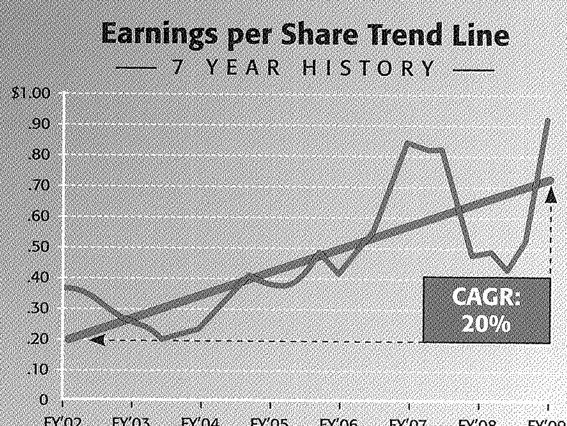
KMG

2009 CEO Letter to the Shareholders

KMG

Dear Fellow Shareholders:

I am very pleased to report that despite an extremely challenging year, your company, KMG, performed exceptionally well in fiscal 2009. The severe global recession necessitated we reduce expenses and adjust annual objectives for each of our businesses. We indeed achieved these recession-adjusted goals, reporting record net sales, operating income, net income and diluted earnings per share. At the same time, we significantly deleveraged the balance sheet, paving the way for our next acquisition, which we expect to consummate in the current fiscal year. This was the result of the additive affect of many successes across the entire organization, and I want to use this forum to express my appreciation and great pride in the entire KMG Team. Their diligence, dedication and determination were foundational to our operational and financial success.

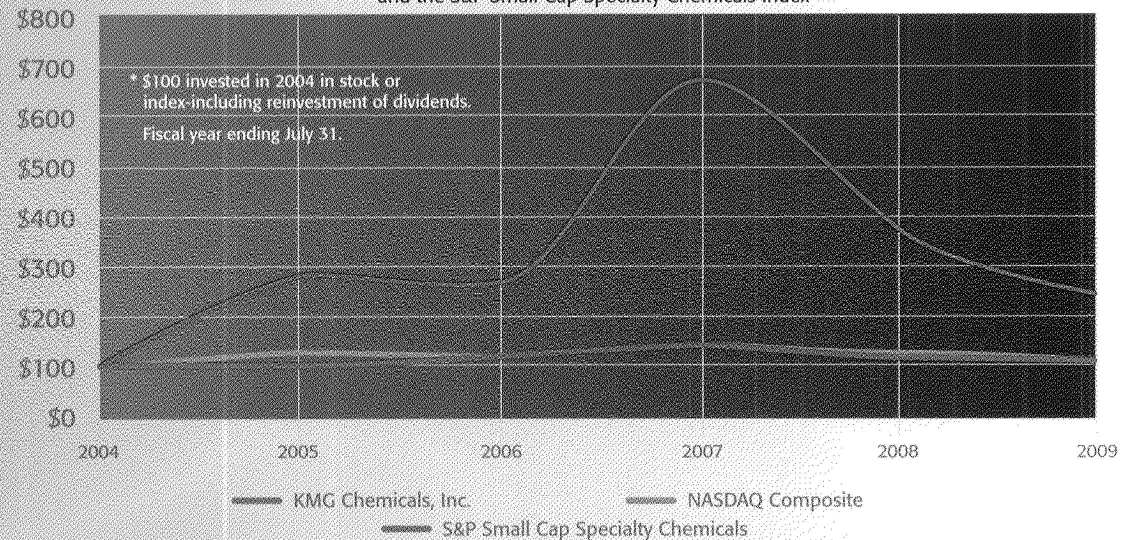


Some of you may recall that in last year's Letter to Shareholders accompanying our 2008 Annual Report, I wrote, "*we were highly dissatisfied with the Company's overall performance*" and promised to you, our shareholders, to do better in Fiscal 2009, and better we did. The year-over-year improvements in the face of one of the most severe economic downturns in recent history, demonstrate the strength of KMG's business model and meticulous execution combined with the commitment and flexibility of the KMG Team.

To appreciate the accomplishments of fiscal 2009, they should be viewed in the context of our hard-earned track record, highlighted by a 20% compound annual growth rate in diluted earnings per share since formalizing our acquisition program seven years ago. Since going public in 1996, our sales and book value per share have grown at a compound annual growth rate of 19% and 18%, respectively. Moreover, for the fourth consecutive year, KMG's growth and success have been

Comparison of Five Year Cumulative Total Return*

Among KMG Chemicals, Inc., The NASDAQ Composite Index
and the S&P Small Cap Specialty Chemicals Index



LOOKING FORWARD – Fiscal 2010 Outlook

Having described our expectations for each of our business segments earlier in this letter, we expect fiscal 2010, in the aggregate, to be modestly better than fiscal 2009, assuming a continuation of the gradual economic recovery we are currently seeing. This excludes the impact of an acquisition. However, the robust pipeline of acquisition opportunities we have been cultivating, along with the strength of our balance sheet, makes us confident that we will accomplish our 2010 goal of closing our next acquisition. We are targeting product lines that fall within our existing segments and would require total invested capital of $30 million or less.

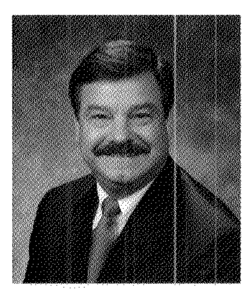
Fiscal 2010 while no doubt challenging, will provide continued opportunity to grow through the execution of our strategies. Beginning the year with a healthy balance sheet, improved operational efficiencies and a fully integrated infrastructure sets the stage for closing on an acquisition that is both financial and strategic within one of our current platforms.

On behalf of our Board of Directors, I again extend our deepest appreciation to the 272 goal-oriented members of the KMG Team for their commitment, creativity and overall contribution to the success of our Company. We also appreciate the support of our customers, bankers, and, very importantly, our shareholders.

Sincerely,

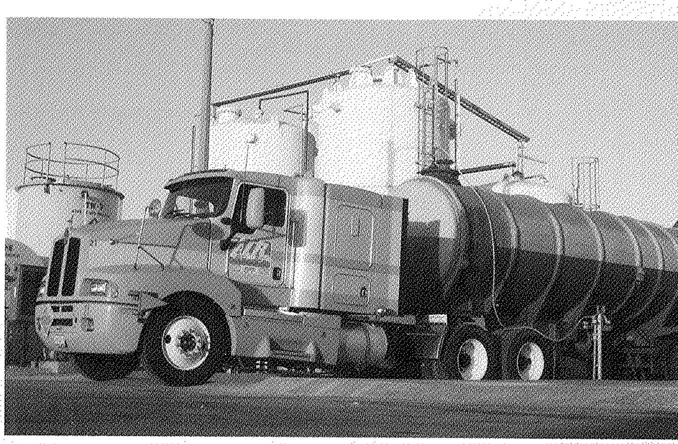
J. Neal Butler

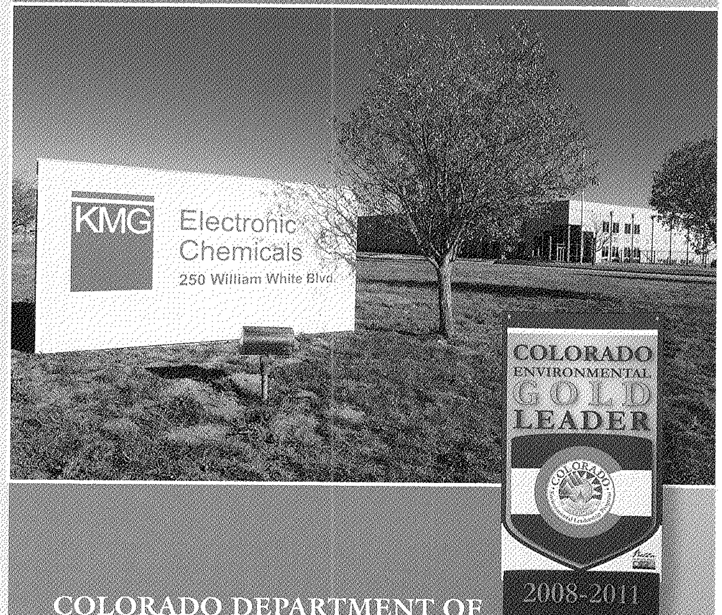
President and CEO



J. Neal Butler
President,
Chief Executive Officer

in a number of ways including 1) an ongoing shift toward using large recyclable containers for chemical products versus disposable containers, and 2) we have also reformulated some of our products with replacements made from renewable sources versus those manufactured from petrochemical-based materials.





COLORADO DEPARTMENT OF PUBLIC HEALTH AND ENVIRONMENT

KMG Electronic Chemicals applied for and was accepted into the Environmental Leadership Program (ELP) in October 2008. We met the standards for the Gold Level ELP Award. This requires a fully developed and functioning Environmental Management System, a clean environmental compliance record, a past record of exceeding the minimum goals of environmental compliance through recycling, waste reduction and reduction of electrical usage and natural resources such as water and natural gas. Our Pueblo, Colorado plant's goals for 2009 were reduction of electrical use by 10%, reclassification of the plant as a small quantity generator, and to consume 5% less natural gas. We are very proud that the Pueblo Plant met or exceeded all these goals.

CORPORATE VALUES

Concurrent with our environmental philosophy, KMG hosted the "World's Environmental Day" with the school, which was also hosted by the city's environmental department. We take pride in being a welcome corporate citizen and making a difference in the communities where we operate.

KMG's corporate philosophy is also reflected in our respect for the environment. Penta-treated utility poles have a 60-plus-year track record of environmental safety, backed by EPA registration. Penta-treated wood poles have an average life span of 40 years and when removed from service, they are reused and recycled in a number of ways, including fence posts, lamp posts and supports for vehicle shelters, as well as burned for energy in combustion units and industrial boilers.

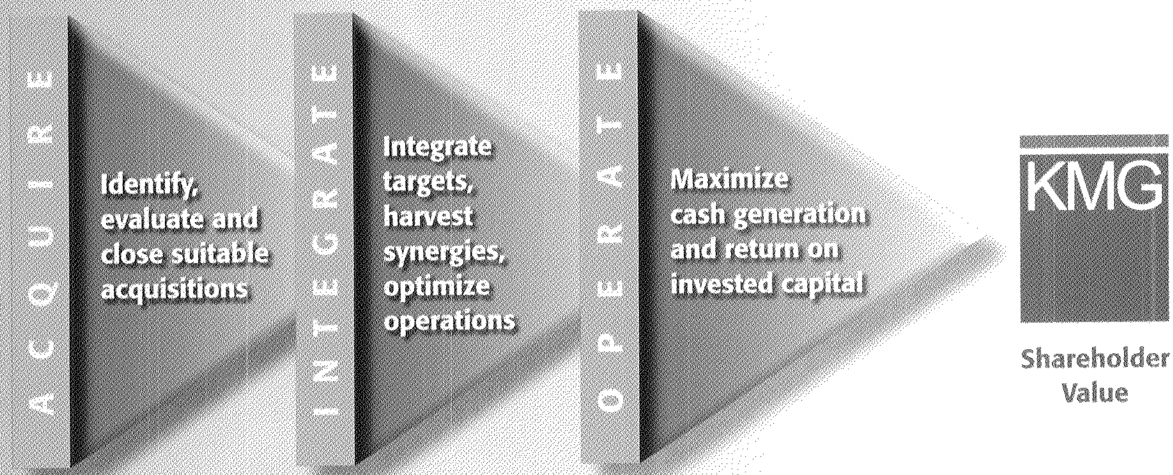
The railroad industry is the largest user of creosote-treated wood and continues to be so because of its unsurpassed cost-effective performance. Creosote-treated wooden crossties have remained in service for over 50 years. Once taken out of service, treated crossties can be recycled in much the same way as Penta-treated wood. Treated wood utility poles and crossties provide for use of a renewable resource and reduce the carbon footprint when compared to replacement with steel or concrete products.

The semiconductor industry has strived to minimize its environmental impact. One of our largest customers was recently cited by *Newsweek* as one of "*The Top 5 Greenest Big Companies in America.*" KMG collaborates with its customers

CORPORATE VALUES

Being a responsible corporate citizen is among our highest priorities, and that means safety first and foremost. It also means providing encouragement, training, and upward mobility to our people. In that vein, we have implemented a formalized development program to provide growth opportunities for our personnel as well as to effectively leverage internal talents and skills across all of our businesses. Ingrained in KMG's corporate culture is to give back to the communities in which we operate. For example, our Penta manufacturing plant is in Matamoros, Mexico. Since 2003, KMG has helped with a wide range of projects for an under-funded elementary school in this community. Last year, we aided in rebuilding the school's roof and the children's restrooms. KMG has also helped organize graduation ceremonies at the school and incentivizes its students with merit-based prizes.

KMG



CORPORATE STRATEGY

Since we embarked on our acquisition strategy in 1996, we have remained committed to our core purpose, which is to *discover and grow value that others overlook*, and in so doing, deliver long-term sustainable growth in earnings per share to our shareholders. KMG's business strategy is simple – identify, evaluate and close suitable acquisitions, then integrate them, harvest synergies, and optimize operations, maximizing cash generation and return on invested capital. The execution of this strategy is in no way easy, and we focus on improving the core competencies necessary to ensure they are a functional part of everything we do.

Our acquisition process is very deliberate and disciplined. Our strategy entails finding product lines and businesses that are proven, require minimal R&D, are generally too small to be attractive for larger players and can provide significant market share with a clear path towards market leadership through further acquisitions and organic growth.

Core Purpose: Discover and grow value that others overlook

CORE VALUES

- *Safety First*
- *Reliability to Customers*
- *Run Lean*
- *Character Counts; Respect for Others*
- *Excellence in Simplicity*

We also look for niche products that have significant barriers to entry and offer potential for margin expansion. With our last acquisition, Electronic Chemicals, we also made significant enhancements to our corporate infrastructure and significantly increased our management bench strength, actions designed to produce integration efficiencies for future acquisitions.

Our core values, *Reliability to Customers*, *Run Lean*, and *Excellence in Simplicity* are much more than buzz words at KMG; they are at the heart of our day-to-day business decisions and actions.

As we pointed out in fiscal 2008's Annual Report Letter to Shareholders and other KMG communications, micro-economic factors including the high cost of feed, fuel and fertilizer had a profound effect on our Animal Health product sales, by adversely impacting the profitability of livestock operations. The same circumstances prevailed in fiscal 2009 coupled with the poor price of beef and poultry causing growers to minimize discretionary purchases, such as insecticidal ear tags and other parasitic fly and pest control products. In addition, the credit crisis of 2009 drove distributors to reduce inventory levels during the 2009 fiscal year.

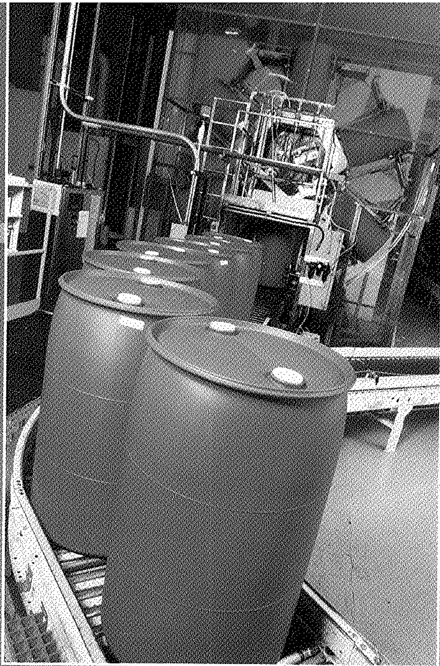
ANIMAL HEALTH

Thus, Animal Health sales declined 6.2% in fiscal 2009 sales from fiscal 2008, but by taking appropriate action, notably downsizing the cost structure of this operation, the Animal Health segment remained profitable in fiscal 2009.

While focusing on improving efficiencies and lowering costs in fiscal 2009, we also continued to look for opportunities to expand and diversify our sales and geographic distribution. That led to an alliance with AgriLabs to market and distribute KMG's Animal Health solutions. We believe this marketing and sales alliance will enhance service to our customers as well as generate greater exposure for our products into the cattle market.

With this leaner organization, expanded U.S. distribution opportunities and continued efforts in Latin America, we look forward to a material improvement in our Animal Health business in fiscal 2010.

