the contractual term of the share option grant in effect at the time of grant.

We believe that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of our stock options granted in the three and six-month periods ended June 30, 2006 and 2005. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards.

Cash proceeds, tax benefits and intrinsic value related to total stock options exercised during the three and six-month periods ended June 30, 2006 are provided in the following table (in thousands):

	Three Months Ended	Six Months Ended
	June 30, 2006	June 30, 2006
Proceeds from stock options exercised	\$ 1,901	\$ 12,856
Tax benefit related to stock options exercised	\$ 858	\$ 4,661
Intrinsic value of stock options exercised	\$ 2,451	\$ 13,318

The intrinsic value of options exercised during the three and six-month periods ended June 30, 2005 was \$0.2 million and \$1.4 million, respectively. The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option.

The following table summarizes information about fixed-price stock options at June 30, 2006 (in thousands, except share and per-share amounts):

Aggregate



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	<u>Number of Stock Options</u>	<u>Weighted- Average Exercise Price</u>	<u>Intrinsic Value</u>	<u>Weighted-Average Remaining Contractual Term</u>
Options outstanding at 6/30/06	2,135,200	\$ 25.41	\$ 47,968	5.1 years
Options exercisable at 6/30/06	1,799,700	\$ 24.08	\$ 42,829	4.5 years

Total compensation cost not yet recognized for nonvested stock options outstanding as of June 30, 2006 is approximately \$1.5 million and is expected to be recognized over a remaining weighted-average period of 2.0 years.

The following table summarizes activity in performance unit awards for the six-month period ended June 30, 2006:

	<u>Performance Unit Awards</u>	<u>Weighted-Average Grant Date Fair Value</u>
Awards outstanding December 31, 2005	578,000	\$ 27.60
Awards canceled	(260,000)	\$ 24.44
Awards issued to employees	(354,750)	\$ 30.20
Awards granted	656,500	\$ 39.78
Awards outstanding June 30, 2006	619,750	\$ 40.34

During the six-month period ended June 30, 2006, performance unit awards granted in 2002 and 2003 were canceled as the performance criteria for the awards was not met. In addition, performance unit awards granted in 2004 were earned at 150% resulting in an additional 166,500 units earned. Of the total units earned under the 2004 award, 354,750 shares with a

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fair value of \$15.3 million at the distribution date were issued during the six-month period ended June 30, 2006 with the remaining 129,750 units to be issued in shares of our common stock upon completion of the remaining vesting requirements at the beginning of 2007. Of the total 354,750 shares issued, 15,000 shares with a fair value of \$0.7 million at the distribution date were issued during the three-month period ended June 30, 2006. During the six-month period ended June 30, 2006, the Executive Compensation Committee of our Board of Directors approved a performance unit award grant totaling 490,000 units to be paid in shares of our common stock. The units will be earned at a level ranging from 0

150% contingent upon the achievement of specific performance criteria over a two-year period. Distribution of 50% of the earned units will occur upon completion of the two-year measurement period and the remaining 50% of the earned units will occur one year thereafter. There were no performance unit awards granted during the three-month period ended June 30, 2006 or the three or six-month periods ended June 30, 2005. Total compensation cost not yet recognized for nonvested performance unit awards outstanding as of June 30, 2006 is approximately \$26.6 million and is expected to be recognized over a remaining weighted-average period of 2.0 years.

The following table summarizes activity in non-performance based restricted stock awards for the six-month period ended June 30, 2006:

	<b>Non-Performance</b>	
	<b>Based Restricted</b>	
	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Awards outstanding December 31, 2005	52,000	\$ 35.03
Awards canceled	(3,000)	\$ 36.67
Awards granted	14,000	\$ 46.45
<b>Awards outstanding June 30, 2006</b>	<b>63,000</b>	<b>\$ 37.49</b>

During 2004, 25,000 shares of non-performance based restricted stock were granted and cliff vest after three years. During 2005, 7,000 and 20,000 shares of non-performance based restricted stock were granted and cliff vest over three and five years, respectively. In the six-month period ended June 30, 2006, 14,000 shares of non-performance based restricted stock were granted and cliff vest after three years. In addition, in the six-month period ended June 30, 2006, a 2005 award of 3,000 shares of non-performance based restricted stock was canceled due to the voluntary termination of an employee prior to the completion of the three year vesting term. The weighted-average grant date fair value of non-performance based restricted stock granted during the three and six-month periods ended June 30, 2006 was \$46.45. There were no non-performance based restricted stock grants during the three-month period ended June 30, 2005. The weighted-average grant date fair value of non-performance based restricted stock granted during the six-month period ended June 30, 2005 was \$38.17. Total compensation cost not yet recognized for nonvested non-performance based restricted shares as of June 30, 2006 is approximately \$1.6 million and is expected to be recognized over a remaining weighted-average period of 3.0 years.

13. Commitments and Contingencies.

The following table summarizes our unused letters of credit and guarantee agreements (in thousands):

3Q	4Q	Sub-total	2007	2008	2009	2010	2011	There-
2006	2006	2006						after

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Letters of credit and guarantees	\$ 4,812	\$ 6,494	\$ 11,306	\$ 40,398	\$ 8,783	\$ 869	\$ 47	\$ 309	\$ 858
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We also have contracts with certain of our customers, which serve as guarantees on product delivery and performance according to customer specifications that can cover both shipments on an individual basis as well as blanket coverage of multiple shipments under customer supply contracts, that are executed through certain financial institutions. The financial coverage provided by these guarantees is typically based on a percentage of net sales value.

In connection with the our remediation of a local landfill site as required by the German environmental authorities, we have pledged certain of our land and housing facilities at our Bergheim, Germany plant site with a recorded value of \$5.6 million.

On April 2, 2004, Albemarle Overseas Development Company, or AODC, one of our wholly owned subsidiaries, initiated a Request for Arbitration against Aventis S.A., the predecessor in interest to Sanofi Aventis, or Aventis, through the International Chamber of Commerce, International Court of Arbitration, Paris, France, or the ICC. The dispute arose out of a 1992 Stock Purchase Agreement, or Agreement, between AODC and a predecessor to Aventis under which 100% of the stock of Potasse et Produits Chimiques, S.A., now known as Albemarle PPC, or APPC, was acquired by AODC. The dispute relates to a chemical facility in Thann, France, owned by APPC, where the French government has required a detailed risk study of groundwater contamination. In 2005 and 2006, the French government instructed APPC to conduct a number of

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additional tests and studies and take certain measures with respect to the containment of certain contamination at, and the emission of certain materials from, the facility. By reason of certain intervening assignments of rights, Albemarle France SAS, another wholly owned subsidiary of Albemarle Corporation, was substituted for AODC as the party in interest in the arbitration.