2009 CEO LETTER TO THE SHAREHOLDERS

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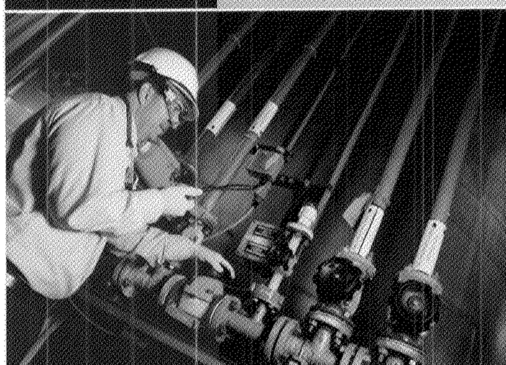
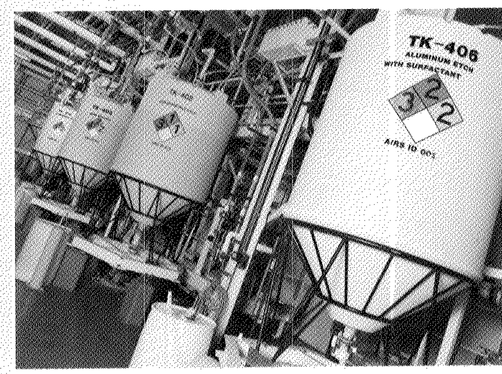


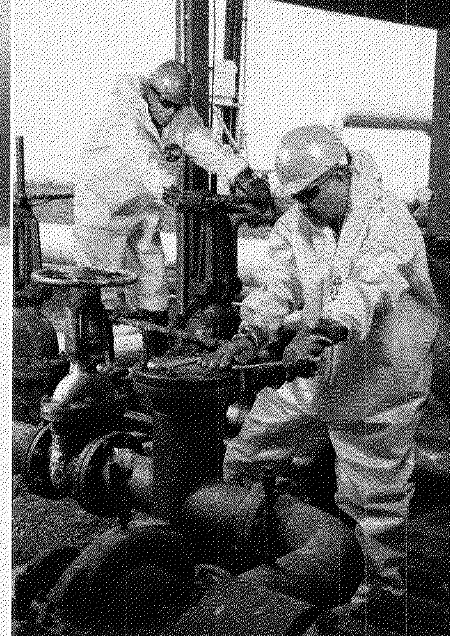


ELECTRONIC CHEMICALS

Our second largest segment, Electronic Chemicals, or high-purity wet-process chemicals used to clean, etch, and otherwise prepare the surface of semiconductor products, was negatively affected by the downturn of the global semiconductor market during the second half of fiscal 2009. For the entire 2009 fiscal year, our Electronic Chemicals segment generated net sales of $85.8 million compared to $61.2 million for the seven months we owned the business in fiscal 2008. Our sales slowed in the second and third quarters due to weakened demand; however, we began to see incremental improvement starting in the fourth quarter. Since our business concentration is in the U.S. rather than Asia, where the semiconductor market was hit the hardest, the sales decline was less severe and our U.S. operations were profitable; however, the more severe contraction in Europe's semiconductor market produced an operating loss for our European operations.

Despite the slowdown in the annual sales rate for Electronic Chemicals, the business generated about $3.7 million of operating income, up from $2.1 million in fiscal 2008, which was achieved through efficiency improvements identified during the integration of that business into our operations as previously discussed.

We believe we have passed the trough of the semiconductor downturn and expect to see a recovery in the Electronic Chemicals business during the 2010 fiscal year. With the increased operating efficiencies in this segment, we have laid the foundation and have the infrastructure in place to achieve a significant improvement in profitability when this happens.



Our Wood Preservatives business performed well in fiscal 2009, especially in the fourth fiscal quarter.

Creosote sales were up 23% to $67.8 million for the year, due primarily to price increases, driven by increased cost of goods that we implemented earlier in the year. We did experience a 4.1% decline in volume mostly due to modestly decreased demand. There was also a short-term, U.S.-sourced supply constraint in the fourth quarter of our fiscal year, but we were able to supplement creosote shipments with international imports and are confident that we can meet market demand going forward. In the second half of the year, demand by railroads for creosote-treated crossties, remained strong but we do expect crosstie purchasing to soften in the second half of our 2010 fiscal year. That could cause creosote sales volumes to decline, but we expect average margins in fiscal 2010 to be in line with those of fiscal 2009.

WOOD TREATING

KMG

Following the decline in Penta's operating income to $6.3 million in fiscal 2008 from $9.1 million in 2007, due primarily to higher raw materials costs, our Penta operating income climbed back to $9.0 million in fiscal 2009. Sales of Penta, the industrial wood preservative used to treat about 45% of utility poles in the U.S., were $26.2 million in fiscal 2009, slightly off from fiscal 2008's $26.4 million. The rebound in that segment's operating income was the result of reductions in several key raw materials in the second half of the fiscal year. In fiscal 2010, we expect sales to approximate those of the past two years, but margins should come under pressure compared to those of the second half of fiscal 2009 due to the price volatility of key raw materials used to manufacture Penta.

2009 CEO LETTER TO THE SHAREHOLDERS

Financial Highlights

(thousands, except per share amounts)	2009	2008	2007	2006	2005
Net Sales	$190,720	$154,394	$86,171	$67,200	$55,064
Gross Profit	64,167	46,831	30,436	23,625	17,396
Operating Income	20,849	11,493	15,118	9,923	5,770
Net Income	10,215	5,375	8,849	3,776	3,052
Earnings per Diluted Share	0.91	0.48	0.80	0.40	0.37
Weighted Average Diluted Shares Outstanding	11,230	11,232	11,034	9,447	8,256
Total Assets	143,508	155,798	81,233	72,702	61,103
Total Shareholders' Equity	70,977	63,687	56,410	46,918	32,888
Long-term Debt, Net of Current Portion	39,326	53,516	10,468	13,981	17,644
Depreciation and Amortization	6,168	5,665	3,832	3,889	2,204

recognized by *FORTUNE Small Business* and we were again named to the 2009 "FSB 100" list of America's fastest-growing small public companies, ranking #56, up from our 2008 rank of #72.

FINANCIAL OVERVIEW

In the first half of fiscal 2009, KMG was confronted by especially difficult business conditions due to a number of continual and intermittent forces including the general economic downturn, and volatile raw material costs. Counteroffensive measures were undertaken including raising prices in response to higher input costs, implementing improvements in supply chain and manufacturing efficiencies, and reducing the investment in receivables and inventory to repay debt, which trimmed our interest expense and strengthened our cash position.

For the year ended July 31, 2009, KMG achieved a 23.5% increase in revenues to a record $190.7 million from the prior year's $154.4 million. Operating income of $20.8 million, and net income and diluted earnings per share of $10.2 million, or $0.91 per diluted share, also set records, and almost doubled the $11.5 million in operating income, and $5.4 million in net income, or $0.48 per diluted share earned in fiscal 2008.

We are equally pleased with our balance sheet accomplishments. In last year's letter, one of our stated goals for fiscal 2009 was to deleverage in order to position the company for the next acquisition. By year-end, we paid off all borrowings under our $35 million revolving line of credit, and in total repaid almost $20 million of debt over the last half of the fiscal year. At year-end, there was $7.2 million in cash on our balance sheet and we had reduced our debt to $46 million, primarily by reducing the working capital requirements of the Electronic Chemicals business, as we optimized that previously acquired business following its integration into our operations.

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

Form 10-K

(Mark one)

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

For the fiscal year ended July 31, 2009

or

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

For the transition period from _________ to _____________

Commission file number: 000-29278

KMG CHEMICALS, INC.

(Exact name of registrant as specified in its charter)

Texas	**75-2640529**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

9555 W. Sam Houston Parkway S., Suite 600
Houston, Texas 77099
(Address of principal executive offices, including zip code)

(713) 600-3800
(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE EXCHANGE ACT:

Title of Each Class	Name of each Exchange on which Registered
Common Stock, $.01 par value	The Nasdaq Global Market

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

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

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

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

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.

Large Accelerated Filer ☐ Accelerated Filer ☐ Non-Accelerated Filer ☑ Smaller Reporting Company ☐

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant computed by reference to the price of $5.21 on the Nasdaq Global Market as of the last business day of the Company's most recently completed second fiscal quarter (January 31, 2009) was $31,618,000.

As of October 13, 2009, there were 11,112,695 shares of the registrant's common stock, par value $.01, per share outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The proxy statement pertaining to the December 8, 2009 annual meeting of shareholders is incorporated by reference in Part III of this report.

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

Company Overview

We manufacture, formulate and globally distribute specialty chemicals. We grow primarily by purchasing product lines and businesses that operate in segments of the specialty chemical industry that:

- provide an opportunity to obtain a significant share of the market segment through further acquisitions and organic growth;
- are of a size that larger industry participants generally find too small to be attractive;
- have niche products with well established and proven commercial uses;
- offer products that have moved well beyond their discovery phase and into their consolidation phase and require little or no on-going research and development expenditures; and
- have significant barriers to entry.

We have acquired and currently operate segments engaged in the electronic chemicals, industrial wood preserving and animal health businesses. Our electronic chemicals segment provides high purity wet process chemicals to the semiconductor industry, primarily to clean and etch silicon wafers in the production of semiconductors. We are the leading supplier of high purity wet process chemicals to the semiconductor industry in the United States, and have a significant presence in Europe. Our wood preserving chemicals, pentachlorophenol, or penta, and creosote, are sold to industrial customers who use these preservatives primarily to extend the useful life of utility poles and railroad crossties. We are the only supplier of penta in North America, and we are the principal supplier of creosote in the United States to wood treaters who do not produce their own creosote. Our animal health pesticides are used on cattle, swine and poultry to protect these animals from flies and other pests.

For the twelve months ended July 31, 2009, we generated revenues of $190.7 million and net income of $10.2 million. On July 31, 2009, we had total long-term debt, including the current portion, of $46.3 million, cash and cash equivalents of $7.2 million and total stockholders' equity of $71.0 million.

Business Strategy

Our goal is to continue to profitably grow in a manner that increases shareholder value. Our business strategies to achieve this are:

- *Operate.* We seek to increase the profitability and maximize the cash flow and return on invested capital of our businesses by focusing on customer satisfaction, rational pricing policies, optimization of operating assets, efficient management of raw material purchasing, and maintaining a low overhead structure.
- *Acquire.* The cash flow generated by the businesses that we operate provides us with the ability to pursue further acquisitions in order to build on one of our existing segments, or to establish a new business platform for future growth. We screen though many market segments and acquisition candidates to find opportunities that exhibit the characteristics described above. We systematically approach identified acquisition candidates to attempt to structure an acquisition that meets our financial requirements. We typically do not spend a material sum of money on third party services in pursuit of an acquisition candidate until we feel the opportunity has a reasonable likelihood of meeting our financial requirements and of closing.
- *Integrate.* We have consistently been improving our ability as an organization to efficiently integrate progressively larger acquisitions. Our focus is to maintain reliable service to our customers during the integration period, identify and harvest the long-term synergies, and efficiently absorb acquisitions into our operations. An effective integration strategy sets the stage for optimized operations.

Business Segments

Electronic Chemicals—North America and International Segments. Our electronic chemicals business sells high purity wet process chemicals to the semiconductor industry. High purity process chemicals are used to clean and etch silicon wafers in the production of semiconductors. The business was acquired in December 2007 from Air Products and Chemicals, Inc. ("Air Products"). Our products include sulfuric, phosphoric, nitric and hydrofluoric acids, ammonium hydroxide, hydrogen peroxide, isopropyl alcohol and various blends of chemicals. Our customers rely on us to provide products with very low levels of contaminants and particles, in some cases at < 100-500 parts per trillion levels. To accomplish that objective, we purchase chemicals as raw materials from various suppliers, some of which are further purified. We are then responsible for their purity level, for analytical testing, blending and packaging, and for distribution to our customers. Our products are sold in several containers, including bottles, drums, totes and in bulk. This process is largely accomplished at our Pueblo, Colorado, and Milan, Italy facilities, although we do contract with Air Products to produce certain products for us at their Dallas, Texas facility. We believe that the market for wet process chemicals is down from a year ago and is now approximately $160 million in the United States, $80 million in Europe and $450 million in Asia, including Japan. Of our total net sales in fiscal year 2009, the Electronic Chemicals-North America segment accounted for 37% and the Electronic Chemicals-International segment accounted for 8%. Our international segment sells primarily in Europe, and we do not yet participate materially in Asia. Our electronic chemicals business accounted for 45% of our net sales in fiscal year 2009 and 40% (over the seven months we had the business) in fiscal year 2008.

Wood Preserving Chemicals—Penta and Creosote Segments. We supply penta and creosote to industrial customers who use these products to extend the useful life of wood, primarily utility poles and railroad crossties. Our penta products include penta blocks, solutions and hydrochloric acid, a byproduct of penta production. Penta is used primarily to treat utility poles, protecting them from insect damage and decay. We estimate that approximately two million treated utility poles are purchased each year by electric utility companies in the United States and that approximately 45% are treated with penta. We manufacture solid penta blocks at our facility in Matamoros, Mexico. We sell solid penta to our customers, or make it into a liquid solution of penta concentrate at our Matamoros, Mexico and Tuscaloosa, Alabama facilities. We sell penta products primarily in the southeastern and northwestern United States and in Canada. The hydrochloric acid we produce as a byproduct of penta production is sold in Mexico for use in the steel and oil well service industries. Our penta segment constituted about 14% of our net sales in fiscal year 2009, 17% in fiscal year 2008 and 33% in fiscal year 2007.

Creosote is a wood preservative used to treat utility poles and railroad crossties. Creosote is produced by the distillation of coal tar, a by-product of the transformation of coal into coke. For several years, purchases of wood crossties by United States and Canadian railroads have been at the top of their historic range of from about 15.0 million to 21.0 million ties. In calendar 2008, we believe that crosstie purchases were somewhat greater than approximately 20.0 million ties per year. Almost all wood crossties are treated with creosote. We believe that less than 10% of utility poles are treated with creosote annually. We sell creosote to wood treaters throughout the United States. Our creosote segment constituted about 35% of our net sales in fiscal year 2009, 36% in 2008 and 51% in 2007.

Animal Health Pesticides Segment. We sell animal health pesticides to protect cattle, swine and poultry from flies and other pests. These animal health pesticides include oral larvicides, ear tags, sprays and dust products. We manufacture these products at our Elwood, Kansas facility or under agreements with third-party formulators. These products are sold under the trade names Avenger, Rabon, Ravap, Patriot and Annihilator, among others. We purchased the Rabon and Ravap product lines in fiscal years 2003 and 2004, respectively. The Rabon and Ravap products contain tetrachlorvinphos and include oral larvicides, insecticidal powders and liquid sprays. We sell these products in the United States and Canada. In February 2006, we expanded our presence in animal health pesticides by purchasing additional product lines, including insecticide ear tags for cattle, along with several liquid and dust formulations for livestock and their premises. These products are sold in the United States, Canada, Australia, Mexico and several other countries in Latin America. Our animal health pesticides segment comprised about 6% of our net sales in fiscal year 2009, 7% in fiscal year 2008 and 16% in fiscal year 2007.

Suppliers

In electronic chemicals we rely on a variety of suppliers for our raw materials, some of which we purchase on open account and others which we purchase under supply contracts, including sulfuric and phosphoric acid, isopropyl alcohol and hydrogen peroxide. The number of suppliers is often limited, particularly as to the specific grade of raw material required by us to supply high purity products to our customers. No assurance can be given that the loss of a supplier would not have a material adverse effect on our financial position or results of operations.

In our wood preserving chemical segments, we depend on outside suppliers for all of the raw materials needed to produce our penta products, and are subject to fluctuations in the price of those materials. The principal raw materials used for our penta products are chlorine, phenol and cosolvent, each of which we purchase from a limited number of suppliers. We purchase almost all of the creosote we sell from two suppliers, VFT Belgium N.V. and Koppers, Inc. Our creosote supply agreements with each of them provide that we purchase an agreed minimum volume of creosote in each calendar year at a fluctuating, mutually agreed or formula-based price. The creosote supply agreement we entered into with Koppers in fiscal year 2007 is for an initial term ending in 2017.

We generally have more than one source for raw materials for our animal health pesticides. However, we have only one major supplier of the tetrachlorvinphos active ingredient used in our Rabon and Ravap products. We also have only one supplier for two other animal health active ingredients, dichlorvos and endosulfan. Each of these three raw materials is purchased under supply agreements. We believe that where we do not have supply contracts, the necessary raw materials for our animal health pesticides are available from a variety of sources.

Customers

We sell our products to approximately 300 customers. One of our customers for electronic chemicals, Intel Corporation, accounted for 10% or more of our revenues in fiscal years 2009 and 2008. No other customer accounted for 10% or more of our revenues in fiscal years 2009 or 2008. No customer accounted for 10% or more of our revenues in fiscal years 2007. Assuming that the level of overall demand for wood preserving chemicals remains the same, we do not believe that the loss of any customer of our wood preserving or animal health segments would have a material adverse effect on sales of our wood preserving chemicals.

Marketing

We sell to our electronic chemicals customers through a combination of key account managers and account managers organized by geographic region. Our wood preserving chemicals and animal health pesticides are sold in the United States through a sales force organized by product or by geographic regions. We no longer sell wood preserving chemicals outside of North America, but for sales of animal health pesticides we have retained a sales representative in Latin America who has established and maintains a network of approximately 10 distributors for our products throughout that region.

Geographical Information

Sales made to customers in the United States were 91% of total revenues in fiscal years 2009 and 2008 and 97% in fiscal year 2007. In fiscal years 2009 and 2008, sales made outside of the United States were primarily electronic chemicals sold in Europe, particularly in Italy, France and England. Sales made outside of the United States in fiscal year 2007 were primarily wood preserving chemicals sold in Canada and Mexico. As of the end of fiscal year 2009, our property, plant and equipment were allocated, based on net book value, 65% in the United States, 30% in Italy where one of our electronic chemical facilities is located and 5% in Mexico where our penta manufacturing facility is located.

Competition

There are only a few firms competing with us in the sale of our products. We compete by selling our products at competitive prices and maintaining a strong commitment to product quality and customer service.

In electronic chemicals in North America, we believe we have the largest market share, and our principal competitors include General Chemical, Honeywell, Kanto Corporation and Mallinckrodt Baker. Internationally, we compete in Europe primarily against BASF, Honeywell and the OM Group. We believe BASF has a more significant market share than we do in Europe, but we believe our market share approximates that of the other two principal competitors in Europe. We do not participate materially in the market in Asia. We believe that the market for wet process chemicals is down from a year ago and is now approximately $160 million in the United States, $80 million in Europe and $450 million in Asia, including Japan.

The principal wood preserving chemicals for industrial users are penta, creosote and chromated copper arsenate, or CCA. We supply United States industrial users with both penta and creosote, but not CCA. We are the only manufacturer of penta in North America. Penta is used primarily to treat electric, telephone and other utility poles, to protect them from insect damage and decay. We estimate that approximately two million treated utility poles are purchased each year by utility companies in the United States. Of that amount, we estimate approximately 45% are treated with penta and that less than 10% are treated with creosote. The remaining poles are treated primarily with CCA. We believe that we have provided and will continue to provide the wood treating industry in the United States with most of its annual consumption of creosote not produced for internal use.