The Request for Arbitration demanded indemnification by Aventis for certain costs incurred by APPC in connection with any environmental claims of the French government for the APPC facility and a declaratory judgment as to the liability of Aventis under the Agreement for costs to be incurred in the future by APPC in connection with such claims. Arbitration hearings took place in June 2005, and the arbitration panel appointed in accordance with the ICC rules issued a Partial Award as to the question of liability on March 11, 2006. In this Partial Award, the arbitration tribunal held that (i) the indemnity given by Aventis with respect to remediation and decontamination at the facility was valid and enforceable; (ii) claims by APPC against Aventis based on mercury contamination must be brought within 10 years of the date of the occurrence of such damage; (iii) claims by APPC against Aventis based on contamination by substances other than mercury must be brought by November 18, 2006; and (iv) APPC had not performed fully its obligation to inform Aventis in a timely fashion of certain matters relating to the indemnity, but that the consequence of such failure was not a forfeiture of APPC's rights under the Agreement. The arbitration tribunal also outlined its interpretation of various requirements of the Agreement related to APPC's obligation to operate the facility with reasonable care and in compliance with applicable laws and regulations in order to be able to enforce the indemnity, but did not rule on whether APPC had operated the facility in such a manner. The parties were unable to reach a resolution of the dispute in the time period specified by the arbitration tribunal. As a result, the arbitration tribunal has indicated that it will appoint an expert to assist the tribunal in making a determination of the exact amount of the liabilities, if any, owed by Aventis to APPC and other matters at issue in the arbitration. A further hearing on the matter of the expert and other issues is currently scheduled for late September 2006. We continue to believe that we are entitled to be fully indemnified by Aventis for any and all environmental liabilities at the site, but no assurance can be given that we will prevail in the next phase of the arbitration.

APPC is currently engaged in the consultation process required by French law with the Works Council at its facility in Thann, France, related to the potential shutdown of that facility. Under French law, a final decision concerning the potential shutdown of a facility can be made only after the consultation process is completed. Upon completion of the process, APPC would expect to take a pre-tax charge in the range of \$100 million, exclusive of any costs related to environmental matters. Under French law, once a facility is closed, a redevelopment plan is to be developed by the operator and local stakeholders. The redevelopment plan would impact any environmental remediation plan for the site. At this time, no redevelopment plan has been developed and it is not possible to predict what redevelopment or remediation activities the French government may require at the site as the regulations do not define specific requirements. Since environmental matters are subject to many uncertainties, the costs of environmental remediation could be significant, but cannot be quantified at this time. In any event, we believe that we are entitled to be fully indemnified by Aventis for all such environmental liabilities, but no assurance can be given that we ultimately will prevail against Aventis.

In addition, we are involved from time to time in legal proceedings of types regarded as common in our businesses, particularly administrative or judicial proceedings seeking remediation under environmental laws, such as Superfund, products liability and premises liability litigation. We maintain a financial accrual for these proceedings that includes defense costs and potential damages, as estimated by our general counsel. We also maintain insurance to mitigate certain of such risks.

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14. In accordance with SFAS No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106, the following information is provided for interim domestic and foreign pension and postretirement benefit plans:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
(In thousands)				
<b>Net Periodic Pension Benefit Cost:</b>				
Service cost	\$ 2,927	\$ 4,761	\$ 5,659	\$ 9,612
Interest cost	7,228	7,439	14,689	14,931
Expected return of assets	(9,630)	(10,881)	(19,574)	(21,807)
<b>Amortization of Unrecognized Amounts:</b>				
Net transition asset	(3)	(2)	(5)	(4)
Prior service (benefit) cost	(408)	115	(483)	230
Net loss	3,285	2,086	5,980	4,172
<b>Total net periodic pension benefit cost</b>	<b>\$ 3,399</b>	<b>\$ 3,518</b>	<b>\$ 6,266</b>	<b>\$ 7,134</b>

Also, during the three-month period ended June 30, 2006, a plan in the Netherlands was favorably settled in the amount of approximately \$0.3 million in accordance with SFAS No. 88, Employers' Accounting for Settlements and Curtailments of Defined Pension Plans and for Termination Benefits, which is not reflected in the table above. This settlement is in connection to a collective bargaining agreement with the employees authorized representatives for our Netherlands operations. In fourth quarter of 2005, we made plan changes that modified projected obligations for certain transition benefits under this defined benefit plan and adopted a new plan for specified Netherlands participants, which is similar to a collective defined contribution plan. The new plan is supported by annuity contracts through an insurance company. The insurance company unconditionally undertakes the legal obligation to provide specified benefits to specific individuals in return for fixed amount of premiums. Our obligation under this new plan is limited to a variable calculated employer match for each participant plus an additional fixed amount of contributions to assist in covering estimated cost of living and salary increases (indexation) and administrative costs for the overall plan.

We made a \$0.2 million contribution to a foreign funded pension plan during the six-month period ended June 30, 2006. We expect to contribute another \$0.2 million to the foreign funded pension plan during the remainder of 2006. We did not make any contributions to our domestic pension plans during the six-month period ended June 30, 2006.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
(In thousands)				
<b>Net Periodic Postretirement Benefit Cost:</b>				
Service cost	\$ 192	\$ 468	\$ 418	\$ 937
Interest cost	1,023	1,097	1,958	2,195
Expected return of assets	(132)	(120)	(265)	(240)
Plan curtailment gain*		(5,603)		(5,603)

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Amortization of Unrecognized Amounts:

Prior service benefit	(976)	(358)	(1,953)	(716)
Net loss	272	96	389	192
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total net periodic postretirement benefit cost (credit)	\$ 379	\$ (4,420)	\$ 547	\$ (3,235)
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

\* The three and six-month periods ended June 30, 2005 include a curtailment gain amounting to \$5.6 million (\$3.6 million after income taxes, or seven cents per-share) that relates to a reduction in our accumulated postretirement benefit obligation (liability) associated with a change in coverage in our unfunded postretirement health care benefits plan for active employees future retiree medical premium payments.

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15. Recently Issued Accounting Pronouncements.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 and 140, or SFAS No. 155. SFAS No. 155 amends FASB Statements No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS No. 155 resolves issues addressed in FASB Statement No. 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial Interests in Securitized Financial Assets*. SFAS No. 155 is effective for fiscal years beginning after September 15, 2006. The adoption of SFAS No. 155 is not expected to have any impact on our reported results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an Interpretation of FASB Statement 109, or FIN No. 48. FIN No. 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return (including a decision whether to file or not to file a return in a particular jurisdiction). The guidance will become effective as of the beginning of the company's fiscal year beginning after December 15, 2006. We are currently evaluating what impact the adoption of FIN No. 48 will have on our reported results of operations.

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

The following is a discussion and analysis of our financial condition and results of operations since December 31, 2005. A discussion of consolidated financial condition and sources of additional capital is included under a separate heading "Financial Condition and Liquidity" on page 28.

***Forward-looking Statements***

Some of the information presented in this Quarterly Report on Form 10-Q may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on our current expectations, which are in turn based on assumptions that we believe are reasonable based on our current knowledge of our business and operations. We have used words such as anticipate, believe, could, estimate, expect, intend, may, should, will and variations of such words and similar expressions to identify forward-looking statements.