In the animal health pesticides segment, we compete with several companies, particularly in the production and marketing of ear tags. Our principal competitors include Bayer, Y Tex and Schering Plough. We believe that the market for animal health pesticides in the United States is currently about $78.0 million, and that our market share is similar to that of our principal competitors.

In our electronic chemicals business, our customers demand that each of their suppliers and each product used to make their semiconductors go through a rigorous qualification process. Once a customer has qualified a particular supplier and product for one of its fabrication facilities, there is often substantial reluctance to change that qualification. That means that once we have been qualified by a customer, it is often difficult for a competitor to get the customer to change. On the other hand, if the competitor is qualified by the customer and we are not, it is difficult for us to become qualified. Sometimes the customer will qualify more than one supplier and product, but where it does not there is a significant barrier to entry for a competitor.

Our wood preserving chemicals and our animal health pesticides must be registered prior to sale under United States law. See "—Environmental and Safety Matters—Licenses, Permits and Product Registrations". As a condition to registration, any company wishing to manufacture and sell these products must provide substantial scientific research and testing data regarding the chemistry and toxicology of the products to the U.S. Environmental Protection Agency ("EPA"). This data must be generated by the applicant, or the applicant must purchase access to the information from other data providers. We believe that the cost of satisfying the data submission requirement serves as an impediment to the entry of new competitors, particularly those with lesser financial resources. While we have no reason to believe that the product registration requirement will be discontinued or materially modified, we cannot give any assurances as to the effect of such a discontinuation or modification on our competitive position.

Employees

As of the end of fiscal year 2009, we had a total of 272 full-time employees. At our corporate offices in Houston, Texas, we employed 41 persons. At the end of the fiscal year, we had 67 employees at our Pueblo, Colorado facility, 71 at our Milan, Italy facility, 55 at the Matamoros, Mexico facility, nine at our Alabama facility, 11 in Kansas at our animal health operating facility, and the remainder of our employees worked from home. None of our employees in the United States are represented by a labor union. Approximately 50% of our employees in Mexico are represented under an annual labor agreement which was last renewed in May 2009. We believe that we have good relations with our employees.

Environmental and Safety Matters

Our operations are subject to extensive federal, state and local laws, regulations and ordinances in the United States and abroad relating to the generation, storage, handling, emission, disposal, transportation and discharge of certain materials, substances and waste into the environment, and various other health and safety matters. Governmental authorities have the power to enforce compliance with their regulations, and violators may be subject to civil, criminal and administrative penalties, injunctions or both. We must devote significant financial resources to ensure compliance, and we believe that we are in substantial compliance with all the applicable laws and regulations.

We anticipate that the regulation of our business operations under federal, state and local environmental regulations in the United States and abroad will increase and become more stringent over time. We cannot estimate the impact of increased and more stringent regulation on our operations, future capital expenditure requirements or the cost of compliance.

United States Regulation. The Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, also known as "CERCLA" and the "Superfund" law, and comparable state laws generally impose joint and several liability for costs of investigation and remediation and for natural resource damages, without regard to fault or the legality of the original conduct, on certain classes of persons with respect to the release into the environment of substances designated under CERCLA as hazardous substances. These persons include the owner or operator of the site where the release occurred and companies that disposed or arranged for the disposal of the hazardous substance at the site. These liabilities can arise in association with the properties where operations were conducted, as well as in association with the disposal facilities where wastes were sent. Under CERCLA, such persons may be liable for the costs of cleaning up the hazardous substances that have been released into the environment, for damages to natural resources and for the costs of certain health studies. Many states have adopted comparable or more stringent state statutes. In the course of our operations, we generated materials that fall within CERCLA's definition of hazardous substances. We may be the owner or operator of sites on which hazardous substances have been released and may have generated hazardous substances that have been transported to or otherwise released upon offsite facilities. We may be responsible under CERCLA for all or part of the costs to clean up facilities at which such substances have been released by previous owners or operators and offsite facilities to which our wastes were transported and for associated damages to natural resources.

The Federal Resource Conservation and Recovery Act, as amended ("RCRA") and comparable state laws, regulate the treatment, storage, disposal, remediation and transportation of wastes including those designated as "hazardous wastes". The EPA and various state agencies have limited the disposal options for these wastes and impose numerous regulations upon the treatment, storage, disposal, remediation and transportation of those wastes. Our operations generate wastes that are subject to RCRA and comparable state statutes. Furthermore, wastes generated by our operations that are currently exempt from treatment as hazardous wastes may be designated in the future as hazardous wastes under RCRA or other applicable statutes and, therefore, may be subject to more rigorous and costly treatment, storage and disposal requirements.

The Clean Water Act imposes restrictions and strict controls regarding the discharge of wastes into waters of the United States. The Clean Water Act, and comparable state laws, provide for civil, criminal and administrative penalties for unauthorized discharges of hazardous substances and of other pollutants. In the event of an unauthorized discharge of wastes, we may be liable for penalties and could be subject to injunctive relief.

Our operations are also governed by laws and regulations relating to workplace safety and worker health, principally the Occupational Safety and Health Act and its regulations. The Occupational Safety and Health Act hazard communication standard, the EPA's community right-to-know regulations and similar state programs may require us to organize and/or disclose information about hazardous materials used or produced in our operations. We believe that we are in substantial compliance with these applicable requirements.

Foreign Regulation. Our Matamoros, Mexico and Milan, Italy facilities and operations are subject to various environmental laws, regulations and ordinances promulgated by governmental authorities of Mexico and Italy. Each country has laws and regulations concerning air and water emissions and hazardous waste treatment, storage and disposal and their respective regulatory authorities are given broad authority to enforce compliance with environmental laws and regulations, and can require that operations be suspended pending completion of required remedial action.

Licenses, Permits and Product Registrations. Certain licenses, permits and product registrations are required for our products and operations in the United States, Mexico, Italy and other countries in which we do business. The licenses, permits and product registrations are subject to revocation, modification and renewal by governmental authorities. In the United States in particular, producers and distributors of chemicals such as penta, creosote, and our animal health pesticides are subject to registration and notification requirements under federal law (including under the Federal Insecticide, Fungicide and Rodenticide Act ("FIFRA") and the Toxic Substances Control Act, and comparable state law) in order to sell those products in the United States. Compliance with these requirements has had, and in the future will continue to have, a material effect on our business, financial condition and results of operations. Under FIFRA, the registration system requires an ongoing submission to the EPA of substantial scientific research and testing data regarding the chemistry and toxicology of pesticide products by manufacturers. Under agreements with other industry participants, we sometimes share research and testing costs pertaining to our chemical products. We incurred expenses of approximately $880,000 in fiscal year 2009, $1.3 million in fiscal year 2008 and $1.5 million in fiscal year 2007 in connection with the research, testing and other expenses related to our participation in several industry task forces.

Environmental Regulatory Proceedings. The Florida Department of Environmental Protection ("FDEP") is cleaning up a Florida site known as the Seminole Refinery/St. Marks Refinery Site. In October 2003, we received correspondence from the FDEP regarding past operations of Idacon, Inc. on this site. One of our subsidiaries purchased substantially all of Idacon's assets, which did not include the refinery site, in 1988. This site is alleged to be contaminated with dioxins, pentachlorophenol and other contaminants. The FDEP alleged in its October 2003 letter that we may be responsible for violations at the site. We have received no further correspondence or demands from the FDEP. We cannot assure you that the FDEP will not designate us as a potentially responsible party.

The EPA has listed the Star Lake Canal Superfund Site in Port Neches and Groves, Texas on the National Priorities List. In December 2002, we received a letter from the EPA addressed to Idacon, Inc. (f/k/a Sonford Chemical Company) notifying Idacon of potential liability under CERCLA in connection with this site. The letter requested reimbursement from Idacon for costs incurred by the EPA in responding to releases at the sites, equal to approximately $500,000 as of July 31, 2002. Idacon sold substantially all of its assets to one of our subsidiaries in 1988. We responded to a request for information from the EPA on the corporate history and relationship between us and Sonford Chemical Company in April 2003. We have received no additional correspondence from the EPA. However, on December 22, 2005, the EPA and certain potentially responsible parties entered an administrative order on consent which requires the implementation of a several year long remedial investigation and feasibility study. A remedy, if any, will not be selected until studies are complete, a proposed remedy plan is released for public comment, and the EPA issues a record of decision documenting the basis for selecting its remedy or decision that no further action is required. We cannot assure you that the EPA will not designate us as a potentially responsible party.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described below, together with all of the other information included in this report. We believe the risks and uncertainties described below are the most significant we face. The occurrence of any of the following risks could materially harm our business, financial condition or results of operations. In that case, the trading price of our common stock could decline, and you may lose all or part of your investment. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our operations.

Risks Relating to Our Business

The industries in which we operate are competitive. This competition may prevent us from raising prices at the same pace as our costs increase, making it difficult for us to maintain existing business and win new business.

We operate in competitive markets. Certain of our competitors have substantially greater financial and technical resources than we do. We may be required to reduce prices if our competitors reduce prices, or as a result of any other downward pressure on prices for our products and services, which could have an adverse effect on us. In electronic chemicals particularly, we compete with several international and North American companies, including Honeywell and BASF. Our customers have regularly requested price decreases and maintaining or raising prices has been difficult over the past several years and will likely continue to be so in the near future. Competition in the electronic chemical segment's markets is based on a number of factors, including price, freight economics, product quality and technical support. If we are unable to compete successfully, our financial condition and results of operations could be adversely affected.

We may experience a reduced demand for our wood preserving chemicals if the demand for the wood products on which those chemicals are used decreases, which may adversely affect our business, results of operations, cash flow and financial condition.

Our wood preserving chemicals, penta and creosote, which represented 49% of our total revenues in fiscal year 2009, are sold into mature markets. The principal consumers of our wood preserving chemicals are industrial wood treating companies who use our products to protect wood utility poles and railroad crossties from insect damage and decay. Although these products are sold into relatively stable markets, the demand for treated wood generally increases or decreases with the financial strength and maintenance budgets of electric utilities and railroads.

Penta is used primarily to treat utility poles in the United States. In recent years, utility pole demand has generally declined, as we believe electric utilities in the United States have reduced their maintenance spending due to competitive pressures arising from deregulation. Although utility pole demand has recently increased, deregulation and consolidation may continue to negatively affect the utility pole market.

The preservation of wood railroad crossties represents the largest market for creosote in the United States. For more than five years, the average annual purchases of wood crossties by United States and Canadian railroads have been in the upper reaches of their normal range. We believe that more than 20.0 million railroad crosstie were purchased in fiscal year 2009, but that purchases are now likely to decline. If the current purchase rate declines, or if railroads shift significantly to a greater use of non-wood ties, such as those made with concrete or plastic, we will experience a decline in our creosote sales.

A significant decline in either utility pole or wood crosstie sales could have a material adverse effect on our business, financial condition and results of operations.

The industries that we compete in are subject to economic downturns.

An economic downturn in the electronic industry as a whole or other events (e.g., labor disruptions) resulting in significantly reduced production at the manufacturing plants of our customers, could have a material adverse impact on the results of our electronic chemicals segments. Similarly, an economic downturn affecting utilities or major railroads could have a material adverse effect on demand for our wood preserving chemicals, and economic distress affecting livestock producers could have a material adverse effect on our animal health segment.

A significant portion of our revenue and operating income from our electronic chemicals segments are concentrated in a small number of customers.

We derive a significant portion of our revenues and operating income in our electronic chemicals segments from sales of products to a small number of customers. As a result, the loss of a significant customer, or a reduction of demand from one of those customers, could adversely affect our revenues and operating income.

If we are unable to identify, fund and execute new acquisitions, we will not be able to execute a key element of our business strategy.

Our strategy is to grow primarily by acquiring additional businesses and product lines. We cannot assure you that we will be able to identify, acquire or profitably manage additional businesses and product lines, or successfully integrate any acquired business or product line without substantial expenses, delays or other operational or financial difficulties. Financing for acquisitions may not be available, or may be available only at a cost or on terms and conditions that are unacceptable to us. Further, acquisitions may involve a number of special risks or effects, including diversion of management's attention, failure to retain key acquired personnel, unanticipated events or circumstances, legal liabilities, impairment of acquired intangible assets and other one-time or ongoing acquisition-related expenses. Some or all of these special risks or effects could have a material adverse effect on our financial and operating results. In addition, we cannot assure you that acquired businesses or product lines, if any, will achieve anticipated revenues and earnings.

The consideration we pay in connection with an acquisition also may affect our financial results. If we were to proceed with one or more significant acquisitions in which the consideration included cash, we could be required to use a substantial portion of our available cash or obtain debt or equity financing. To the extent that we issue shares of our capital stock or other rights to purchase shares of our common stock as consideration for an acquisition or in connection with the financing of an acquisition, including options or other rights, our existing common shareholders may be diluted, and our earnings per share may decrease.

We may experience increased costs and production delays if suppliers fail to deliver materials or if prices increase for raw materials and other goods and services that we purchase from third parties.

We purchase raw materials for our electronic chemicals business from a number of domestic and foreign suppliers. Although we believe that the raw materials we require in our electronic chemicals business will be available in sufficient supply on a competitive basis for the foreseeable future, continued increases in the cost of raw materials, including energy and other inputs used to make our products, could affect future sales volumes, prices and margins for our products. If a supplier should cease to deliver goods or services to us, we would probably find other sources. However, such a disruption could result in added cost and manufacturing delays. In addition, political instability, war, terrorism and other disruptions to international transit routes could adversely impact our ability to obtain key raw materials in a timely fashion, or at all.

Increases in the price of our primary raw materials for our wood preserving chemicals business may decrease our profitability and adversely affect our liquidity, cash flow, financial condition and results of operations.

Chlorine is a key component in the manufacture of penta. The price we pay for chlorine has often been at very high levels, and although we have increased prices, those increases have not always been sufficient to maintain the previous profitability of that product. High energy prices have increased the competition for creosote, since it can be burned as a fuel in certain markets and can be used as feed stock in the carbon black market. Creosote is produced by our suppliers from the distillation of coal tar. Coal tar supplies, particularly in the United States, are in short supply, a situation which we expect will continue indefinitely. Historically, the cost of our creosote has increased each year, and we believe that it will continue to increase.

The prices we pay for raw materials in our wood preserving chemicals business have increased significantly in the last several years, and we have not always been able to pass those increases through to our customers fully and timely. In the future, we may be unable to pass on increases in our raw material costs, and raw material price increases may erode the profitability of our products by reducing our gross profit. Price increases for raw materials may also increase our working capital needs, which could adversely affect our liquidity and cash flow. For these reasons, we cannot assure you that raw material cost increases in our wood preserving chemicals business would not have a material adverse effect on our financial condition and results of operations.

We are dependent on a limited number of suppliers for cosolvent, creosote and several of our animal health pesticides, the loss of any one of which could have a material adverse effect on our financial condition and results of operations.

We depend on a limited number of suppliers for the cosolvent needed to produce the liquid formulation of our penta product. These suppliers produce cosolvent as a byproduct of a process intended to manufacture a higher value product. Changes in that process or in market conditions affecting the higher value product could materially affect the availability or price of cosolvent. Our creosote is supplied primarily by two suppliers. There are no other significant suppliers of creosote for the North American market. We have one supplier of the tetrachlorvinphos active ingredient for our Rabon and Ravap products, and only one supplier for each of two other active ingredients in our animal health pesticides, dichlorvos and endosulfan.

If we were to lose any of these suppliers, we might have difficulty securing a replacement supplier at reasonable cost, and no assurance can be given that such loss would not have a material adverse effect on our financial condition and results of operations.

Our profitability could be adversely affected by high petroleum prices.

The profitability of our business depends to a degree upon the price of petroleum products, both as a component of transportation costs for delivery of products to our customers and as a raw material used to make our products, including penta solutions. High petroleum prices also affect the businesses of our customers. In particular, the purchasers of our animal health pesticides have experienced increased feed costs for their livestock and increased fuel costs, each of which is impacted by high petroleum prices. Unfavorable changes in petroleum prices or in other business and economic conditions affecting our customers could reduce purchases of our products, and impose practical limits on our pricing. Any of these factors could lower our profit margins, and have a material adverse affect on our results of operations. Petroleum prices have recently risen to historic or near historic highs. We are unable to predict what the price of crude oil and petroleum-based products will be in the future. We may be unable to pass along to our customers the increased costs that result from higher petroleum prices. Therefore, high petroleum prices could have a material adverse impact on our business and profitability.

Our ability to make payments on our debt will be contingent on our future operating performance, which will depend on a number of factors that are outside of our control.

Our ability to make principal and interest payments on our debt is contingent on our future operating performance, which will depend on a number of factors, many of which are outside of our control. The degree to which we are leveraged could have other important negative consequences, including the following:

- we must dedicate a substantial portion of our cash flows from operations to the payment of our indebtedness, reducing the funds available for future working capital requirements, capital expenditures, acquisitions or other general corporate requirements;
- a significant portion of our borrowings are, and will continue to be, at variable rates of interest, which may result in higher interest expense in the event of increases in interest rates;
- we may be more vulnerable to a downturn in the segments in which we operate or a downturn in the economy in general;
- we may be limited in our flexibility to plan for, or react to, changes in our businesses and the segments in which we operate;
- we may be placed at a competitive disadvantage compared to our competitors that have less debt;
- we may be limited in our ability to react to unforeseen increases in certain costs and obligations arising in our businesses, including environmental liabilities;
- we may determine it to be necessary to dispose of certain assets or one or more of our businesses to reduce our debt; and
- our ability to borrow additional funds may be limited.