These forward-looking statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict and many of which are beyond our control. There can be no assurance, therefore, that our actual results will not differ materially from the results and expectations expressed or implied in the forward-looking statements. Factors that could cause actual results to differ materially include, without limitation:

- the timing of orders received from customers;
- the gain or loss of significant customers;
- competition from other manufacturers;
- changes in the demand for our products;
- limitations or prohibitions on the manufacture and sale of our products;
- increases in the cost of raw materials and energy, and our inability to pass through such increases;
- changes in our markets in general;
- fluctuations in foreign currencies;
- changes in laws and regulations;



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the occurrence of claims or litigation;

the inability to maintain current levels of product or premises liability insurance or the denial of such coverage;

political unrest affecting the global economy, including adverse effects from terrorism or hostilities;

changes in accounting standards;

the inability to achieve results from our global manufacturing cost reduction initiatives as well as our ongoing continuous improvement and rationalization programs;

changes in interest rates, to the extent they (1) affect our ability to raise capital or increase our cost of funds, (2) have an impact on the overall performance of our pension fund investments and (3) increase our pension expense and funding obligations;

the costs associated with any redevelopment or remediation activities at the Thann, France facility that may be required by the French government; and

the other factors detailed from time to time in the reports we file with the SEC.

We assume no obligation to provide revisions to any forward-looking statements should circumstances change, except as otherwise required by securities and other applicable laws. The following discussion should be read together with our consolidated financial statements and related notes included in this Quarterly Report on Form 10-Q.

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### ***Overview and Outlook***

We are a leading global developer, manufacturer and marketer of highly engineered specialty chemicals. Our products and services enhance the value of our customers' end-products by improving performance, providing essential product attributes, lowering cost and simplifying processing. We sell a highly diversified mix of products to a wide range of customers, including manufacturers of consumer electronics, building and construction materials, automotive parts, packaging, pharmaceuticals and agrichemicals, and petroleum refiners. We believe that our commercial and geographic diversity, technical expertise, flexible, low-cost global manufacturing base and experienced management team enable us to maintain leading market positions in those areas of the specialty chemicals industry in which we operate.

Growth of our Polymer Additives segment is expected to be derived from increasing demand for electrical and electronic equipment, new construction and increasingly stringent fire-safety regulations in many countries around the world. Growth in our Catalysts segment is expected to be driven by increasing global demand for petroleum products, generally deteriorating quality of crude oil feedstock and implementation of more stringent fuel quality requirements as a part of anti-pollution initiatives. The Fine Chemicals segment continues to benefit from the continued rapid pace of innovation and the introduction of new products, coupled with a movement by pharmaceutical companies to outsource certain research, product development and manufacturing functions.

### ***2006 Outlook***

#### ***Polymer Additives***

During the second half of the year, we expect stable volumes and continued pricing initiatives to offset raw material and energy costs that continue to rise.

We are continuing our progress in establishing a presence in China as a foundation for expanding our business in Asia. Our technology center in Nanjing is expected to be operational by late 2006. This center will provide technical support for our Polymer Additives customers in the Asia Pacific region. In addition, we plan to build a phosphorous flame retardant plant in Nanjing, which should be fully operational in the second half of 2007. We would produce two of our phosphorous flame retardants at this site to serve the growing Asian construction and electronic markets.

We will continue our efforts to educate manufacturers and the public about the safety and benefits of our flame-retardants. Various groups continue to evaluate the impact of brominated flame-retardants on the environment and we intend to continue our support of sound scientific testing of these materials.

#### ***Catalysts***

We continue to operate in essentially a sold out position in both our fluidized catalytic cracking, or FCC, and hydroprocessing, or HPC, catalysts product lines. We expect strong HPC catalysts volumes for the third quarter, dropping off moderately in the fourth quarter as new diesel sulfur specifications went into effect mid-year. In addition, as oil prices remain elevated, we believe refiners will use more sour crudes, which will

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require HPC catalysts to remove the metals and impurities, further driving demand for these catalysts. We have begun construction on our new HPC catalysts plant at Bayport, Texas, which is expected to be operational in early 2007. This plant will add approximately 10,000 metric tons to our capacity.

Our focus in FCC catalysts is on improving margins by driving price increases to support the value these products bring to the market. In 2005, we announced the first significant price increase for these catalysts in over ten years and have focused intently in 2006 on achieving these increases. We believe that this price increase, along with announced surcharges, will help offset the increasing raw material and energy costs to manufacture these catalysts and will allow margin recovery and expansion for these catalysts.

We are focused on new product development in catalysts, and have introduced high-throughput experimentation to more rapidly test and develop new technologies. Our marketing and research groups are tightly aligned so we can continue to bring innovative technologies to the market. We will continue to explore new opportunities for our catalysts in the rapidly growing gas to liquids (GTL) and coal to liquids (CTL) markets, which remain viable as oil remains at historically high levels.

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### *Fine Chemicals*

We expect to continue the turnaround of our fine chemicals segment in the second half of 2006; however, increased profitability may come at the expense of lower sales. In addition to an overall focus on margin improvement, our two strategic areas of focus in Fine Chemicals have been to maximize our bromine franchise value and to continue the growth of our fine chemistry services business. Our goal is to profitably grow our globally competitive bromine and derivatives production network to serve all major bromine consuming products and markets. We will also continue our focus on developing our fine chemistry services business. Our new products pipeline in this business has approximately doubled in the last three years, allowing us to develop preferred outsourcing positions serving leading chemical innovators in diverse industries.

We remain confident in continuing to generate growth in profitable niche products leveraged from this service business. Last quarter we announced the initiation of the consultation process required by French law with the Works Council at our facility in Thann, France related to the potential shutdown of that facility. Upon completion of the process, we would expect to take a pre-tax charge in the range of \$100 million, exclusive of any costs related to environmental matters. Since environmental matters are subject to many uncertainties, the costs of any environmental remediation at this facility could be significant, but cannot be quantified at this time. As we have previously stated, we believe that we are entitled to be fully indemnified for all such environmental liabilities, but no assurance can be given that we will prevail in any proceeding s seeking indemnification.

We are optimistic for the prospects of our plant in Orangeburg, South Carolina, that we recently converted into a multi-purpose asset, enabling us to take advantage of new products commercializing from our research and development pipeline. We will continue to explore other similar ways to profitably redeploy assets where possible.

### *Corporate and Other*

We are in the final stages of completing the implementation of a Belgian-based European trading company that will allow us to centralize certain European activities at a single focal point and pay down external debt faster than we would otherwise. We estimate the benefit of this structure to provide approximately \$1 million monthly, or \$12 million annually, in tax savings on a sustainable basis beginning in the third quarter of this year. As part of this trading company structure, we have relocated certain of our long-term debt, approximately \$128 million, from the U.S. to Europe, where we will be able to use lower-taxed foreign earnings to repay it locally.

Additional information regarding our products, markets and financial performance is provided at our web site, [www.albemarle.com](http://www.albemarle.com). Our web site is not a part of this document nor is it incorporated herein by reference.

**Table of Contents****Results of Operations**

The following data and discussion provides an analysis of certain significant factors affecting our results of operations during the periods included in the accompanying condensed consolidated statements of income.