If we are unable to make scheduled debt payments or comply with the other provisions of our debt instruments, our lenders may be permitted under certain circumstances to accelerate the maturity of the indebtedness owed to them and exercise other remedies provided for in those instruments and under applicable law.

Restrictions in our debt agreements could limit our growth and our ability to respond to changing conditions.

Our debt agreements contain a number of significant covenants which affect our ability to take certain actions and restrict our ability to incur additional debt. These include covenants that prohibit acquisitions that are not approved by our lenders. In addition, our debt agreements require us to maintain certain financial ratios and satisfy certain financial condition tests, which may require us to take action to reduce our debt or take some other action to comply with them.

These restrictions could limit our ability to obtain future financings, make needed capital expenditures, withstand a future downturn in our business or the economy in general or otherwise conduct necessary corporate activities. We may also be prevented from taking advantage of business opportunities that arise because of the limitations that these restrictive covenants impose on us.

A breach of any of these covenants would result in a default under the applicable debt agreement. A default, if not waived, could result in acceleration of the debt outstanding under the agreement and in a default with respect to, and acceleration of, the debt outstanding under our other debt agreements. The accelerated debt would become immediately due and payable. If that should occur, we may not be able to pay all such debt or to borrow sufficient funds to refinance it. Even if new financing were then available, it may not be on terms that are acceptable to us.

We will continue to pursue new acquisitions or joint ventures, and any such transaction could result in operating or management problems that adversely affect operating results. We remain subject to the ongoing risks of successfully managing the acquisitions and joint ventures that are completed.

We acquired our electronic chemicals business in fiscal year 2008. Other acquisitions we may make in the future expose us to the risk of successfully integrating a major acquisition. An integration impacts various areas of our business, including, but not limited to, our workforce, management, production facilities, information systems, accounting and financial reporting, and customer service. Disruption to any of these areas could materially harm our financial condition or results of operations.

We continue to pursue new acquisitions or joint ventures in the future, a pursuit which could consume substantial time and resources. The successful implementation of our operating strategy in current and future acquisitions and joint ventures may require substantial attention from our management team, which could divert management attention from existing businesses. The businesses acquired, or the joint ventures entered into, may not generate the cash flow and earnings, or yield the other benefits anticipated at the time of their acquisition or formation. The risks inherent in any such strategy could have an adverse impact on our results of operation or financial condition.

If our products are not re-registered by the EPA or are re-registered subject to new restrictions, our ability to sell our products may be curtailed or significantly limited.

Our creosote, penta and many of our animal health products registration are under continuous review by the EPA under FIFRA. We have submitted and will submit a wide range of scientific data to support our U.S. registrations. To satisfy the registration review, we are required to demonstrate, among other things, that our products will not cause unreasonable adverse effects on human health or the environment when used according to approved label directions. In September 2008, EPA announced that it had determined that creosote and penta were eligible for re-registration, but EPA proposed new restrictions on the use of those products that will require some of our customers to incur substantial additional costs and to revise certain operating procedures. EPA also required that creosote and penta registrants provide additional research and testing data respecting certain potential risks to human health or the environment as a further condition to continued re-registration. EPA is also reviewing the risk profile of penta under its Interated Risk Information System database. That review will establish a toxicological profile that may prompt EPA to reconsider its risk assessment. Additionally, EPA has requested more testing in its registration review of certain animal health pesticides. We cannot assure you as to when or if the EPA will issue a final decision concluding that the conditions of re-registration for our creosote and penta products have been satisfied, or concluding the registration review of our animal health pesticides. Even if our products are re-registered by the EPA, we cannot assure you that our products will not be subject to further data submission requirements, or subject to use or labeling restrictions, that have an adverse effect on our financial position and results of operations. The failure of our current or future-acquired products to be re-registered or to satisfy the registration review by the EPA, or the imposition of new use, labeling or other restrictions in connection with re-registration would have a material adverse effect on our financial condition and results of operations.

Our products may be rendered obsolete or less attractive by changes in industry requirements or by supply-chain driven pressures to shift to environmentally preferable alternatives.

Changes in regulatory, legislative and industry requirements, or changes driven by supply-chain pressures, may shift current customers away from products using penta, creosote or certain of our other products and toward alternative products that are believed to have fewer environmental effects. The EPA, foreign and state regulators, local governments, private environmental advocacy organizations and a number of large industrial companies have proposed or adopted policies designed to decrease the use of a variety of chemicals, including penta, creosote and others included in certain of our products. Our ability to anticipate changes in regulatory, legislative, and industry requirements, or changes driven by supply-chain pressures, will be a significant factor in our ability to remain competitive. Further, we may not be able to comply with changed or new regulatory or industrial standards that may be necessary for us to remain competitive.

We cannot assure you that the EPA, foreign and state regulators and local governments will not restrict the uses of penta, creosote or certain of our other products or ban the use of one or more of these products, or that the companies who use our products may decide to reduce significantly or cease the use of our products voluntarily. As a result, our products may become obsolete or less attractive to our customers.

We may be unable to identify liabilities associated with the properties that may be acquired or obtain protection from sellers against them.

The acquisition of properties requires assessment of a number of factors, including physical condition and potential environmental and other liabilities. Such assessments are inexact and inherently uncertain. The assessments made result from a due diligence review of the subject properties, but such a review may not reveal all existing or potential problems. We may not be able to obtain contractual indemnities from the seller for liabilities that it created or that were created by any predecessor of the seller. We may be required to assume the risk of the physical or environmental condition of the properties in addition to the risk that the properties may not perform in accordance with expectations.

We are dependent upon many critical systems and processes, many of which are dependent upon hardware that is concentrated in a limited number of locations. If a catastrophe were to occur at one or more of those locations, it could have a material adverse effect on our business.

The business is dependent on certain critical systems, which support various aspects of our operations, from our computer network to our billing and customer service systems. The hardware supporting a large number of such systems is housed in a small number of locations. If one or more of these locations were to be subject to fire, natural disaster, terrorism, power loss, or other catastrophe, it could have a material adverse effect on our business. While we believe that we maintain reasonable disaster recovery programs, there can be no assurance that, despite these efforts, any disaster recovery, security and service continuity protection measures it may have or may take in the future will be sufficient.

In addition, computer viruses, electronic break-ins or other similar disruptive technological problems could also adversely affect our operations. Our insurance policies may not adequately compensate us for any losses that may occur due to any failures or interruptions in our computer systems.

Weather may impact adversely our ability to conduct business.

Much of the creosote we sell is supplied from Europe, and we import that product through a terminal in New Orleans, Louisiana. Several other suppliers of raw materials for our electronic chemicals business are located on the Gulf Coast of the United States. Thus, we are dependent on terminals and facilities located in coastal areas for a substantial portion of the creosote we use and for certain of the raw materials we use for our electronic chemicals products. These terminals and facilities are vulnerable to hurricanes and other adverse weather conditions that have the potential to cause substantial damage and to interrupt operations. For example, in 2005 Hurricane Katrina closed our terminal in New Orleans, Louisiana temporarily and forced us to locate an interim substitute terminal. We cannot assure you that adverse weather conditions will not affect our importation of creosote or the availability of certain other raw materials in the future, the occurrence of which could have a material adverse effect on our financial condition and results of operations.

The distribution and sale of our products is subject to prior governmental approvals and thereafter ongoing governmental regulation.

Our products are subject to laws administered by federal, state and foreign governments, including regulations requiring registration, approval and labeling of our products. The labeling requirements restrict the use and type of application for our products. More stringent restrictions could make our products less desirable which would adversely affect our sales and profitability. All of our wood preserving and animal health products are subject to the EPA's registration and re-registration requirements, and are conditionally registered in accordance with FIFRA. Those registration requirements are based, among other things, on data demonstrating that the product will not cause unreasonable adverse effects on human health or the environment when used according to approved label directions. All states where our products are used also require registration before they can be marketed or used in that state.

Governmental regulatory authorities have required, and may require in the future, that certain scientific testing and data production be provided on our products. We have and are currently furnishing certain required data relative to our products. Under FIFRA, the federal government requires registrants to submit a wide range of scientific data to support U.S. registrations. This requirement significantly increases our operating expenses, and we expect those expenses will continue in the future. Because scientific analyses are constantly improving, we cannot determine with certainty whether or not new or additional tests may be required by regulatory authorities. While Good Laboratory Practice standards specify the minimum practices and procedures which must be followed in order to ensure the quality and integrity of data related to these tests submitted to the EPA, there can be no assurance that the EPA will not request certain tests or studies be repeated. In addition, more stringent legislation or requirements may be imposed in the future. We can provide no assurance that our resources will be adequate to meet the costs of regulatory compliance or that the cost of such compliance will not adversely affect our profitability.

The Registration Evaluation and Authorization of Chemicals ("REACH") legislation may affect our ability to manufacture and sell certain products in the European Union.

REACH, which was effective on June 1, 2007, will require chemical manufacturers and importers in the European Union to prove safety of their products. As a result, we will be required to pre-register certain products and file comprehensive reports, including testing data, on each chemical substance, and perform chemical safety assessments. REACH required all covered substances to be pre-registered by November 30, 2008. Products containing covered substances cannot be manufactured or imported into the EU after that date unless they are pre-registered. Additionally, substances of high concern are subject to an authorization process. Authorization may result in restrictions on certain uses of products or even prohibitions on the manufacture or importation of products. The full registration requirements of REACH will be phased in over the next ten years. We will incur additional expense to affect the registration of our products under these regulations. REACH may also affect our ability to manufacture and sell certain products in the European Union.

We are subject to extensive environmental laws and regulations and may incur costs that have a material adverse effect on our financial condition as a result of violations of or liabilities under environmental laws and regulations.

Like other companies involved in environmentally sensitive businesses, our operations and properties are subject to extensive and stringent federal, state, local and foreign environmental laws and regulations, including those concerning, among other things:

- the treatment, storage and disposal of wastes;
- the investigation and remediation of contaminated soil and groundwater;
- the discharge of effluents into waterways;
- the emission of substances into the air; and
- other matters relating to environmental protection and various health and safety matters.

The EPA and other federal and state agencies, as well as comparable agencies in Mexico, Italy and in other countries where we sell our products, have the authority to promulgate regulations that could have a material adverse impact on our operations. These environmental laws and regulations may require permits for certain types of operations, requires the installation of expensive pollution control equipment, place restrictions upon operations or impose substantial liability for pollution resulting from our operations. We expend substantial funds to minimize the discharge of hazardous materials in the environment and to comply with governmental regulations relating to protection of the environment. Compliance with environmental and health and safety laws and regulations has resulted in ongoing costs for us, and could restrict our ability to modify or expand our facilities or continue production, or require us to install costly pollution control equipment or incur significant expenses, including remediation costs. We have incurred, and expect to continue to incur, significant costs to comply with environmental and health and safety laws. Federal, state and foreign governmental authorities may seek fines and penalties, as well as injunctive relief, for violation of the various laws and governmental regulations, and could, among other things, impose liability on us for cleaning up the damage resulting from a release of pesticides, hazardous materials or other chemicals into the environment.

Our use of hazardous materials exposes us to potential liabilities.

Our manufacturing and distribution of chemical products involve the controlled use of hazardous materials. Our operations, therefore, are subject to various associated risks, including chemical spills, discharges or releases of toxic or hazardous substances or gases, fires, mechanical failure, storage facility leaks and similar events. Our suppliers are subject to similar risks which may adversely impact the availability of raw materials. While we adapt our manufacturing and distribution processes to the environmental control standards of regulatory authorities, we cannot completely eliminate the risk of accidental contamination or injury from hazardous or regulated materials, including injury of our employees, individuals who handle our products or goods treated with our products, or others who claim to have been exposed to our products, nor can we completely eliminate the unanticipated interruption or suspension of operations at our facilities due to such events. We may be held liable for significant damages or fines in the event of contamination or injury, and such assessed damages or fines could have a material adverse effect on our financial performance and results of operations.

Our business success depends significantly on the reliability and sufficiency of our manufacturing facilities.

Our revenues depend significantly on the continued operation of our manufacturing facilities. The operation of our facilities involves risks, including the breakdown, failure, or substandard operation or performance of equipment, power outages, explosions, fires, natural disasters and other unscheduled downtime. The occurrence of material operational problems or the loss or shutdown of our facilities over an extended period of time due to these or other events could have a material adverse effect on our financial performance and operating results.

Our business is subject to many operational risks for which we may not be adequately insured.

We cannot assure you that we will not incur losses beyond the limits of, or outside the coverage of, our insurance policies. From time to time, various types of insurance for companies in the chemical industry have not been available on commercially acceptable terms or, in some cases, have been unavailable. In addition, we cannot assure you that in the future we will be able to maintain existing coverage or that premiums will not increase substantially.

We maintain limited insurance coverage for sudden and accidental environmental damages. We do not believe that insurance coverage for environmental damages that occur over time is available at a reasonable cost. Also, we do not believe that insurance coverage for the full potential liability that could be caused by sudden and accidental incidences is available at a reasonable cost. Accordingly, we may be subject to an uninsured or under-insured loss in such cases.

Our business may be adversely affected by cyclical and seasonal effects.

In general, the chemical industry is cyclical and product demand for certain products is seasonal. Many of our products are used in industries that are cyclical in nature. Changes affecting these industries can adversely affect our revenues and margins. Seasonal usage of our chemical products follows varying agricultural seasonal patterns, weather conditions and weather-related pressure from pests, as well as customer marketing programs and requirements. Weather patterns can have an impact on our sales, particularly sales of our animal health chemicals. There can be no assurance that we will adequately address any adverse seasonal effects.

We depend on our senior management team and the loss of any member could adversely affect our operations.

Our success is dependent on the management and leadership skills of our senior management team, including J. Neal Butler, our President and Chief Executive Officer, John V. Sobchak, our Chief Financial Officer, Roger C. Jackson, our General Counsel, and Ernest C. Kremling, our Vice President of Operations. The loss of any member of our senior management team or an inability to attract, retain and maintain additional qualified personnel could prevent us from implementing our business strategy. We cannot assure you that we will be able to retain our existing senior management personnel or attract additional qualified personnel when needed.

If we are unable to successfully negotiate with the labor unions representing our employees, we may experience a material work stoppage.

More than half of our full-time employees who work at our facility in Matamoros, Mexico, and about a quarter of those who work in Milan, Italy are represented under a labor contract that is negotiated annually. We cannot assure you that a new agreement will be reached each year without union action, or that a new agreement will be reached on terms satisfactory to us. An extended work stoppage, slowdown or other action by our employees could significantly disrupt our business. Future labor contracts may be on terms that result in higher labor costs to us, which also could adversely affect our results of operations.

We are subject to possible risk of terrorist attacks which could adversely affect our business.

Since September 11, 2001, there have been increasing concerns that chemical manufacturing facilities and railcars carrying hazardous chemicals may be at an increased risk of future terrorist attacks. Additionally, federal, state and local governments have begun a regulatory process that could lead to new regulations impacting the security of chemical industry facilities and the transportation of hazardous chemicals. Our business could be adversely impacted if a terrorist incident were to occur at any chemical facility or while a railcar or tank truck was transporting chemicals. In addition, our business could be affected due to the cost of complying with new regulations. We are not insured against terrorist attacks, and there can be no assurance that losses that could result from a terrorist attack on one of our facilities, railcars or tank trucks would not have a material adverse effect on our business, results of operations and financial condition.

We are subject to risks inherent in foreign operations, including changes in social, political and economic conditions.

We have facilities in the United States, Mexico, and Italy, and generate a significant portion of our sales in foreign countries. Like other companies with foreign operations and sales, we are exposed to market risks relating to fluctuations in foreign currency exchange rates. We are also exposed to risks associated with changes in the laws and policies governing foreign investments in Mexico and Italy and, to a lesser extent, changes in United States laws and regulations relating to foreign trade and investment. While such changes in laws, regulations and conditions have not had a material adverse effect on our business or financial condition, we cannot assure you as to the future effect of any such changes.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We own or lease the following properties.

Location	Primary Use	Approximate Size	Owned/ Leased	Lease Expiration Date
Houston, Texas	Corporate Office	17,527 square feet	Leased	September 2013
Elwood, Kansas	Manufacture and Warehouse: Animal Health Pesticides	14.9 acres	Owned	N/A
Matamoros, Mexico	Manufacture and Warehouse: Penta and MSMA	13.0 acres	Owned	N/A
Tuscaloosa, Alabama	Formulation and Distribution: Penta	2.0 acres	Owned	N/A
Pueblo, Colorado	Manufacture and Warehouse: Electronic Chemicals	37.4 acres	Owned	N/A
Milan, Italy	Manufacture and Warehouse: Electronic Chemicals	7.3 acres	Owned	N/A

We manufacture and warehouse our electronic chemicals at our Pueblo, Colorado and Milan, Italy facilities. We manufacture and warehouse certain of our animal health pesticides at our Elwood, Kansas facility. We manufacture and warehouse penta products at our Matamoros, Mexico facility, and formulate and distribute penta solutions at our Tuscaloosa, Alabama facility. We believe that all of these properties are adequately insured, in good condition and suitable for their anticipated future use. We believe that if the lease for our corporate office is not renewed or is terminated, we can obtain other suitable facilities.

We also have one long-term tank storage agreement with a commercial terminal facility where we store creosote for distribution, and have several storage agreements with commercial warehouses from which we distribute our electronic chemicals and animal health products. Our bulk storage terminal is on the Mississippi River near New Orleans at Avondale, Louisiana. That terminal is used primarily for creosote imported by us from Europe. If our tank storage agreement is not renewed or is terminated, we believe we can obtain other suitable facilities.