**Second Quarter 2006 Compared with Second Quarter 2005**

Selected Financial Data (Unaudited)	Three Months Ended June 30,		
	2006	2005	Percentage Change
	(In millions, except percentages and per-share amounts)		
Net sales	\$ 568.8	\$ 502.8	13%
Cost of goods sold	437.4	397.6	10%
As a percentage of net sales	76.9%	79.1%	
Gross profit	131.4	105.2	25%
As a percentage of net sales	23.1%	20.9%	
Selling, general and administrative and research and development expenses	73.4	64.0	15%
As a percentage of net sales	12.9%	12.7%	
Effective tax rate	25.3%	38.8%	
Net income available for common shareholders	\$ 43.3	\$ 32.1	35%
Basic earnings per-share	\$ 0.92	\$ 0.69	
Diluted earnings per-share	\$ 0.89	\$ 0.67	

**Net Sales**

For the three-month period ended June 30, 2006, we recorded net sales of \$568.8 million, an increase of \$66.0 million, or 13%, compared to net sales of \$502.8 million for the three-month period ended June 30, 2005. This increase was due primarily to improved pricing and increased volume in our Catalysts and Polymer Additives segments, partially offset by reduced volumes in our Fine Chemicals segment and by the effects of unfavorable foreign exchange rates. Overall prices increased 9% and volumes grew 5% compared to the same period last year.

Polymer Additives net sales increased \$24.1 million, or 12%, for the three-month period ended June 30, 2006 compared to the same period in 2005. Compared to last year, prices rose 12% and volume grew 1%. Catalysts net sales increased \$46.7 million, or 32%, due mainly to a 4% increase in prices and a 29% increase in volume. Fine Chemicals net sales decreased \$4.8 million, or 3%, primarily due to reduced volumes of 12% offset by improved pricing of 10%. Offsetting these revenue increases were the effects of unfavorable foreign exchange rates in all segments. For a detailed discussion of revenues and segment income before taxes for each segment see Segment Results below.

*Gross Profit*

For the three-month period ended June 30 2006, our gross profit increased \$26.2 million to \$131.4 million, or 25%, from the corresponding 2005 period due to increased volume and improved pricing. These increases were partially offset by increased manufacturing cost, raw material cost, and the effect of unfavorable foreign exchange rates. Our gross profit margin for the three-month period ended June 30, 2006 increased to 23.1% from 20.9% for the corresponding period in 2005.

*Selling, General and Administrative and Research and Development Expenses*

For the three-month period ended June 30 2006, our selling, general and administrative, or SG&A, expenses and research and development, or R&D, expenses increased \$9.4 million, or 15%, from the three-month period ended June 30, 2005. This increase was primarily due to higher SG&A costs from increased consulting fees related to the implementation of a Belgian-based trading company, and increased wages and incentive compensation. As a percentage of net sales, SG&A and R&D were 12.9% in the three-month period ended June 30, 2006 versus 12.7% in the three-month period ended June 30, 2005.

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### *Interest and Financing Expenses*

Interest and financing expenses for the three-month period ended June 30, 2006 amounted to \$12.0 million, an increase of \$1.9 million from \$10.1 million in the three-month period ended June 30, 2005. This increase was primarily due to the impact of \$1.6 million for the consolidation of Jordan Bromine Company Limited, or JBC, effective August 1, 2005 and higher rates on our average outstanding debt in the 2006 period.

### *Other (Expenses) Income, Net*

For the three-month period ended June 30, 2006, our other (expenses) income, net amounted to (\$2.3 million), an increase of \$2.4 million from the three-month period ended June 30, 2005. This increase was primarily due to a foreign exchange adjustment of approximately \$3.0 million on foreign denominated debt at JBC.

### *Income Taxes*

Our effective tax rate fluctuates based on, among other factors, where income is earned and the level of income relative to available tax credits. For the three-month period ended June 30, 2006, our effective income tax rate was 25.3%, down from 38.8% for the three-month period ended June 30, 2005. This decrease is due primarily to the effects of foreign subsidiaries' earnings, which were permanently reinvested, and the benefits from foreign tax credits associated with high taxed earnings from foreign operations.

### *Minority Interests in Income of Consolidated Subsidiaries*

For the three-month period ended June 30, 2006, minority interests' share of net income was \$0.4 million compared to \$1.0 million in the same period last year. Our minority interests in income of consolidated subsidiaries included the minority ownership charges for Stannica LLC, or Stannica, and JBC as compared to the three-month period ended June 30, 2005, when only the minority ownership charges of Stannica were included. More than offsetting the inclusion of JBC in 2006 is the minority interest portion of the foreign exchange adjustment on foreign denominated debt at JBC, see *Other (Expenses) Income, Net* above.

### *Equity in Net Income of Unconsolidated Investments*

Equity in net income of unconsolidated investments was \$11.1 million for both three-month periods ended June 30, 2006 and 2005. The three-month period ended June 30, 2005 included equity income of \$4.6 million for our portion of JBC's earnings. Offsetting the decrease due to the consolidation of JBC in 2006, was an increase in the equity income of our Catalysts' segment joint ventures of \$4.1 million, which had strong sales and improved pricing.

### *Net Income*

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Our net income increased 35% to \$43.3 million in the three-month period ended June 30, 2006 from \$32.1 million in the three-month period ended June 30, 2005 primarily due to increased sales, improved margins, and reduced taxes.

*Segment Results*

	Three months ended		Percentage Change
	June 30,		
	2006	2005	
(In millions, except percentages)			
<b>Segment net sales:</b>			
Polymer Additives	\$ 228.6	\$ 204.5	12%
Catalysts	194.0	147.3	32%
Fine Chemicals	146.2	151.0	(3)%
<b>Total segment net sales</b>	<b>\$ 568.8</b>	<b>\$ 502.8</b>	<b>13%</b>
<b>Segment income (loss):</b>			
Polymer Additives	\$ 39.2	\$ 28.4	38%
Catalysts	29.5	24.3	21%
Fine Chemicals	13.8	14.9	(7)%
Corporate & Other	(13.8)	(11.5)	20%
<b>Total segment income</b>	<b>\$ 68.7</b>	<b>\$ 56.1</b>	<b>22%</b>



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Segment income (losses) includes equity in net income of unconsolidated investments and is reduced by minority interests in income of consolidated subsidiaries. See Note 11 in the Notes to the Condensed Consolidated Financial Statements.

### *Polymer Additives*

The Polymer Additives segment recorded net sales for the three-month period ended June 30, 2006 of \$228.6 million, up \$24.1 million, or 12%, versus the three-month period ended June 30, 2005. Our brominated, mineral, and phosphorous flame retardant portfolios volumes were flat; however, pricing in these portfolios improved 15%. Net sales improved in stabilizers and curatives as volumes increased 5% and prices improved 6%. Segment income increased 38%, or \$10.8 million, to \$39.2 million due mainly to improved pricing and increased volume, partially offset by increased manufacturing costs and the effect of unfavorable foreign exchange rate, for the three-month period ended June 30, 2006 as compared to the three-month period ended June 30, 2005, which included a special gain item of \$2.2 million.