ITEM 3. LEGAL PROCEEDINGS

We have previously reported that a lawsuit was filed in 2007 against us in Superior Court, Fulton County, Georgia (Atlanta) styled *John Bailey, et al vs Cleveland G. Meredith et al.* The plaintiffs are persons living near the wood treating facility of one of our customers. The plaintiffs complain that emissions from the wood treating facility have caused harm to their property and person, and claim that we are also responsible because we sold wood treating chemicals to the facility. Given the inherent uncertainties of litigation, the ultimate outcome cannot be predicted at this time, nor can the amount of any potential loss be reasonably estimated.

We have discontinued the operation of our agricultural herbicide product line, referred to as MSMA, but in connection with that product line we were a member of the MSMA task force. As previously reported, an entity related to the MSMA task force, Arsonate Herbicide Products, Limited) ("AHP"), was sued by Albaugh, Inc. in 2007 claiming that AHP overbilled it for certain task force expenses. Although Albaugh Inc. had agreed to reimburse AHP for certain task force expenses for MSMA studies and registration support costs, it now claims that it was overbilled for many years by at least $900,000. The case is in the U.S. District Court for the So. District of Iowa, and styled as *Albaugh, Inc. vs. Arsonate Herbicide Products, Limited.* AHP has responded that the billings were proper and as agreed. Given the inherent uncertainties of litigation, the ultimate outcome cannot be predicted at this time, nor can the amount of any potential loss be reasonably estimated.

We have previously reported that a lawsuit was filed against KMEX respecting the title to the land on which our facility in Matamoros is located. The plaintiffs claim that their title to the land was superior to the person from whom our subsidiary bought the land. The lawsuit was filed in 1998 Matamoros, Mexico under *Adolfo Cazares Rosas, et al vs. KMG de Mexico and Guillermo Villarreal.* The plaintiffs seek to have our purchase overturned and to recover the land or its value. In January 2008, the case was sent by the appeals court back to the lower court to obtain additional factual information, and in 2009 the plaintiffs were required to re-file the case. The ultimate outcome of this litigation cannot be determined at this time, nor can the amount of any potential loss be reasonably estimated.

We are periodically a party to other legal proceedings and claims that arise in the ordinary course of business. We do not believe that the outcome of any of those matters will have a material adverse effect on our business, financial condition and operating results.

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

No matter was submitted during the fourth quarter of fiscal 2009 to a vote of security holders through the solicitation of proxies or otherwise.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUES PURCHASER OF EQUITY SECURITIES

Our common stock, par value $.01 per share, has traded on The Nasdaq Global Market (trading symbol KMGB). As of October 13, 2009, there were 11,112,695 shares of Common Stock issued and outstanding held by approximately 500 shareholders of record, and more than 300 round lot holders. The following table represents:

- the high and low sale prices for our common stock as reported by the Nasdaq Global Market during fiscal years 2009 and 2008; and

- the quarterly dividends we declared and paid during fiscal years 2009 and 2008.

	Common Stock Prices		Dividends Declared and Paid	
	High	Low	Per Share	Amount
Fiscal 2009				
First Quarter	$ 11.92	$ 3.93	$ 0.02	$ 221,000
Second Quarter	6.49	2.25	0.02	222,000
Third Quarter	5.73	3.75	0.02	222,000
Fourth Quarter	9.01	5.41	0.02	222,000
Fiscal 2008				
First Quarter	$ 26.75	$ 13.65	$ 0.02	$ 218,000
Second Quarter	17.27	12.69	0.02	219,000
Third Quarter	17.70	13.03	0.02	220,000
Fourth Quarter	14.50	9.71	0.02	220,000

We intend to pay out a reasonable share of cash from operations as dividends, consistent on average with the payout record of past years. We declared and paid a dividend in the first quarter of fiscal year 2010 of $0.02 per share, or approximately $222,000. The current quarterly dividend rate represents an annualized dividend of $0.08 per share. The future payment of dividends, however, will be within the discretion of the Board of Directors and depends on our profitability, capital requirements, financial condition, growth, business opportunities and other factors which our Board of Directors may deem relevant.

We repurchased no shares in fiscal years 2009 or 2008.

ITEM 6. SELECTED FINANCIAL DATA

The following table shows selected historical consolidated financial data for the five fiscal years ended July 31, 2009. The consolidated statements of income and cash flow data for each of the three fiscal years ended July 31, 2009, and the balance sheet data for the two fiscal years ended July 31, 2009, have been derived from our audited consolidated financial statements included elsewhere in this report. The consolidated statements of income and cash flow data for the two fiscal years ended July 31, 2006, and the balance sheet data for the three fiscal years ended July 31, 2007, has been derived from our audited consolidated financial statements. The data should be read in conjunction with our consolidated financial statements and notes to consolidated financial statements.

	Year Ended July 31,				
	2009	2008	2007	2006	2005
	(Amounts in thousands, except per share data)				
Statement of Income Data (1):					
Net sales	$ 190,720	$ 154,394	$ 86,171	$ 67,200	$ 55,064
Cost of sales	126,553	107,563	55,735	43,575	37,668
Gross profit	64,167	46,831	30,436	23,625	17,396
Selling, general & administrative expenses	43,318	35,338	15,318	13,702	11,626
Operating income	20,849	11,493	15,118	9,923	5,770
Interest income	7	438	560	281	73
Interest expense	(3,032)	(2,670)	(945)	(1,044)	(620)
Other income (expense), net	(340)	(55)	6	(35)	(35)
Total other income (expense), net	(3,365)	(2,287)	(379)	(798)	(582)
Income from continuing operations before income taxes	17,484	9,206	14,739	9,125	5,188
Provision for income taxes	(7,248)	(3,550)	(5,576)	(3,190)	(1,903)
Income from continuing operations	10,236	5,656	9,163	5,935	3,285
Loss from discontinued operations	(21)	(281)	(314)	(2,159)	(233)
Net income	$ 10,215	$ 5,375	$ 8,849	$ 3,776	$ 3,052
Earnings per share from continuing operations-basic	$ 0.92	$ 0.52	$ 0.87	$ 0.66	$ 0.42
Loss per share from discontinued operations-basic	—	(0.03)	(0.03)	(0.24)	(0.03)
Earnings per share—basic	$ 0.92	$ 0.49	$ 0.84	$ 0.42	$ 0.39
Earnings per share from continuing operations-diluted	$ 0.91	$ 0.50	$ 0.83	$ 0.63	$ 0.40
Loss per share from discontinued operations-diluted	—	(0.02)	(0.03)	(0.23)	(0.03)
Earnings per share—diluted	$ 0.91	$ 0.48	$ 0.80	$ 0.40	$ 0.37
Weighted average shares outstanding—basic	11,085	10,978	10,573	8,914	7,901
Weighted average shares outstanding—diluted	11,230	11,232	11,034	9,447	8,256
Cash Flow Data (1):					
Net cash provided by operating activities	$ 26,502	$ 15,668	$ 8,968	$ 7,055	$ 7,563
Net cash used in investing activities	6,268	75,540	802	10,967	13,442
Net cash provided by (used in) financing activities	(15,442)	46,442	(3,330)	6,300	13,685
Payment of dividends	887	877	791	660	529
Depreciation and amortization	6,168	5,665	3,832	3,889	2,204
Impairment charge	15	102	—	2,368	—
Additions to property, plant and equipment	3,009	2,729	581	2,085	445
Balance Sheet Data (1):					
Total assets	$ 143,508	$ 155,798	$ 81,233	$ 72,702	$ 61,103
Long-term debt, net of current portion	39,326	53,516	10,468	13,981	17,644
Total stockholders' equity	70,977	63,687	56,410	46,918	32,888

(1) Our historical results are not necessarily indicative of results to be expected for any future period. The comparability of the data is affected by our acquisitions since 2005.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the "Selected Financial Data" section of this report and our consolidated financial statements and the related notes and other financial information included elsewhere in this report. In addition to historical financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results and timing of selected events may differ materially from those anticipated in these forward-looking statements as a result of many factors, including those discussed under the section entitled "Risk Factors" and elsewhere in this report.

Introduction

We manufacture, formulate and globally distribute specialty chemicals. We operate specialty chemical businesses selling electronic chemicals, industrial wood preservatives and animal health pesticides. Our electronic chemicals are sold to the semiconductor industry where they are used primarily to clean and etch silicon wafers in the production of semiconductors. Our wood preserving chemicals, penta and creosote, are used by industrial customers primarily to extend the useful life of utility poles and railroad crossties. Our animal health pesticides are used on cattle, swine and poultry to protect them from flies and other pests.

In fiscal year 2009, approximately 45% of our revenues were from electronic chemicals, 49% were from industrial wood preservation chemicals, and 6% were from animal health pesticides.

Our results of operations are impacted by various competitive and other factors including:

- fluctuations in sales volumes;
- raw material pricing and availability;
- our ability to acquire and integrate new products and businesses; and
- the difference between prices received by us for our specialty chemical products and the costs to produce those products.

Acquisitions

A key element of our business strategy is to acquire businesses and assets that operate in segments of the specialty chemical industry exhibiting those characteristics we believe provide us with opportunities to grow our company in a manner that increases shareholder value. The acquisitions we have completed since fiscal year 2004 are summarized below.

In December 2007, we acquired the high-purity process chemicals business of Air Products. That business sells high purity wet process chemicals to the semiconductor industry. The chemicals are used primarily to clean and etch silicon wafers in the production of semiconductors. Our purchase of this electronic chemicals business included two facilities, accounts receivable, inventory, and intangible assets. The cost of the acquisition was approximately $75.7 million, which included $25.8 million for working capital.

In February 2006, we purchased an animal health pesticides business of Boehringer Ingelheim. We purchased one production facility, pesticide registrations for products used on cattle, swine, poultry and livestock premises and inventory. The pesticides registrations acquired in the transaction were for the United States, Canada, Australia, Mexico and several other countries in Latin America. These products complemented our existing animal health pesticides registrations, and included a leading brand of insecticidal ear tags for cattle and several liquid and dust formulations for livestock and their premises. The purchase price was approximately $8.9 million, including $2.7 million of inventory.

In June 2005, we purchased certain penta assets from Basic Chemicals Company, LLC, a wholly-owned subsidiary of Occidental Chemical. We purchased product registrations and data, manufacturing equipment and certain other assets. The product registrations we acquired in the transaction were for the United States and Canada. Following this acquisition, we became the sole producer and registration holder for penta in North America. The purchase price was $13.4 million.

In fiscal year 2004, we made three acquisitions with an aggregate purchase price of approximately $11.6 million. In December 2003, we purchased penta distribution assets from Wood Protection Products, Inc., including distribution and plant equipment, inventory and penta product registrations. In June 2004, we purchased creosote product registrations from Trenton Sales. In connection with our purchase, we entered into a long term supply agreement with Lufkin Creosoting Co., an affiliate of Trenton Sales, under which we sell Lufkin Creosoting its creosote requirements for its wood treating operations. Also in June 2004, we expanded our animal health product line by purchasing the Ravap trade name and inventory from Boehringer Ingelheim.

Results of Operations

Segment Data

Segment data is presented for our five segments for the three fiscal years ended July 31, 2009, 2008 and 2007. You should read the foregoing segment data in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this report. The information for the fiscal year ended July 31, 2007 has been revised to reflect the discontinuation of the agricultural chemicals segment as discussed in note 5 to our consolidated financial statements.

	Year Ended July 31,		
	2009	2008	2007
	(Amounts in thousands)		
Sales:			
Electronic Chemicals — North America	$ 69,701	$ 47,645	$ —
Electronic Chemicals — International	16,123	13,524	—
Penta	26,189	26,366	28,377
Creosote	67,776	55,207	43,645
Animal Health	10,931	11,652	14,149
Total sales for reportable segments	$ 190,720	$ 154,394	$ 86,171

Segment Sales

We operate the electronic chemicals business as two segments, one segment for North America and one for the international portion of the business. In fiscal year 2009, net sales from the North America segment increased by $22.1 million, or 46.3%, to $69.7 million from $47.6 million in fiscal year 2008. The international segment increased net sales by $2.6 million, or 19.2%, to $16.1 million from $13.5 million in the prior year. The prior year comparison is skewed by the fact that we owned the two electronic chemicals segments for only seven months in fiscal year 2008. The economic downturn caused demand for electronic chemicals for the semiconductor industry to soften beginning in the second quarter of fiscal year 2009, and demand decreased by approximately 28.0% over the last half of the year as compared to fiscal year 2008. Although demand appears to have improved toward the end of the fiscal year, we are continuing to experience weakness in demand in both segments, particularly in our international segment.

Penta segment net sales were essentially flat in fiscal year 2009 at $26.2 million as compared to $26.4 million for the prior year, but in fiscal year 2008 penta net sales decreased by $2.0 million, or 7.1%, to $26.4 million from $28.4 million in fiscal year 2007. Despite the recession, utility company demand for poles treated with penta held steady in fiscal year 2009 as compared to the prior year. In fiscal year 2008, however, penta sales decreased on reduced sales of penta solutions when several customers switched to our penta blocks, and because spending for maintenance of utility poles in the southeast United States was at reduced levels.

Sales in the creosote segment increased $12.6 million, or 22.8%, to $67.8 million in fiscal year 2009 as compared with fiscal year 2008, which came after an increase in fiscal year 2008 over 2007 of $11.6 million, or 26.5%. Our creosote revenues were higher in both fiscal years on price increases, as volume was down about 4.1% in fiscal year 2009 and up only about 1.3% in fiscal year 2008. Demand for treated railroad crossties by major railroads, the principal use for creosote, continued at approximately 20.0 million crossties per year, near the upper end of the historic range.

Animal health pesticides segment sales decreased by $721,000, or 6.2%, to $10.9 million in fiscal year 2009 as compared to fiscal year 2008. In fiscal year 2008 animal health segment sales decreased $2.5 million, or 17.6%, to $11.7 million. In fiscal year 2009 the recession held down purchases of our animal health products, in both fiscal years 2009 and 2008 high costs for feed, fuel, and fertilizer led our customers to economize by reducing ear tag purchases. Sales also lagged in fiscal year 2008 because cooler than normal weather reduced parasitic fly infestation, and because the distribution chain had ended fiscal year 2007 with a substantial base inventory of ear tags. Sales of our animal health products are seasonal, and occur primarily in the second half of our fiscal year. Seasonal usage follows varying agricultural seasonal patterns, weather conditions and weather related pressure from pests, and customer marketing programs and requirements. The end users of some of our products may, because of weather patterns, delay or intermittently curtail use of some products, which may result in a reduction of our revenues and profitability. The combined revenues from products subject to seasonal variations represented about 5.7% of our total annual revenues in fiscal year 2009. Their peak selling season is during the last two quarters of the fiscal year, and revenue and profit are concentrated in these periods.

Segment Income (Loss) from Operations

Income from operations of the electronic chemicals segment in North America was $5.0 million in fiscal year 2009 and $3.3 million for the seven months we owned the business in fiscal 2008. Our international electronic chemicals segment, however, had a loss from operations of $1.3 million in fiscal year 2009 and a loss of $1.2 million in fiscal year 2008. Both segments suffered in fiscal year 2009 from the effect of the world-wide recession, and our operations in Europe were particularly affected. In fiscal year 2008, our electronic chemicals international segment income was adversely affected by selling through the Air Products distribution chain for much of the year. Fiscal year 2008 also saw significant raw material price volatility, and we were not always able to respond timely with increased prices, particularly in Europe. We also operated the electronic chemicals business under a transition services agreement with Air Products in fiscal year 2008 and for the first two months of fiscal year 2009. Under that agreement, Air Products supplied certain supply chain, information technology and accounting services for the business, while we developed the infrastructure to integrate the new business into our operations. We estimated that the transition services cost us approximately $175,000 per month more than it would have cost us to provide those functions internally. During the first two months of fiscal year 2009 we built and staffed our post-transition infrastructure while at the same time purchasing transitional services from Air Products. We believe that the redundant infrastructure added approximately $600,000 of additional expense during fiscal year 2009. We additionally incurred consulting costs associated with the integration of the business of approximately $434,000 in fiscal year 2009 and $667,000 in fiscal year 2008.

In fiscal year 2009 income from operations of the penta segment increased $2.7 million, or 43.8%, to $9.0 million, and in fiscal year 2008 it decreased $2.9 million, or 31.3%, to $6.3 million. The increase in fiscal year 2009 resulted from a decrease in certain raw material costs of $1.6 million along with a decrease in amortization expense of $1.1 million related to intangible assets primarily from the fiscal year 2005 acquisition of certain penta assets. Those intangible assets were fully amortized during fiscal year 2009. The decline in fiscal year 2008 was mainly due to a 35.4% increase in the cost of a petroleum-based raw material combined with a 7.1% decline in penta net sales.

Creosote segment income increased $6.5 million in fiscal year 2009 to $15.6 million, a 71.2% increase, and increased $278,000 in fiscal year 2008 to $9.1 million, a 3.1% increase. Higher creosote prices contributed to the increases in each year. Additionally, improved pricing on our imported creosote, and a greater proportion of imported creosote in our sales mix during the second half of fiscal year 2009, improved segment income.

Animal health pesticides segment income from operations decreased $616,000, or 75.5%, in fiscal year 2009 to $200,000, and decreased $2.1 million, or 72.1%, in fiscal year 2008 to $816,000. The reduction in income from operations for the animal health pesticides segment in each year largely hinged on the sales volume decline, primarily because of lower sales of our ear tags in response to the recession.

Net Sales and Gross Profit

Net Sales and Gross Profit for Fiscal Year 2009 vs. Fiscal Year 2008.