### *Catalysts*

Our Catalysts segment recorded net sales for the three-month period ended June 30, 2006 of \$194.0 million, up \$46.7 million, or 32%, versus the three-month period ended June 30, 2005, due mainly to a 4% pricing improvement and increased volume of 27% in refinery catalysts. These increases were offset in part by lower volumes in our polyolefin catalysts. Segment income increased 21%, or \$5.2 million, to \$29.5 million due mainly to higher pricing and increased volume offset by increased raw material cost and higher manufacturing costs associated with a planned shutdown at our Pasadena, Texas, polyolefin catalysts plant, for the three-month period ended June 30, 2006 as compared to the three-month period ended June 30, 2005, which included a special item gain of \$0.6 million. In addition, equity income of our Catalysts joint ventures increased \$4.0 million compared to the same period last year, due to strong sales and improved pricing.

### *Fine Chemicals*

Fine Chemicals segment net sales for the three-month period ended June 30, 2006 were \$146.2 million, down \$4.8 million, or 3%, versus the three-month period ended June 30, 2005. This decrease was due mainly to reduced volume of the bromine portfolio and our fine chemistry services of 10% and 17%, respectively, partially offset by pricing improvements of 16% across the bromine portfolio. Prices remained flat in our fine chemistry services business. Fine Chemicals segment income for the three-month period ended June 30, 2006 was \$13.8 million, down \$1.1 million, or 7%, from the three-month period ended June 30, 2005, due mainly to a special item gain of \$2.2 million in 2005, increased raw material and manufacturing costs partially offset by improved pricing.

### *Corporate and Other*

For the three-month period ended June 30, 2006, our Corporate and Other expenses increased \$2.3 million, or 20%, to \$13.8 million from the three-month period ended June 30, 2005. This increase was primarily due to the higher SG&A costs related to increased consulting fees and increased wages and incentive compensation partially offset by the minority interest portion of the foreign exchange adjustment on foreign denominated debt at JBC.



**Table of Contents***Six-Months 2006 Compared with Six-Months 2005*

Selected Financial Data (Unaudited)	Six Months Ended June 30,		Percentage Change
	2006	2005	
	(In millions, except percentages and per-share amounts)		
Net sales	\$ 1,176.2	\$ 1,012.7	16%
Cost of goods sold	922.4	800.2	15%
As a percentage of net sales	78.4%	79.0%	
Gross profit	253.8	212.5	19%
As a percentage of net sales	21.6%	21.0%	
Selling, general and administrative and research and development expenses	142.7	132.0	8%
As a percentage of net sales	12.1%	13.0%	
Effective tax rate	25.7%	38.3%	
Net income available for common shareholders	\$ 77.7	\$ 56.4	38%
Basic earnings per-share	\$ 1.65	\$ 1.22	
Diluted earnings per-share	\$ 1.60	\$ 1.19	

*Net Sales*

For the six-month period ended June 30, 2006, we recorded net sales of \$1,176.2 million, an increase of \$163.5 million, or 16%, compared to the net sales of \$1,012.7 for the six-month period ended June 30, 2005. This increase was mainly due to improved pricing and increased volume in our Polymer Additives and Catalysts segments and improved pricing in our Fine Chemicals segment, partially offset by the effects of unfavorable foreign exchange rates. Overall prices increased 12% and volumes grew 7% compared to the same period last year.

Polymer Additives net sales increased \$48.0 million, or 12%, for the six-month period ended June 30, 2006 compared to the same period in 2005. Compared to last year, prices rose 12% and volume grew 3%. Catalysts net sales increased \$109.3 million, or 34%, due mainly to an 11% increase in prices and a 27% increase in volume. Fine Chemicals net sales increased \$6.2 million, or 2%, primarily due to improved pricing of 12%; however, this increase was partially offset by reduced volumes of 7%. Offsetting these revenue increases were the effects of unfavorable foreign exchange rates in all segments. For a detailed discussion of revenues and segment income before taxes for each segment and division see Segment Results below.

*Gross Profit*

For the six-month period ended June 30, 2006, our gross profit increased \$41.3 million to \$253.8 million, or 19%, from the corresponding 2005 period due to increased volume and improved pricing. These increases were partially offset by increased raw material and manufacturing costs, and the effect of unfavorable foreign exchange rates. In addition, our Catalysts segment had higher manufacturing costs associated with a planned shutdown at our Pasadena, Texas polyolefin catalysts plant. Our gross profit margin for the six-month period ended June 30, 2006 increased nominally to 21.6% from 21.0% for the corresponding period in 2005.

*Selling, General and Administrative and Research and Development Expenses*

For the six-month period ended June 30, 2006, our SG&A and R&D expenses increased \$10.7 million, or 8%, from the six-month period ended June 30, 2005. This increase was primarily due to higher SG&A costs from increased consulting fees related to the implementation of a Belgian-based trading company, and increased wages and incentive compensation. As a percentage of net sales, SG&A and R&D were 12.1% in the six-month period ended June 30, 2006 versus 13.0% in the six-month period ended June 30, 2005.

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### *Interest and Financing Expenses*

Interest and financing expenses for the six-month period ended June 30, 2006 amounted to \$22.7 million, an increase of \$2.3 million from \$20.4 million in the six-month period ended June 30, 2005. This increase was primarily due to the consolidation of JBC effective August 1, 2005 and the impact of \$2.5 million in the six-month period ended June 30, 2006 on our interest and financing expenses from the inclusion of the debt of JBC. The higher interest and financing expenses were also impacted by higher rates on our average outstanding debt in the 2006 period. Interest and financing expenses for 2005 included the write-off of \$1.4 million of deferred financing expenses associated with a \$450.0 million 364-day bridge loan that we retired on January 20, 2005.

### *Other (Expenses) Income, Net*

For the six-month period ended June 30, 2006, our other (expenses) income, net amounted to \$1.4 million, an increase of \$1.9 million from the six-month period ended June 30, 2005. This increase was primarily due to a foreign exchange adjustment of approximately \$3.0 million on foreign denominated debt at JBC.

### *Income Taxes*

Our effective tax rate fluctuates based on, among other factors, where income is earned and the level of income relative to available tax credits. For the six-month period ended June 30, 2006, our effective income tax rate was 25.7%, down from 38.3% for the six-month period ended June 30, 2005. This decrease is due primarily to the effects of foreign subsidiaries' earnings, which were permanently reinvested, and the benefits from foreign tax credits associated with high taxed earnings from foreign operations.

### *Minority Interests in Income of Consolidated Subsidiaries*

For the six-month period ended June 30, 2006, minority interests' share of net income was \$3.6 million compared to \$2.5 million in the same period last year. Our minority interests in income of consolidated subsidiaries included the minority ownership charges for Stannica and JBC as compared to the six-month period ended June 30, 2005, when only the minority ownership charges of Stannica were included, as JBC was an unconsolidated investment for that period. Partially offsetting the inclusion of JBC is the minority interest benefit of the foreign exchange adjustment on foreign denominated debt at JBC.

### *Equity in Net Income of Unconsolidated Investments*

Equity in net income of unconsolidated investments decreased to \$16.6 million from \$18.5 million due to the consolidation of JBC in the six-month period ended June 30, 2006. The six-month period ended June 30, 2005 included equity income of \$6.5 million for our portion of JBC's earnings. Partially offsetting this decrease was an increase in the equity income of our Catalysts' segment joint ventures of \$4.0 million, which had strong sales and improved pricing.