Net sales increased $36.3 million, or 23.5%, in fiscal year 2009 to $190.7 million from $154.4 million in fiscal year 2008. The increase was composed of increased sales from our two electronic chemicals segments of a combined $24.7 million, and an increase of $12.6 million in sales from our creosote segment. We acquired our electronic chemicals business in December 2007.

Gross profit increased in fiscal year 2009 by $17.3 million, or 37.0%, to $64.2 million as compared to gross profit of $46.8 million in fiscal year 2008. Gross profit as a percent of sales improved in fiscal year 2009 to 33.6% of sales as compared to 30.3% of sales in fiscal year 2008.

Our electronic chemicals business contributed to higher gross profit in fiscal year 2009 due to price increases and cost initiatives implemented since the business was acquired. We also realized improved margins in our penta and creosote segments as compared to fiscal year 2008 because of a reduction in the cost of the chlorine and solvent raw materials used to make our penta products, and because of improved pricing for creosote.

Because other companies may include certain of the costs that we record in cost of sales in selling, general and administrative expenses, and may include certain of the costs that we record in selling, general and administrative expenses as cost of sales, our gross profit may not be comparable to that reported by other companies.

Net Sales and Gross Profit for Fiscal Year 2008 vs. Fiscal Year 2007.

Net sales increased $68.2 million, or 79.2%, in fiscal year 2008 to $154.4 million from $86.2 million in fiscal year 2007. The increase was attributable to the addition of the electronic chemicals business and improved creosote pricing. For fiscal year 2008, $47.6 million of improved net sales came from the electronic chemicals North America segment, $13.5 million came from the international segment, and $11.6 million came from the creosote segment. On the other hand, penta segment net sales revenue declined $2.0 million and animal health net sales revenue declined $2.5 million, reductions of 7.1% and 17.6%, respectively.

Gross profit increased in fiscal year 2008 by $16.4 million, or 53.9%, to $46.8 million as compared to gross profit of $30.4 million in fiscal year 2007. Gross profit as a percent of sales declined in fiscal year 2008 to 30.3% of sales as compared to 35.3% of sales in fiscal year 2007. Price increases in electronic chemicals were implemented after we acquired the business in December 2007. However, margins for these products for fiscal year 2008 were lower than margins we have been able to achieve over time on some of our wood preserving and animal health products. Our creosote segment gross profit improved by $700,000 in fiscal year 2008, but our penta segment and animal health segments both declined significantly as compared to fiscal year 2007. The penta segment gross profit decreased by $2.5 million, and the animal health segment decreased by $2.0 million.

Margins were impacted in fiscal year 2008 by the high costs of raw materials used to produce our products. In electronic chemicals, raw material price increases beginning in January 2008 in phosphoric acid, sulfuric acid and isopropyl alcohol put serious pressure on product pricing. Penta raw material costs for chlorine and phenol remained at high levels in fiscal year 2008 and the cost of solvent used for penta solutions increased approximately 35.4% over fiscal year 2007.

Selling, General and Administrative Expenses

SG&A for Fiscal Year 2009 vs. Fiscal Year 2008.

Selling, general and administrative expenses increased to $43.3 million in fiscal year 2009 from $35.3 million in fiscal year 2008, an increase of $8.0 million, or 22.6%. Those expenses were 22.7% of net sales in fiscal year 2009 and 22.9% in the prior year. Increased selling, general and administrative expenses in our electronic chemicals North America and international segments, of $6.4 million and $2.5 million, respectively, contributed to the higher expense in fiscal year 2009. The prior year comparison is skewed by the fact that we owned the two electronic chemicals segments for only seven months in fiscal year 2008. Corporate expenses not directly identified with a particular segment increased $873,000 to $7.7 million in fiscal year 2009 from $6.8 million in fiscal year 2008. The increase was primarily because of increased employee related costs.

Our distribution expenses, which are included as a sales expense, increased by $5.4 million to $20.6 million in fiscal year 2009 as compared with $15.2 million in fiscal year 2008. In our wood treating and animal health segments, distribution expense only represents 2.8% of their aggregate net sales, or $2.9 million in fiscal year 2009. However, distribution expense for the electronic chemicals business was 20.7% of that business's fiscal 2009 revenue, which was an increase in distribution expense of $6.2 million in fiscal year 2009 over that expense for the seven months we owned that business in fiscal 2008. While we incurred no distribution expense associated with electronic chemicals during the first five months of fiscal 2008 before we owned the business, we incurred $8.8 million of distribution expense during the first five months of fiscal 2009 associated with that business.

Administrative expenses include the amortization of intangible assets. Starting January 2009, certain amortization expenses associated with an earlier acquisition in the Penta segment ceased as that asset was fully amortized. As a result, amortization expense for fiscal 2009 was approximately $1.1 million less than fiscal 2008. Also, amortization expense associated with those same assets will decrease by approximately $800,000 in fiscal 2010 versus fiscal 2009.

Also included in sales, general and administrative expenses for fiscal 2009 was approximately $1.0 million of non-recurring costs associated with the transition and integration of the acquired electronic chemicals business. Those costs were predominantly incurred in the first fiscal quarter of fiscal year 2009.

SG&A for Fiscal Year 2008 vs. Fiscal Year 2007.

Selling, general and administrative expenses increased to $35.3 million in fiscal year 2008 from $15.3 million in fiscal year 2007, an increase of $20.0 million, or 130.7%. Selling, general and administrative expenses were 22.9% of net sales in fiscal year 2008 and 17.8% in the prior year. Of the increase in fiscal year 2008, $17.4 million was attributable to the addition of the electronic chemicals North America and international segments. Corporate expense not directly identified with a particular business segment increased to $6.8 million in fiscal year 2008 from $5.8 million in fiscal year 2007. The increase in other corporate expense in fiscal year 2008 was primarily because of increased expense for legal and professional services of $646,000, including accounting expense, and $177,000 in increased employee related costs.

Selling, general and administrative expenses included charges for transitional services provided by Air Products and approximately $667,000 for consultants assisting with the integration of the electronic chemicals business. Although approximately 60% of transitional services were costs from third parties allocated to us by Air Products, about $3.7 million were allocated to us in fiscal year 2008 for Air Products' internal costs, including corporate overhead.

Selling, general and administrative expenses attributable to our wood preserving chemicals and animal health segments increased in fiscal 2008 over the prior fiscal year by $2.6 million in the aggregate. We had increases in supply chain costs of approximately $477,000 primarily related to our creosote segment, increased expenses for new product research and for employee, marketing and advertising expenses for animal health of approximately $746,000, increased legal and regulatory expenses of approximately $605,000, and increased headquarters administrative expenses of $700,000. Supply chain increases consisted of rail car maintenance and creosote storage facility costs. Legal expenses increased because of higher litigation expense and added regulatory personnel. Headquarters administrative costs increased because of higher costs generally, higher auditing costs and because of Sarbanes-Oxley compliance costs. We incurred $466,000 of expense in fiscal year 2008 for additional auditing and third-party consulting in connection with our first year of assessing internal control over financial reporting under Sarbanes-Oxley.

Interest Expense

Interest expense was $3.0 million in fiscal year 2009 compared with $2.7 million in fiscal year 2008 and $945,000 in fiscal year 2007. The year-over-year increase was due to increased borrowings to complete our acquisition of the electronic chemicals business in December 2007.

Income Taxes

We had income tax expense of $7.2 million, $3.6 million and $5.6 million in fiscal years 2009, 2008 and 2007, respectively. Our effective tax rate was 41.5% in fiscal year 2009, 38.8% in fiscal year 2008 and 37.7% in fiscal year 2007. In fiscal year 2009, the effective tax rate varied from the statutory rate primarily due to the recognition of a valuation allowance in connection with our deferred tax asset and foreign exchange losses relating to our electronic chemicals international segment.

Liquidity and Capital Resources

Cash Flows

Net cash provided by operating activities was $26.5 million in fiscal year 2009 as compared with $15.7 million in fiscal year 2008 and $9.0 million in fiscal year 2007.

In fiscal year 2009, net income adjusted for depreciation and amortization increased cash by $16.5 million. We realized an additional increase in cash of $16.5 million resulting from a reduction in trade accounts receivables from collections of amounts obtained in our acquisition of the electronic chemicals business. Cash was unfavorably impacted from increased inventories of $3.4 million and a decrease in accounts payable of $6.0 million. The increase in inventory was primarily made up of an increase of $2.4 million in creosote inventory, due to timing of inventory purchases, and an increase of $2.3 million in inventory for our electronic chemicals North America segment as sales declined in the recession. That increased inventory was offset by a decrease of $620,000 in our electronic chemicals international segment. The decrease in accounts payable was related to both of our electronic chemicals segments.

In fiscal year 2008, net income added $5.4 million to net cash provided by operations. However, substantial net cash from operations was used in the year as accounts receivable increased by $13.7 million. Accounts receivable increased during fiscal year 2008 from sales in our electronic chemicals segments and due to the transitional services provided by Air Products. Accounts receivable owed to us by Air Products was approximately $10.1 million, which primarily represented amounts owed to us for customer payment to the Air Products lock box account. Inventories, net of the effect of $12.4 million of acquired electronic chemicals inventory, declined by $1.0 million in fiscal year 2008, or 7.5%, because inventory from discontinued operations was sold. Accounts payable increased in fiscal year 2008 by $14.8 million, $13.8 million of which was from increased payables in our electronic chemicals business which include $10.4 million payable to Air Products primarily for amounts paid to vendors on our behalf. Accrued liabilities increased in fiscal year 2008 by $3.9 million, primarily because of liabilities pertaining to the electronic chemicals business increased by $1.9 million, net of accrued liabilities acquired in the purchase of that business.

In fiscal year 2007, net income increased cash by $8.8 million, but that was offset in the year by an increase in accounts receivable of $3.8 million. The increase in net income was primarily a result of higher sales revenue. Inventories increased in fiscal year 2007 by $3.1 million, due to increases in animal health inventory necessary to support higher sales volume and to higher than normal creosote inventory.

Net cash used in investing activities was $6.3 million in fiscal year 2009, $75.5 million in fiscal year 2008 and $802,000 in fiscal year 2007. In fiscal year 2009 we made additions to property, plant and equipment of $3.0 million, mainly comprised of $1.8 million in capital expenditures for our electronic chemicals business for shipping containers and other equipment, and $496,000 for the purchase of additional land adjacent to our facility in Matamoros. We also spent $2.9 million in fiscal year 2009 to purchase inventory and accounts receivable pertaining to our electronic chemicals acquisition. In fiscal year 2008, we used approximately $72.5 million for the electronic chemicals business acquisition, and another $2.7 million for capital expenditures. About $1.8 million of the additions to property, plant and equipment in fiscal year 2008 were in the electronic chemicals segment for totes for large quantity product deliveries, for a project to improve our sewer system at our facility in Milan, Italy, and for normal facility improvements in Pueblo, Colorado and Milan. Otherwise in fiscal year 2008, we added to property plant and equipment consistent with normal practices. In fiscal year 2007, $581,000 of net cash from investing activities was used for additions to property and plant, primarily in Matamoros, Mexico, and Tuscaloosa, Alabama.

In fiscal year 2009, net cash used in financing activities was $15.4 million which included principal payments of $9.5 million on our long term borrowings and net payments on our revolving line of $5.2 million. The payments on our long term borrowings included $5.5 million of indebtedness incurred with the purchase of the electronic chemicals business and $4.0 million used to pay the principal outstanding on seller-financed indebtedness incurred with we purchased certain penta assets in fiscal year 2006. We repaid that indebtedness in full in October 2008 from available cash. In fiscal year 2008, net cash provided by financing activities was $46.4 million. We borrowed $64.0 million to finance the acquisition of the electronic chemicals business and refinance existing bank debt at the end of December 2007. That amount consisted of $55.0 million borrowed on our term loans and $9.0 million borrowed on our revolving facility. In connection with the new financing, we paid $466,000 of deferred financing costs. In fiscal year 2008, we made principal payments of $13.3 million on our borrowings under our term loans, $7.4 million of which paid our then outstanding bank facility when we financed for the purchase of our electronic chemicals business, and $2.0 million went to reduce the indebtedness we incurred in fiscal year 2005 to finance our acquisition of the penta business from Basic Chemicals Company. At July 31, 2008 we had reduced the amount outstanding on our revolving facility to $5.2 million.

We paid dividends of $887,000 in fiscal year 2009, $877,000 in fiscal year 2008 and $791,000 in fiscal year 2007.

Working Capital

We have a revolving line of credit under an amended and restated credit agreement. At July 31, 2009, we had no amount outstanding under that revolving facility, and our net borrowing base availability was $35.0 million. Management believes that our current credit facility, combined with cash flows from operations, will adequately provide for our working capital needs for current operations for the next twelve months.

Long Term Obligations

To finance the acquisition of the electronic chemicals business, we entered into an amended and restated credit agreement and a note purchase agreement. The new credit facility included a revolving loan facility of $35.0 million and a term loan facility of $35.0 million. The amended and restated facility was entered into with Wachovia Bank, National Association, a subsidiary of Wells Fargo & Co., Bank of America, N.A., The Prudential Insurance Company of America, and Pruco Life Insurance Company. Advances under the revolving loan and the term loan mature December 31, 2012. They each bear interest at varying rate of LIBOR plus a margin based on our funded debt to EBITDA.

Ratio of Funded Debt to EBITDA	**Margin**
Equal to or greater than 3.0 to 1.0	2.75%
Equal to or greater than 2.5 to 1.0, but less than 3.0 to 1.0	2.50%
Equal to or greater than 2.0 to 1.0, but less than 2.5 to 1.0	2.25%
Equal to or greater than 1.5 to 1.0, but less than 2.0 to 1.0	2.00%
Less than 1.5 to 1.0	1.75%

Currently, advances bear interest at LIBOR plus 2.50%, but advances will bear interest at 2.00% beginning in the first quarter of fiscal year 2010. For the first 24 months of the term facility, principal payments are $458,333 per month and will then become $666,667 per month for the balance of the term prior to maturity. At July 31, 2009, $0 was outstanding on the revolving facility and $26.3 million was outstanding on the term loan. At September 30, 2009, $0 was outstanding on the revolving facility, and $26.3 million was outstanding on the term loan.

The financing for the acquisition of the electronic chemicals business included a $20.0 million note purchase agreement we entered into with the Prudential Insurance Company of America. Advances under the note purchase agreement mature December 31, 2014, and bear interest at 7.43% per annum. Principal is payable at maturity. At July 31, 2009, $20.0 million was outstanding under the note purchase agreement.

Loans under the amended and restated credit facility and the note purchase agreement are secured by our assets, including inventory, accounts receivable, equipment, intangible assets and real property. The credit facility and the note purchase agreement have restrictive covenants, including that we must maintain a fixed charge coverage ratio of 1.25 to 1 through July 31, 2008 and 1.5 to 1.0 thereafter, and a ratio of funded debt to EBITDA of 3.5 to 1.0 through January 31, 2009, 3.25 to 1.0 from February 1, 2009 through April 30, 2009 and 3.0 to 1.0 thereafter. We are also obligated to maintain a debt to capitalization ratio of not more than 60% through April 30, 2009, 50% from then until April 30, 2010, and 45% thereafter. For purposes of calculating these financial covenant ratios, we use a pro forma EBITDA, but add back extraordinary or non-recurring expense or loss as may be approved by our lenders. Our lenders approved adding back approximately $1.0 million in integration costs incurred in the first quarter of fiscal year 2009 in connection with our acquisition of the electronic chemicals business. On July 31, 2009, we were in compliance with all of our debt covenants.

Our purchase of certain penta assets from Basic Chemical Company in fiscal 2005 was financed in part by a $10.0 million loan from the seller. The indebtedness was payable in five equal annual installments of $2.0 million plus interest at 4% per annum. The loan was paid in full on October 30, 2008.

Capital Expenditures

In fiscal year 2009 our capital expenditures included $3.0 million of additions to property, plant and equipment mainly comprised of $1.8 million in connection with our electronic chemicals business for shipping containers and other equipment, and $496,000 for the purchase of additional land adjacent to our facility in Matamoros. We also spent $2.9 million to purchase additional assets pertaining to our electronic chemicals acquisition in completing the transition of certain operations. In fiscal year 2008, we incurred capital expenditures, net of $49.6 million included in our acquisition of the electronic chemicals business, of $2.7 million. About $1.8 million of that amount was for expenditures attributable to the electronic chemicals business, including expenditures for the cost of totes for large quantity product deliveries, and for normal facility improvements. In fiscal year 2007 our capital expenditures were approximately $581,000 for normal improvements to our production facilities, particularly in Matamoros, Mexico and in Tuscaloosa, Alabama.

Our capital expenditures and operating expenses for environmental matters, excluding testing, data submission and other costs associated with our product task force participation, were approximately $576,000 in fiscal year 2009, $454,000 in fiscal year 2008 and $621,000 in fiscal year 2007.

We expensed approximately $880,000 for testing, data submission and other costs associated with our participation in product task forces in fiscal year 2009, and approximately $1.3 million and $1.5 million in fiscal years 2008 and 2007, respectively. The decreased expense was due to decreased activity in the product reauthorization process conducted by the EPA. In September 2008, EPA determined conditionally that our two wood treating pesticides, penta and creosote, were entitled to re-registration. Nevertheless, we estimate that we will continue to incur additional testing, data submission and other costs in fiscal year 2010 of approximately $900,000. Since environmental laws have traditionally become increasingly stringent, costs and expenses relating to environmental control and compliance may increase in the future. While we do not believe that the incremental cost of compliance with existing or future environmental laws and regulations will have a material adverse effect on our business, financial condition or results of operations, we cannot assure that costs of compliance will not exceed current estimates.

Contractual Obligations

Our obligations to make future payments under contracts as of July 31, 2009 are summarized in the following table (in thousands).