*Net Income*

Our net income increased 38% to \$77.7 million in the six-month period ended June 30, 2006 from \$56.4 million in the six-month period ended June 30, 2005 primarily due to increased sales, improved margins, and reduced taxes.

**Table of Contents****Segment Results**

	Six months ended June 30,		Percentage Change
	2006	2005	
(In millions, except percentages)			
<b>Segment net sales:</b>			
Polymer Additives	\$ 450.5	\$ 402.5	12%
Catalysts	429.4	320.1	34%
Fine Chemicals	296.3	290.1	2%
<b>Total segment net sales</b>	<b>\$ 1,176.2</b>	<b>\$ 1,012.7</b>	<b>16%</b>
<b>Segment income (loss):</b>			
Polymer Additives	\$ 70.5	\$ 50.7	39%
Catalysts	54.8	49.4	11%
Fine Chemicals	23.5	26.4	(11)%
Corporate & Other	(24.7)	(25.2)	(2)%
<b>Total segment income</b>	<b>\$ 124.1</b>	<b>\$ 101.3</b>	<b>23%</b>

Segment income (losses) includes equity in net income of unconsolidated investments and is reduced by minority interests in income of consolidated subsidiaries. See Note 11 in the Notes to the Condensed Consolidated Financial Statements.

*Polymer Additives*

The Polymer Additives segment recorded net sales for the six-month period ended June 30, 2006 of \$450.5 million, up \$48.0 million, or 12%, versus the six-month period ended June 30, 2005. Our brominated, mineral and phosphorous flame retardant portfolios experienced 3% volume increases and 14% pricing improvements. Net sales improved in stabilizers and curatives as volumes increased 6% and prices improved 3%. Segment income increased 39%, or \$19.8 million, to \$70.5 million due mainly to improved pricing and increased volume, partially offset by increased manufacturing costs and the effect of unfavorable foreign exchange rate, for the six-month period ended June 30, 2006 as compared to the six-month period ended June 30, 2005, which included a special gain item of \$2.2 million.

*Catalysts*

Our Catalysts segment had net sales for the six-month period ended June 30, 2006 of \$429.4 million, up \$109.3 million, or 34%, versus the six-month period ended June 30, 2005, due mainly to a 11% pricing improvement and increased volume of 27% in refinery catalysts. These increases were offset in part by lower volumes in our polyolefin catalysts. Segment income increased 11%, or \$5.4 million, to \$54.8 million due mainly to higher pricing and increased volume offset by increased raw material cost and higher manufacturing costs associated with a planned

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shutdown at our Pasadena, Texas, polyolefin catalysts plant, for the six-month period ended June 30, 2006 as compared to the six-month period ended June 30, 2005, which included a special item gain of \$0.6 million. In addition, equity income of our Catalysts joint ventures increased \$4.0 million compared to the same period last year, due to strong sales and improved pricing.

### *Fine Chemicals*

Fine Chemicals segment net sales for the six-month period ended June 30, 2006 were \$296.3 million, up \$6.2 million, or 2% versus the six-month period ended June 30, 2005. This increase was due mainly to pricing improvements of 13% across the bromine portfolio and increased prices of 3% in our fine chemistry services with reduced volume of 2% and 10%, respectively, partially offsetting the increase. Segment income decreased 11%, or \$2.9 million, to \$23.5 million for the six-month period ended June 30, 2006 from the six-month period ended June 30, 2005, due mainly to a special item gain of \$2.2 million in 2005, and increased raw material and manufacturing costs, partially offset by improved pricing.

### *Corporate and Other*

For the six-month period ended June 30, 2006, our Corporate and Other expenses decreased \$0.5 million, or 2%, to \$24.7 million for the six-month period ended June 30, 2005. This decrease was primarily due to the minority interest portion of the foreign exchange adjustment on foreign denominated debt at JBC partially offset by higher SG&A costs related to increased consulting fees and increased wages.



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### ***Financial Condition and Liquidity***

#### ***Overview***

The principal uses of cash in our business generally have been investment in our assets, funding working capital, and repayment of debt. Cash to fund the needs of our business has been provided primarily by operations, debt financing, and equity issuances.

We expect activity levels to continue to increase over the next twelve to twenty-four months. The increase in activity may cause working capital to increase. We have initiated a program to improve working capital efficiency and working capital metrics particularly in the areas of accounts receivable and inventory. We expect our current cash balances and our availability under our revolving credit facility, which is discussed below, to be sufficient to fund working capital requirements. Identified capital expenditure projects for the remainder of 2006 are expected to be approximately \$50 million to \$60 million. These projects are primarily related to new facilities and upgrades and expansions to our existing facilities.

#### ***Cash Flow***

Our cash balance increased by \$40.4 million to \$99.0 million at June 30, 2006 from \$58.6 million at December 31, 2005. For the six-month period ended June 30, 2006, our continuing operations provided \$131.8 million of cash compared to \$41.3 million in the six-month period ended June 30, 2005 primarily due to improvements in working capital as a proportion to revenue and an increase in net income. Cash flows from operating activities funded investing activities of \$52.1 million, which consisted principally of capital expenditures for plant machinery and equipment improvements. Remaining cash flows from operating activities together with proceeds from borrowings and the exercise of stock options of \$130.7 million and \$12.9 million, respectively, funded long-term debt repayments of \$165.0 million, purchases of our common stock of \$9.9 million and quarterly dividends to shareholders. This resulted in net cash used by financing activity of \$44.9 million.

Net current assets increased \$61.7 million to \$513.5 million at June 30, 2006 from \$451.7 million at December 31, 2005. The increase in net current assets was related to increased activity and was due primarily to an increase in cash and accounts receivable.

Our foreign currency translation adjustments, net of related deferred taxes, included in accumulated other comprehensive income (loss) in the condensed consolidated balance sheets on page 4 increased from December 31, 2005, primarily due to the weakening of the U.S. dollar against the Euro.

#### ***Long-Term Debt***

We currently have \$325.0 million of 5.10% senior notes that are due in 2015. These notes are senior unsecured obligations and will rank equally with all of our other senior unsecured indebtedness from time to time outstanding. The senior notes will be effectively subordinated to any of our future secured indebtedness and to existing and future indebtedness of our subsidiaries. We may redeem the senior notes before their maturity, in whole at any time or in part from time to time, at a redemption price equal to the greater of (1) 100% of the principal amount of the senior notes

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to be redeemed or (2) the sum of the present values of the remaining scheduled payments of principal and interest thereon (exclusive of interest accrued to the date of redemption) discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate (as defined in the indenture governing the senior notes) plus 15 basis points, plus, in each case, accrued interest thereon to the date of redemption.

The principal amount of the senior notes becomes immediately due and payable upon the occurrence of certain bankruptcy or insolvency events involving us or certain of our subsidiaries and may be declared immediately due and payable by the trustee or the holders of not less than 25% of the senior notes upon the occurrence of an event of default. Events of default include, among other things: failure to pay principal or interest at required times; failure to perform or remain in breach of covenants within prescribed periods; an event of default on any of our other indebtedness or certain of our subsidiaries of \$40.0 million or more that is caused by a failure to make a payment when due or that results in the acceleration of that indebtedness before its maturity; and certain bankruptcy or insolvency events involving us or certain of our subsidiaries.