	Payments Due by Period (in thousands)			
	Total	**1 Year**	**2-5 Years**	**More than 5 Years**
Long-term debt	$ 46,292	$ 6,966	$ 19,326	$ 20,000
Estimated interest payments on debt (1)	9,340	2.195	6,650	495
Operating leases	5,390	1,468	3,899	23
Other long-term liabilities (2)	541	—	541	—
Purchase obligations (3)	189,536	33,291	97,719	58,526
	$ 251,099	$ 43,920	$ 128,135	$ 79,044

(1) Estimated payments are based on interest rates as of July 2009.

(2) Post retirement benefit obligations.

(3) Consists primarily of raw materials purchase contracts. These are typically not fixed prices arrangements. The prices are based on the prevailing market prices.

Outlook for Fiscal Year 2010

Due to the recession, the demand for our electronic chemicals decreased approximately 28.0% in the second half of fiscal year 2009 versus the run rate in the first half of the year. However, efficiency improvements implemented during the year enabled the business to maintain a positive contribution to operating income. We anticipate seeing at least a partial recovery in the electronic chemicals business during fiscal year 2010, and believe that our new cost structure for the business will yield a significant improvement in profitability.

In wood treating chemicals, we expect that penta revenue will decline in fiscal year 2010 as a result of a moderate lessening of demand. Because of the continuing effect of the economic recession, we also expect to see a slight reduction in purchases of crossties by railroads from the high levels we have enjoyed over the last several years, primarily occurring in the second half of fiscal year 2010.

The cattle and poultry businesses in the United States have been depressed for two years, but we have been able to maintain market share, and the business continues to be profitable. We have made a number of adjustments to strengthen our commercial organization, strip out costs in our supply chain and decrease capital demand. We believe we are well positioned to take advantage of a recovery in the cattle and poultry sector.

Raw material prices increased dramatically from the second half of fiscal 2008 through the first half of fiscal 2009 in our electronic chemicals and wood treating segments, putting pressure on our profitability during that time. In the second half of fiscal year 2009, raw material prices in electronic chemicals and in our wood treating segments retracted sharply, resulting in an increase in profits and margins. We anticipate that in fiscal year 2010, raw material prices in electronic chemicals and in wood treating chemicals will be higher than the very low prices we had in the fourth quarter of fiscal year 2009.

We expect a strong first quarter in fiscal year 2010, but anticipate that higher raw material prices, along with an easing of demand for treated wood by utilities and railroads will cause a partial retraction in the exceptional profitability we have experienced in recent quarters. Overall, we expect fiscal year 2010 results to be slightly better than 2009. These expectations assume a continued gradual economic recovery, and exclude the impact of any acquisitions.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, such as financing or unconsolidated variable interest entities.

Recent Accounting Standards

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("FAS") No. 168 The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles -- a Replacement of FASB Statement No. 162. That FASB Accounting Standards Codification ("Codification") will become the source of authoritative U.S. generally accepted accounting principles ("GAAP") to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. This adoption of FAS No. 168 is not expected to have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position ("FSP") 142-3, "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors an entity should consider when developing renewal or extension assumptions for determining the useful life of recognized intangible assets under FAS 142, "Goodwill and Other Intangible Assets." FSP FAS 142-3 is intended to improve the consistency between the useful life of recognized intangible assets under FAS 142 and the period of expected cash flows used to measure the fair value of assets under FAS 141R and other GAAP. The guidance also requires expanded disclosure related to an entity's intangible assets. The guidance for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years and early adoption is prohibited. We adopted FSP FAS 142-3 on August 1, 2009, which did not have a material impact on our consolidated financial statements.

In November 2008, the FASB ratified Emerging Issues Task Force ("EITF") Issue No. 08-7, "Accounting for Defensive Intangible Assets." EITF 08-7 refers to intangible assets acquired in a business combination or asset acquisition that an entity does not intend to actively use but intends to hold as defensive intangible assets to prevent others from obtaining access to them. Historically, these assets have been typically allocated little or no value. EITF 08-7 requires defensive intangible assets to be accounted for as a separate identifiable asset recognized at fair value with an assigned useful life. The effective date of EITF 08-7 is for fiscal years beginning on or after December 15, 2008. We adopted EITF 08-7 on August 1, 2009, which did not have a material impact on our consolidated financial statements, and will apply the requirements prospectively to intangible assets acquired on or after that date.

In December 2007, the FASB issued FAS 141(R), "Business Combinations." FAS 141(R) establishes revised principles and requirements for the recognition and measurement of assets and liabilities in a business combination. FAS 141(R) requires (i) recognition of the fair values of acquired assets and assumed liabilities at the acquisition date, (ii) contingent consideration to be recorded at fair value at acquisition date, (iii) transaction costs to be expenses as incurred, (iv) pre-acquisition contingencies to be accounted for at acquisition date at fair value and (v) costs of a plan to exit an activity or terminate or relocate employees to be accounted for as post-combination costs. In February 2009, the FASB issued FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in Business Combinations that Arise from Contingencies," to amend certain provisions of FAS 141(R) related to the accounting for contingencies. FAS 141(R) and FSP FAS 141(R)-1 are effective for fiscal years beginning on or after December 15, 2008. We adopted FAS 141(R) and FSP FAS 141(R)-1 on August 1, 2009, which did not have a material impact on our consolidated financial statements, and will apply the requirements prospectively to business combinations that occur after the date of adoption.

In February 2007, the FASB issued FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities." FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. FAS 159 is effective for fiscal years beginning after November 15, 2007. We adopted FAS 159 on August 1, 2008. We did not elect the fair value option for any of its assets and liabilities, and as a result there was no impact on our consolidated financial statements.

In September 2006, the FASB issued FAS 157, "Accounting for Fair Value Measurements." FAS 157 defines fair value, and establishes a framework for measuring fair value in GAAP, and expands disclosure about fair value measurements. In February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement 157" to defer the effective date for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis until fiscal years beginning after November 15, 2008. In February 2008, the FASB also issued FSP FAS 157-1, "Application of FASB Statement 157 to FASB Statement 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13," which excludes FAS 13, "Accounting for Leases" ("FAS 13"), as well as other accounting pronouncements that address fair value measurements on lease classification or measurement under FAS 13. The provisions of FAS 157 for financial assets and liabilities and nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) were effective for our fiscal year beginning August 1, 2008. We accordingly adopted the provisions of FAS 157 for these items on August 1, 2008, which did not have an impact on our consolidated financial statements.

We elected to apply the deferral under FSP FAS 157-2, and accordingly, will not apply FAS 157 to our goodwill, indefinite-lived intangibles and non-financial assets measured at fair value for annual impairment assessment, until fiscal year 2010. We do not expect the application of the deferred portion of FAS 157 will have a significant impact on our consolidated financial statements.

Critical Accounting Policies

Our consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. The preparation of these consolidated financial statements requires the use of estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the periods presented. The significant accounting principles that we believe are the most important to aid in fully understanding our financial results are the following:

Revenue Recognition — Our chemical products are sold in the open market and revenue is recognized when risk of loss and title to the products transfers to customers.

Allowance for Doubtful Accounts — We record an allowance for doubtful accounts to reduce accounts receivable where we believe accounts receivable may not be collected. A provision for bad debt expense recorded to selling, general and administrative expenses increases the allowance. Accounts receivable that are written off decrease the allowance. The amount of bad debt expense recorded each period and the resulting adequacy of the allowance at the end of each period are determined using a customer-by-customer analyses of accounts receivable balances each period and subjective assessments of future bad debt exposure. Historically, write offs of accounts receivable balances have been insignificant. The allowance was $595,000 and $342,000 at July 31, 2009 and 2008, respectively.

Goodwill — In accordance with SFAS 142, "Goodwill and Other Intangible Assets," the carrying value of goodwill will be reviewed at least annually, and if this review indicates that it will not be recoverable, as determined based on the estimated fair value of the applicable reporting unit, our carrying value of goodwill will be adjusted in accordance with SFAS 142. Using discounted cash flow methodology based on projections of the amounts and timing of future revenues and cash flows, we determined that as of July 31, 2009 and 2008, goodwill was not impaired. As a result, there was no change in the carrying value of goodwill of $3.8 million as of July 31, 2009 and 2008.

Impairment of Long-Lived Assets — Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting form the use of the asset or its disposition. The measurement of an impairment loss for long-lived assets, where management expects to hold and use the asset, are based on the asset's estimated fair value. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value. No impairment existed as of July 31, 2009 and 2008.

Income Taxes — We have deferred tax assets that are reviewed periodically for recoverability. These assets are evaluated by using estimates of future taxable income streams. Valuations related to tax accruals and assets could be impacted by changes to tax codes, changes in the statutory tax rates and our future taxable income levels. We have provided a valuation allowance for the full amount of the net deferred tax asset related to our international electronic chemicals segment due to uncertainty regarding our ability to generate sufficient taxable income in future periods. A significant portion of the net deferred tax asset is related to net operating losses, which have no time expiration. At July 31, 2009 and 2008, our valuation allowance totaled $1.5 million and $0, respectively.

Inventory Valuation — We review inventories periodically to ensure the valuation of these assets is recorded at the lower of cost or market and to record an obsolescence reserve for when inventory is considered unsellable. Lower of cost or market adjustments and inventory obsolescence reserve are recorded as an expense in cost of goods sold and as a reduction in inventories. During the fiscal years ended July 31, 2009 and 2008, we recognized inventory valuation adjustments of $766,000 and $0, respectively, to reflect inventory at lower of cost or market. As of July 31, 2009 and 2008, we had recorded $395,000 and $484,000, respectively of reserves for inventory obsolescence.

Disclosure Regarding Forward Looking Statements

We are including the following discussion to inform our existing and potential security holders generally of some of the risks and uncertainties that can affect us and to take advantage of the "safe harbor" protection for forward-looking statements that applicable federal securities law affords. From time to time, our management or persons acting on our behalf make forward-looking statements to inform existing and potential security holders about our company. These forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as future capital expenditures, business strategy, competitive strengths, goals, growth of our business and operations, plans and references to future successes may be considered forward-looking statements. Also, when we use words such as "anticipate," "believe," "estimate," "intend," "plan," "project," "forecast," "may," "should," "budget," "goal," "expect," "probably" or similar expressions, we are making forward-looking statements. Many risks and uncertainties may impact the matters addressed in these forward-looking statements. Our forward-looking statements speak only as of the date made and we will not update forward-looking statements unless the securities laws require us to do so.

Some of the key factors which could cause our future financial results and performance to vary from those expected include:

- the loss of primary customers;
- our ability to implement productivity improvements, cost reduction initiatives or facilities expansions;
- market developments affecting, and other changes in, the demand for our products and the introduction of new competing products;
- availability or increases in the price of our primary raw materials or active ingredients;
- the timing of planned capital expenditures;
- our ability to identify, develop or acquire, and market additional product lines and businesses necessary to implement our business strategy and our ability to finance such acquisitions and development;
- the condition of the capital markets generally, which will be affected by interest rates, foreign currency fluctuations and general economic conditions;
- cost and other effects of legal and administrative proceedings, settlements, investigations and claims, including environmental liabilities which may not be covered by indemnity or insurance;
- the ability to obtain registration and re-registration of our products under applicable law;
- the political and economic climate in the foreign or domestic jurisdictions in which we conduct business; and
- other United States or foreign regulatory or legislative developments which affect the demand for our products generally or increase the environmental compliance cost for our products or impose liabilities on the manufacturers and distributors of such products.

The information contained in this report, including the information set forth under the heading "Risk Factors", identifies additional factors that could cause our results or performance to differ materially from those we express in our forward-looking statements. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions and, therefore, the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements which are included in this report and the exhibits and other documents incorporated herein by reference, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to certain market risks in the ordinary course of our business, arising primarily from changes in interest rates and to a lesser extent foreign currency exchange rate fluctuations. Generally we do not utilize derivative financial instruments or hedging transactions to manage that risk.

Interest Rate Sensitivity

As of July 31, 2009 our fixed rate debt consisted of $20.0 million of term notes with an interest rate of 7.43%, maturing on December 31, 2014.

Our variable rate debt as of July 31, 2009 consisted of a credit facility with an interest rate of 2.50% plus LIBOR, maturing on December 31, 2012. On July 31, 2009, we had $0 borrowed on a $35.0 million revolving credit line under that facility, and $26.3 million borrowed on a term loan under that same facility. Principal payments on the term loan are $458,333 per month for the first two years of the term facility and $666,667 per month for the remaining term of the facility.

Based on the outstanding balance of the term loan, a 1.0% change in the LIBOR interest rate as of July 31, 2009 would result in a change of approximately $232,000 in annual interest expense.

Foreign Currency Exchange Rate Sensitivity

We are exposed to fluctuations in foreign currency exchange rates from our electronic chemicals international segment. This segment uses a different functional currency than the U.S. Dollar which is our consolidated reporting currency. Currency translation gains and losses result from the process of translating the segment's financial statements from its functional currency (Euros) into our reporting currency. Currency translation gains and losses have no impact on the consolidated statements of income and are recorded as accumulated other comprehensive income (loss) within stockholders' equity in our consolidated balance sheets. Assets and liabilities have been translated using exchange rates in effect at the balance sheet dates. Revenues and expenses have been translated using the average exchange rates during the period.

During the fiscal year 2009, we recognized foreign currency translation losses of $2.6 million as accumulated other comprehensive loss in the consolidated balance sheets. The losses reflect the weakening of the U.S. Dollar against the Euro during fiscal year 2009. At July 31, 2009, the cumulative foreign currency translation loss reflected in accumulated other comprehensive loss was $1.5 million.

Additionally we have limited exposure to certain transactions denominated in a currency other than the functional currency in our Italy operations. Accordingly, we recognize exchange gains or losses in our consolidated statement of operations from these transactions. We believe the impact of changes in foreign currency exchange rates do not have a material effect on our results of operations or cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements

Consolidated Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of KMG Chemicals, Inc.:

We have audited the accompanying consolidated balance sheets of KMG Chemicals, Inc. ("the Company") as of July 31, 2009 and 2008, and the related consolidated statements of income, stockholders' equity and cash flows for each of the three years in the period ended July 31, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

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

We were not engaged to examine the Company's assertion about the effectiveness of the Company's internal control over financial reporting as of July 31, 2009 included in the accompanying annual report on Form 10-K and, accordingly we do not express an opinion thereon.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of KMG Chemicals, Inc. as of July 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended July 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ UHY LLP

Houston, Texas
October 14, 2009

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KMG CHEMICALS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF JULY 31, 2009 AND 2008 (in thousands, except for share and per share data)

	2009	2008
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 7,174	$ 2,605
Accounts receivable:		
Trade, net of allowances of $595 at July 31, 2009 and $342 at July 31, 2008	21,206	37,126
Other	1,896	2,060
Inventories, net	28,163	24,620
Current deferred tax asset	698	325
Prepaid expenses and other current assets	1,638	1,449
Total current assets	60,775	68,185
PROPERTY, PLANT AND EQUIPMENT, net	54,834	57,759
DEFERRED TAX ASSET	923	1,295
GOODWILL	3,778	3,778
INTANGIBLE ASSETS, net	20,149	21,918
RESTRICTED CASH	313	343
OTHER ASSETS, net	2,736	2,520
TOTAL ASSETS	$ 143,508	$ 155,798
LIABILITIES & STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 16,606	$ 23,016
Accrued liabilities	7,151	6,658
Current deferred tax liability	328	35
Current portion of long-term debt	6,966	7,500
Total current liabilities	31,051	37,209
LONG-TERM DEBT, net of current portion	39,326	53,516
DEFERRED TAX LIABILITY	874	—
OTHER LONG-TERM LIABILITIES	1,280	1,386
Total liabilities	72,531	92,111
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value, 10,000,000 shares authorized, none issued	—	—
Common stock, $.01 par value, 40,000,000 shares authorized. 11,101,345 shares issued and outstanding at July 31, 2009 and 11,034,795 shares issued and outstanding at July 31, 2008	111	110
Additional paid-in capital	23,084	22,525
Accumulated other comprehensive income (loss)	(1,464)	1,134
Retained earnings	49,246	39,918
Total stockholders' equity	70,977	63,687
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 143,508	$ 155,798

See notes to consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED JULY 31, 2009, 2008 AND 2007 (in thousands, except per share data)

	2009	2008	2007
NET SALES	$ 190,720	$ 154,394	$ 86,171
COST OF SALES	126,553	107,563	55,735
Gross Profit	64,167	46,831	30,436
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	43,318	35,338	15,318
Operating income	20,849	11,493	15,118
OTHER INCOME (EXPENSE):			
Interest income	7	438	560
Interest expense	(3,032)	(2,670)	(945)
Other, net	(340)	(55)	6
Total other expense, net	(3,365)	(2,287)	(379)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	17,484	9,206	14,739
Provision for income taxes	(7,248)	(3,550)	(5,576)
INCOME FROM CONTINUING OPERATIONS	10,236	5,656	9,163
DISCONTINUED OPERATIONS			
Loss from discontinued operations, before income taxes	(29)	(425)	(533)
Income tax benefit	8	144	219
Loss from discontinued operations	(21)	(281)	(314)
NET INCOME	$ 10,215	$ 5,375	$ 8,849
EARNINGS PER SHARE:			
Basic			
Income from continuing operations	$ 0.92	$ 0.52	$ 0.87
Loss from discontinued operations	—	(0.03)	(0.03)
Net income	$ 0.92	$ 0.49	$ 0.84
Diluted			
Income from continuing operations	$ 0.91	$ 0.50	$ 0.83
Loss from discontinued operations	—	(0.02)	(0.03)
Net income	$ 0.91	$ 0.48	$ 0.80
WEIGHTED AVERAGE SHARES OUTSTANDING:			
Basic	11,085	10,978	10,573
Diluted	11,230	11,232	11,034

See notes to consolidated financial statements.