For additional funding and liquidity purposes, we currently maintain a senior credit agreement with financial institutions that consists of a \$300.0 million revolving credit facility and a \$450.0 million five-year term loan facility. In June 2006, we amended our senior credit facilities to add certain additional subsidiary borrowers located outside the U.S. and to allow borrowings by those our foreign subsidiaries to be denominated in currencies other than the U.S. dollar. Key terms of this agreement remain unchanged. There were no borrowings outstanding under the revolving credit facility and an aggregate of \$357.1 million equivalent outstanding under the five-year term loan facility at June 30, 2006. The aggregate of

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\$357.1 million equivalent outstanding was comprised of \$235.5 million of borrowings denominated in U.S. dollars borrowed by domestic subsidiaries and 97.0 million (\$121.6 million based on the applicable exchange rate on June 30, 2006) of borrowings denominated in Euros borrowed by subsidiaries in Germany and the Netherlands. Borrowings under the five-year term loan facility bear interest at variable rates, which was a weighted average of 5.20% at June 30, 2006. The \$450.0 million five-year term loan facility is payable in quarterly installments of \$7.4 million and 3.0 million (\$3.8 million based on the applicable exchange rate on June 30, 2006) through June 30, 2008, and quarterly payments of \$58.9 million and 24.2 million (\$30.4 million based on the applicable exchange rate on June 30, 2006) at September 30, 2008, December 31, 2008 and March 31, 2009.

Borrowings under our senior credit agreement are conditioned upon compliance with the following financial covenants: (a) consolidated fixed charge coverage ratio, as defined, must be greater than or equal to 1.25:1.00 as of the end of any fiscal quarter; (b) consolidated debt to capitalization ratio, as defined, at the end of any fiscal quarter must be less than or equal to 60%; (c) consolidated tangible domestic assets, as defined, must be or greater than or equal to \$750.0 million for us to make investments in entities and enterprises that are organized outside the United States; and (d) with the exception of liens specified in our new senior credit agreement, liens may not attach to assets where the aggregate amount of all indebtedness secured by such liens at any time exceeds 10% of consolidated net worth, as defined in the agreements.

The noncurrent portion of our long-term debt amounted to \$748.3 million at June 30, 2006, compared to \$775.9 million at the end of 2005. In addition, at June 30, 2006, we had the ability to borrow an additional \$395.3 million under our various credit arrangements.

Capital expenditures for the six-month period ended June 30, 2006 of \$49.0 million were approximately 35% higher than the 2005 level of \$36.2 million. Our capital spending program in 2006 is expected to be approximately \$100 million to \$110 million with expenditures expected to expand capacities at existing facilities to support an expected increase in sales. We expect our capital spending program to be approximately \$80 to \$90 million in 2007 and 2008. We anticipate that future capital spending will be financed primarily with cash flow provided from operations with additional cash needed, if any, provided by borrowings, including borrowings under our revolving credit facility. The amount and timing of any additional borrowings will depend on our specific cash requirements.

**Other Obligations**

The following table summarizes our contractual obligations for plant construction, purchases of equipment, unused letters of credit, and various take or pay and throughput agreements (in thousands):

	3Q	4Q	Sub-total						There-
	2006	2006	2006	2007	2008	2009	2010	2011	after
Long-term debt obligations	\$ 12,169	\$ 12,169	\$ 24,338	\$ 48,786	\$ 205,234	\$ 129,587	\$ 4,861	\$ 341,267	\$ 25,773
Capital lease obligation		1,419	1,419	2,963	3,135	3,317	3,509	3,711	1,935
Expected interest payments on long-term debt obligations*	9,229	11,135	20,364	35,672	32,220	20,538	19,156	18,693	55,860
Operating lease obligations (rental)	2,567	2,567	5,134	6,595	4,893	3,679	3,326	3,097	22,977
Take or pay / throughput agreements	50,760	50,760	101,520	14,054	8,788	6,895	6,514	6,029	21,014
Letters of credit and guarantees	4,812	6,494	11,306	40,398	8,783	869	47	309	858
Capital projects	23,459	5,695	29,154	15,260	627	690	627		
Additional investment commitment payments		48	48	117	51	21	20		

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Natural gas contracts	2,974	904	3,878							
Total	\$ 105,970	\$ 91,191	\$ 197,161	\$ 163,845	\$ 263,731	\$ 165,596	\$ 38,060	\$ 373,106	\$ 128,417	

\* These amounts are based on a weighted-average interest rate of 5.5% for term loans and the revolving credit facility, 5.1% for variable rate long-term debt obligations and a capital lease and an interest rate of 5.1% for the senior notes for 2006. The weighted average rate for years 2007 and thereafter are 6.25% for term loans and the revolving credit facility and 4.6% for the variable rate long-term debt obligations and a capital lease and an interest rate of 5.1% for the senior notes.

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We are subject to federal, state, local and foreign requirements regulating the handling, manufacture and use of materials (some of which may be classified as hazardous or toxic by one or more regulatory agencies), the discharge of materials into the environment and the protection of the environment. To our knowledge, we are currently complying and expect to continue to comply in all material respects with applicable environmental laws, regulations, statutes and ordinances. Compliance with existing federal, state, local and foreign environmental protection laws is not expected to have in the future a material effect on earnings or our competitive position, but the costs associated with increased legal or regulatory requirements could have an adverse effect on our results.

Among other environmental requirements, we are subject to the federal Superfund law, and similar state laws, under which we may be designated as a potentially responsible party, or PRP, and may be liable for a share of the costs associated with cleaning up various hazardous waste sites. Management believes that in most cases, our participation is de minimis. Further, almost all such sites represent environmental issues that are quite mature and have been investigated, studied and in many cases settled. In de minimis situations, our policy generally is to negotiate a consent decree and to pay any apportioned settlement, enabling us to be effectively relieved of any further liability as a PRP, except for remote contingencies. In other than de minimis PRP matters, our records indicate that unresolved PRP exposures should be immaterial. We accrue and expense our proportionate share of PRP costs. Because management has been actively involved in evaluating environmental matters, we are able to conclude that the outstanding environmental liabilities for unresolved PRP sites should not be material to operations.

### ***Liquidity Outlook***

We anticipate that cash provided from operating activities in the future and borrowings under our senior credit agreement will be sufficient to pay our operating expenses, satisfy debt service obligations, fund capital expenditures and make dividend payments. For flexibility, we maintain a shelf registration statement that permits us to issue from time to time a range of securities, including common stock, preferred stock and senior and subordinated debt of up to \$220.0 million. In addition, as we have historically done, we will continue to evaluate the merits of any opportunities that may arise for acquisitions of equipment or businesses, which may require additional liquidity.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

There have been no significant changes in our interest rate risk, marketable security price risk or raw material price risk from the information we provided in the Annual Report on Form 10-K for the year ended December 31, 2005, except as noted below.

We had outstanding variable interest rate borrowings at June 30, 2006 of \$398.4 million, bearing an average interest rate of 5.08%. A change of 0.125% in the interest rate applicable to these borrowings would change our annualized interest expense by approximately \$0.5 million. Due to the increase in our outstanding indebtedness as a result of the acquisition of the refinery catalysts business, we may enter into interest rate swaps, collars or similar instruments with the objective of reducing interest rate volatility relating to our borrowing costs.

In 2004, we entered into treasury lock agreements, or T-locks, with a notional value of \$275.0 million, to fix the yield on the U.S. Treasury security used to set the yield for approximately 85% of our January 2005 public offering of senior notes. The T-locks fixed the yield on the U.S. Treasury security at approximately 4.25%. The value of the T-locks resulted from the difference between (1) the yield-to-maturity of the 10-year U.S. Treasury security that had the maturity date most comparable to the maturity date of the notes issued and (2) the fixed rate of approximately 4.25%. The cumulative loss effect of the T-lock agreements was \$2.2 million and is being amortized over the life of the notes as an adjustment to the notes interest expense. At June 30, 2006, there were unrealized losses of approximately \$1.9 million (\$1.2 million after income taxes) in accumulated other comprehensive income (loss) that remain to be expensed.

In addition, certain of our operations use natural gas as a source of energy, which can expose our business to market risk when the price of natural gas changes suddenly. In an attempt to mitigate the impact and volatility of price swings in the natural gas market, we purchase natural gas contracts, when appropriate, for a portion of our 12-month rolling forecast for North American natural gas requirements.

Our natural gas hedge transactions are executed with a major financial institution. Such derivatives are held to secure natural gas at fixed prices and not for trading.

Our natural gas contracts qualify as cash flow hedges and are marked to market. The unrealized gains and/or losses on these contracts are deferred and accounted for in accumulated other comprehensive income (loss) to the extent that the unrealized gains and losses are offset by the forecasted transaction. At June 30, 2006, there were unrealized losses of approximately \$1.0 million (\$0.6 million after income taxes). Realized natural gas hedge losses for the six-month period ended June 30, 2006 were nominal. Additionally, any unrealized gains and/or losses on the derivative instrument that are not offset by the forecasted transaction are recorded in earnings as appropriate.

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

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act), as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer concluded that, as of end of the period covered by this report, our disclosure controls and procedures are effective 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, and that such information 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.

No change in our internal control over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f)) occurred during the second quarter ended June 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

On April 2, 2004, Albemarle Overseas Development Company, or AODC, one of our wholly owned subsidiaries, initiated a Request for Arbitration against Aventis S.A., the predecessor in interest to Sanofi Aventis, or Aventis, through the International Chamber of Commerce, International Court of Arbitration, Paris, France, or the ICC. The dispute arose out of a 1992 Stock Purchase Agreement, or Agreement, between AODC and a predecessor to Aventis under which 100% of the stock of Potasse et Produits Chimiques, S.A., now known as Albemarle PPC, or APPC, was acquired by AODC. The dispute relates to a chemical facility in Thann, France, owned by APPC, where the French government has required a detailed risk study of groundwater contamination. In 2005 and 2006, the French government instructed APPC to conduct a number of additional tests and studies and take certain measures with respect to the containment of certain contamination at, and the emission of certain materials from, the facility. By reason of certain intervening assignments of rights, Albemarle France SAS, another wholly owned subsidiary of Albemarle Corporation, was substituted for AODC as the party in interest in the arbitration.

The Request for Arbitration demanded indemnification by Aventis for certain costs incurred by APPC in connection with any environmental claims of the French government for the APPC facility and a declaratory judgment as to the liability of Aventis under the Agreement for costs to be incurred in the future by APPC in connection with such claims. Arbitration hearings took place in June 2005, and the arbitration panel appointed in accordance with the ICC rules issued a Partial Award as to the question of liability on March 11, 2006. In this Partial Award, the arbitration tribunal held that (i) the indemnity given by Aventis with respect to remediation and decontamination at the facility was valid and enforceable; (ii) claims by APPC against Aventis based on mercury contamination must be brought within 10 years of the date of the occurrence of such damage; (iii) claims by APPC against Aventis based on contamination by substances other than mercury must be brought by November 18, 2006; and (iv) APPC had not performed fully its obligation to inform Aventis in a timely fashion of certain matters relating to the indemnity, but that the consequence of such failure was not a forfeiture of APPC's rights under the Agreement. The arbitration tribunal also outlined its interpretation of various requirements of the Agreement related to APPC's obligation to operate the facility with reasonable care and in compliance with applicable laws and regulations in order to be able to enforce the indemnity, but did not rule on whether APPC had operated the facility in such a manner. The parties were unable to reach a resolution of the dispute in the time period specified by the arbitration tribunal. As a result, the arbitration tribunal has indicated that it will appoint an expert to assist the tribunal in making a determination of the exact amount of the liabilities, if any, owed by Aventis to APPC and other matters at issue in the arbitration. A further hearing on the matter of the expert and other issues is currently scheduled for late September 2006. We continue to believe that we are entitled to be fully indemnified by Aventis for any and all environmental liabilities at the site, but no assurance can be given that we will prevail in the next phase of the arbitration.

In addition, we are involved from time to time in legal proceedings of types regarded as common in our businesses, particularly administrative or judicial proceedings seeking remediation under environmental laws, such as Superfund, products liability and premises liability litigation. We maintain a financial accrual for these proceedings that includes defense costs and potential damages, as estimated by our general counsel. We also maintain insurance to mitigate certain of such risks.



**Table of Contents****Item 1A. Risk Factors.**

While we attempt to identify, manage and mitigate risks and uncertainties associated with our business to the extent practical under the circumstances, some level of risk and uncertainty will always be present. Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2005 describes some of the risks and uncertainties associated with our business. These risks and uncertainties have the potential to materially affect our results of operations and our financial condition. We do not believe that there have been any material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2005.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

The following table summarizes our repurchases of equity securities for the three months ended June 30, 2006:

<u>Period</u>	<u>Total Number of Shares Repurchased</u>	<u>Average Price Paid Per-Share</u>	<u>Total Number of Shares Repurchased as Part of Publicly Announced Plan or Program *</u>	<u>Maximum Number of Shares that May Yet Be Repurchased Under the Plans or Programs *</u>
April 1, 2006 to April 30, 2006				
May 1, 2006 to May 31, 2006				
June 1, 2006 to June 30, 2006	19,800	\$ 45.74	19,800	3,649,946
<b>Total</b>	<b>19,800</b>	<b>\$ 45.74</b>	<b>19,800</b>	<b>3,649,946</b>

\* The stock repurchase plan, which was authorized by our Board of Directors, became effective on October 25, 2000 and included five million shares. The stock repurchase plan will expire when we have repurchased all shares authorized for repurchase thereunder, unless the repurchase plan is earlier terminated by action of our Board of Directors.

**Item 6. Exhibits.**

(a) Exhibits

- 31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)
- 31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)
- 32.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350
- 32.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(b) and 18 U.S.C. Section 1350