See notes to consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED JULY 31, 2009, 2008 AND 2007 (in thousands)

	Common Stock Shares Issued	Common Stock Par Value	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Income (loss)	Retained Earnings	Total Stockholders' Equity
BALANCE AT AUGUST 1, 2006	10,677	$ 107	$ 20,117	$ (721)	$ 53	$ 27,362	$ 46,918
Cash dividends						(791)	(791)
Stock options exercised	97	1	(1,458)				(1,457)
144 treasury shares issued			(721)	721			—
Additional costs of stock placement			(5)				(5)
Stock-based compensation			510				510
Tax benefit — nonqualified stock options exercised			2,439				2,439
Comprehensive income:							
Net income						8,849	8,849
Change in unrealized value on interest rate swap (net of taxes of $33)					(53)		(53)
Total comprehensive income							8,796
BALANCE AT JULY 31, 2007	10,774	$ 108	$ 20,882	$ —	$ —	$ 35,420	$ 56,410
Cash dividends						(877)	(877)
Stock options/warrants exercised	195	1	537				538
Restricted stock issued	66	1	(1)				—
Stock-based compensation			751				751
Tax benefit — nonqualified stock options exercised			356				356
Comprehensive income:							
Net income						5,375	5,375
Gain on foreign currency translation					1,134		1,134
Total comprehensive income							6,509
BALANCE AT JULY 31, 2008	11,035	$ 110	$ 22,525	$ —	$ 1,134	$ 39,918	$ 63,687
Cash dividends						(887)	(887)
Stock options/warrants exercised	45		119				119
Restricted stock issued	21	1	(1)				—
Stock-based compensation			391				391
Tax benefit — nonqualified stock options exercised			50				50
Comprehensive income:							
Net income						10,215	10,215
Loss on foreign currency translation					(2,598)		(2,598)
Total comprehensive income							7,617
BALANCE AT JULY 31, 2009	11,101	$ 111	$ 23,084	$ —	$ (1,464)	$ 49,246	$ 70,977

See notes to consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JULY 31, 2009, 2008 AND 2007 (in thousands)

	2009	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 10,215	$ 5,375	$ 8,849
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	6,168	5,665	3,832
Amortization of loan costs included in interest expense	88	51	50
Impairment on assets of discontinued operations	15	102	—
Stock-based compensation	391	751	510
Bad debt expense	253	—	13
Inventory valuation adjustment	766	—	—
Loss on disposal of property	87	13	157
Gain on termination of interest rate swap	—	—	(30)
Deferred rental income	(48)	(86)	(86)
Deferred income tax expense (benefit)	1,123	(600)	(307)
Excess tax benefit from exercise of stock options	(50)	(356)	(2,439)
Changes in operating assets and liabilities, net of effects of acquisition:			
Accounts receivable — trade	16,503	(12,757)	(2,890)
Accounts receivable — other	107	(914)	(872)
Inventories	(3,355)	983	(3,096)
Prepaid expenses and other current assets	(486)	(1,264)	175
Accounts payable	(6,015)	14,824	2,194
Accrued liabilities	740	3,881	2,908
Net cash provided by operating activities	26,502	15,668	8,968
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, plant and equipment	(3,009)	(2,729)	(581)
Cash used in connection with electronic chemicals acquisition	(3,257)	(72,468)	—
Proceeds from sale of property		—	10
Proceeds from termination of interest rate swap	—	—	30
Increase in restricted cash	(2)	(343)	—
Additions to other assets	—	—	(261)
Net cash used in investing activities	(6,268)	(75,540)	(802)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Deferred financing cost	—	(466)	—
Net borrowings (payments) under revolver credit agreement	(5,224)	5,224	—
Proceeds from borrowings on term loans	—	55,000	8,400
Principal payments on borrowings on term loan	(9,500)	(13,333)	(11,921)
Proceeds from exercise of stock options	119	538	83
Excess tax benefit from exercise of stock options	50	356	2,439
Payments of employee withholding tax for employee cashless exercise of employee stock options	—	—	(1,540)
Payment of dividends	(887)	(877)	(791)
Net cash (used in) provided by financing activities	(15,442)	46,442	(3,330)
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(223)	31	—
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,569	(13,399)	4,836
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	2,605	16,004	11,168
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 7,174	$ 2,605	$ 16,004
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the year for interest	$ 2,980	$ 2,492	$ 1,008
Cash paid during the year for income taxes	$ 2,821	$ 3,983	$ 3,814

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General — KMG Chemicals, Inc. (the "Company") is involved principally in the manufacture and sale of specialty chemicals in carefully focused markets through its two wholly-owned subsidiaries, KMG-Bernuth, Inc. ("KMG Bernuth") and KMG Electronic Chemicals, Inc. ("KMG EC"). The Company sells two wood preserving chemicals—pentachlorophenol ("penta") and creosote. The Company also sells animal health pesticides to protect livestock and poultry from flies and other pests, including insecticidal ear tags for cattle, and feed-through and pour-on insecticidal products for use on livestock and their premises. In its electronic chemicals business, the Company sells high purity wet process chemicals to the semiconductor industry.

The Company manufactures penta at its plant in Matamoros, Mexico through KMG de Mexico ("KMEX"), a Mexican corporation which is a wholly-owned subsidiary of KMG-Bernuth. The Company has two main suppliers of creosote, which it sells throughout the United States. The Company contracts with third parties for the supply of tetrachlorvinphos and other animal health active ingredients. The Company operates its electronic chemicals business through KMG EC in North America and through KMG Italia, S.r.l. ("KMG Italia"), a subsidiary of KMG EC and the Company, in Europe and elsewhere. That business has facilities in Pueblo, Colorado and Milan, Italy.

Subsequent Events — The Company evaluates events and transactions that occur after the balance sheet date but before the financial statements are issued. The Company evaluated such events and transactions through October 14, 2009 when the financial statements were filed electronically with the Securities and Exchange Commission.

Principles of Consolidation — The consolidated financial statements include the accounts of KMG Chemicals, Inc. and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Reclassifications — Certain reclassifications of prior year amounts have been made to conform to current year presentation.

Cash and Cash Equivalents — The Company considers all investments with original maturities of three months or less when purchased to be cash equivalents.

Restricted Cash — Restricted cash includes cash balances which are legally or contractually restricted to use. The Company's restricted cash as of July 31, 2009 and 2008 was related to its operations in Italy in connection with certain utilities and warehouse providers.

Fair Value of Financial Instruments — The carrying value of financial instruments, including cash and cash equivalents, accounts receivable, and accounts payable approximate fair value because of the relatively short maturity of these instruments. The fair value of the Company's debt at July 31, 2009 and 2008 approximated its carrying value since the debt obligations bear interest at a rate consistent with current market rates.

Accounts Receivable — The Company's accounts receivable are primarily from wood-treating customers and agriculture chemicals distributors in the United States and from electronic chemical customers worldwide. The Company extends credit based on an evaluation of the customer's financial condition, generally without requiring collateral. Exposure to losses on receivables is dependent on each customer's financial condition. At July 31, 2009, there were no customers that represented a significant portion of total accounts receivable. At July 31, 2008, one customer represented approximately 10% of total accounts receivable, and Air Products and Chemicals, Inc. ("Air Products") represented approximately 27%, which reflects amounts owed to us for payments into the Air Products lock box account under the transition services agreement. See note 2 to the consolidated financial statements.

The Company records an allowance for doubtful accounts to reduce accounts receivable when the Company believes an account may not be collected. A provision for bad debt expense is recorded to selling, general and administrative expenses. The amount of bad debt expense recorded each period and the resulting adequacy of the allowance at the end of each period are determined using a customer-by-customer analyses of accounts receivable balances each period and our assessment of future bad debt exposure. Historically, write offs of accounts receivable balances have been insignificant. The allowance was $595,000 and $342,000 at July 31, 2009 and 2008, respectively.

Inventories — Inventories are valued at the lower of cost or market. Cost is generally determined using the first-in first-out ("FIFO") method, and in certain instances cost estimates of FIFO are used. The Company records inventory obsolescence as a reduction in its inventory when considered unsellable.

Property, Plant, and Equipment — Property, plant, and equipment are stated at cost less accumulated depreciation and amortization. Major renewals and betterments are capitalized. Repairs and maintenance costs are expensed as incurred.

Depreciation for equipment commences once placed in service, and depreciation for buildings and leasehold improvements commences once they are ready for their intended use. Depreciable life is determined through economic analysis. Depreciation for financial statement purposes is provided on the straight-line method.

The estimated useful lives of classes of assets are as follows:

Asset Description	Life (Years)
Building	15 to 30
Plant	10 to 18
Equipment	3 to 10
Leasehold improvements	remaining life of the lease

Depreciation expense was approximately $4.4 million, $2.8 million and $1.1 million in fiscal years 2009, 2008 and 2007, respectively.

Intangible Assets — Identifiable intangible assets with a defined life are being amortized using the straight-line method over the useful lives of the assets. Identifiable intangible assets of an indefinite life are not amortized. These assets are required to be tested for impairment at least annually. The Company performed its annual impairment analysis of intangible assets not subject to amortization as of July 31, 2009 and 2008 and concluded that an impairment charge was not necessary.

Goodwill — In accordance with Statement of Financial Accounting Standards ("SFAS") 142, "Goodwill and Other Intangible Assets," the carrying value of the Company's goodwill is reviewed at least annually, and if this review indicates that it will not be recoverable, as determined based on the estimated fair value of the applicable reporting unit, and the Company's carrying value of goodwill will be adjusted to fair value. Using discounted cash flow methodology based on projections of the amounts and timing of future revenues and cash flows, the Company determined that as of July 31, 2009 and 2008, goodwill was not impaired. As a result, there was no change in the carrying value of goodwill of $3.8 million as of July 31, 2009 and 2008.

Impairment of Long-Lived Assets — Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset or its disposition. The measurement of an impairment loss for long-lived assets, where management expects to hold and use the asset, are based on the asset's estimated fair value. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value.

Revenue Recognition — The Company's chemical products are sold in the open market and revenue is recognized when risk of loss and title to the products transfers to customers. In general, risk of loss transfers upon shipment to customers.

Cost of Sales — Cost of sales includes inbound freight charges, purchasing and receiving costs, inspection costs and internal transfer costs. In the case of products manufactured by the Company, direct and indirect manufacturing costs (including depreciation and amortization) and associated plant administrative expenses are included as well as laid-in cost of raw materials consumed in the manufacturing process. We include depreciation on our property, plant and equipment in cost of sales.

Selling, General and Administrative Expenses — These expenses include selling expenses, product storage and handling costs and the cost (primarily common carrier freight) of distributing products to the Company's customers. Corporate headquarters' expenses, amortization of intangible assets and environmental regulatory support expenses are also included.

Advertising Costs — Our policy is to expense advertising costs as they are incurred. Advertising costs were approximately $859,000, $871,000 and $537,000 in fiscal years ended July 31, 2009, 2008 and 2007, respectively.

Shipping and Handling Costs — Shipping and handling costs are included in cost of sales and selling, general and administrative expenses. Inbound freight charges and internal transfer costs are included in cost of sales. Product storage and handling costs and the cost of distributing products to the Company's customers (distribution expense) are included in selling, general and administrative expenses.

Income Taxes — Deferred income tax assets and liabilities are determined using the asset and liability method in accordance with Statement of Financial Accounting Standards ("FAS") No. 109, "Accounting for Income Taxes." Under this method, deferred tax assets and liabilities are established for future tax consequences of temporary differences between the financial statement carrying amounts of assets and liabilities and their tax basis. The Company adopted Financial Accounting Standards Board ("FASB") Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48"), effective August 1, 2007. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Based on an evaluation of tax years that remain open and subject to potential examination, the Company determined that it had no significant unrecognized tax benefits and no interest or penalties accrued at the date of adoption of FIN 48 or as of July 31, 2009. The Company's policy is to recognize interest and penalties related to uncertain tax positions in income tax expense. Fiscal years subsequent to 2005 remain open and subject to examination of United States federal taxes and subsequent to fiscal year 2004 for state tax jurisdictions. In Mexico, tax years subsequent to 2002, and in Italy tax years beginning with our acquisition of the electronic chemicals business in December 2007, remain open and subject to examination.

Earnings Per Share — Basic earnings per common share amounts are calculated using the average number of common shares outstanding during each period. Diluted earnings per share assumes the issuance of restricted stock awards and the exercise of all stock options having exercise prices less than the average market price during the period of the common stock using the treasury stock method.

Foreign Currency Translation — The functional currency of the Company's Mexico operations is the U.S. Dollar. As a result, monetary assets and liabilities for KMEX are re-measured to U.S. dollars at current rates at the balance sheet dates, income statement items are re-measured at the average monthly exchange rates for the dates those items were recognized, and certain assets (including plant and production equipment) are re-measured at historical exchange rates. Foreign currency transactions gains and losses are included in the statement of operations as incurred along with gains and losses from currency re-measurement. These gains and losses resulted in a nominal net exchange loss in fiscal years 2009, 2008 and 2007, respectively.

The functional currency of the Company's KMG Italia subsidiary is the local currency (Euro). The currency translation from the local currency into the reporting currency (U.S. Dollar) is included as a separate component of stockholders' equity. The assets and liabilities have been translated from Euros into U.S. Dollars using exchange rates in effect at the balance sheet dates. Results of operations have been translated using the average exchange rates during the year. Foreign currency translation resulted in a loss of $2.6 million in fiscal year 2009 and a gain of $1.1 million in fiscal year 2008, each of which are included in accumulated other comprehensive income (loss) in the consolidated balance sheets.

Stock-Based Compensation — The Company accounts for stock-based compensation costs at fair value which is measured on the date of the grant of the award. The grant date fair value is measured using a Black-Scholes option valuation model for stock option awards. The Company's stock price on the date of the grant of stock awards is used to measure grant date fair value for stock awards. Stock-based compensation costs are recognized as an expense over the requisite service period of the award using the straight-line method.

Recent Accounting Standards

In June 2009, the Financial Accounting Standards Board ("FASB") issued FAS No. 168 "The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles — a Replacement of FASB Statement No. 162" The FASB Accounting Standards Codification (Codification) will become the source of authoritative U.S. generally accepted accounting principles ("GAAP") to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission ("SEC") under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become non-authoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of FAS No. 168 is not expected to have a material impact on the company's consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position ("FSP") FAS 142-3, "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors an entity should consider when developing renewal or extension assumptions for determining the useful life of recognized intangible assets under FAS 142, "Goodwill and Other Intangible Assets." FSP FAS 142-3 is intended to improve the consistency between the useful life of recognized intangible assets under FAS 142 and the period of expected cash flows used to measure the fair value of assets under FAS 141R and other GAAP. The guidance also requires expanded disclosure related to an entity's intangible assets. The guidance for determining the useful life of a recognized intangible asset shall be applied prospectively to intangible assets acquired after the effective date and the disclosure requirements shall be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years and early adoption is prohibited. The Company adopted FSP FAS 142-3 on August 1, 2009, which did not have a material impact on its consolidated financial statements.

In November 2008, FASB ratified Emerging Issues Task Force ("EITF") Issue No. 08-7, "Accounting for Defensive Intangible Assets." EITF 08-7 refers to intangible assets acquired in a business combination or asset acquisition that an entity does not intend to actively use but intends to hold as defensive intangible assets to prevent others from obtaining access to them. Historically, these assets have been typically allocated little or no value. EITF 08-7 requires defensive intangible assets to be accounted for as a separate identifiable asset recognized at fair value with an assigned useful life. The effective date of EITF 08-7 is for fiscal years beginning on or after December 15, 2008. The Company adopted EITF 08-7 on August 1, 2009, which did not have a material impact on our consolidated financial statements, and will apply the requirements prospectively to intangible assets acquired on or after that date.

In December 2007, the FASB issued FAS 141(R), "Business Combinations." FAS 141(R) establishes revised principles and requirements for the recognition and measurement of assets and liabilities in a business combination. FAS 141(R) requires (i) recognition of the fair values of acquired assets and assumed liabilities at the acquisition date, (ii) contingent consideration to be recorded at fair value at acquisition date, (iii) transaction costs to be expenses as incurred, (iv) pre-acquisition contingencies to be accounted for at acquisition date at fair value and (v) costs of a plan to exit an activity or terminate or relocate employees to be accounted for as post-combination costs. In February 2009, the FASB issued FSP FAS 141(R)-1, "Accounting for Assets Acquired and Liabilities Assumed in Business Combinations that Arise from Contingencies," to amend certain provisions of FAS 141(R) related to the accounting for contingencies. FAS 141(R) and FSP FAS 141(R)-1 are effective for fiscal years beginning on or after December 15, 2008. The Company adopted FAS 141(R) and FSP FAS 141(R)-1 on August 1, 2009, which did not have a material impact on our consolidated financial statements, and will apply the requirements prospectively to business combinations that occur after the date of adoption.

In February 2007, the FASB issued FAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities." FAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. FAS 159 is effective for fiscal years beginning after November 15, 2007. The Company adopted FAS 159 on August 1, 2008. The Company did not elect the fair value option for any of its assets and liabilities, and as a result there was no material impact on its consolidated financial statements.

In September 2006, the FASB issued FAS 157, "Accounting for Fair Value Measurements." FAS 157 defines fair value, and establishes a framework for measuring fair value in GAAP, and expands disclosure about fair value measurements. In February 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement 157" to defer the effective date for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis until fiscal years beginning after November 15, 2008. In February 2008, the FASB also issued FSP FAS 157-1, "Application of FASB Statement 157 to FASB Statement 13 and Other Accounting Pronouncements that Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13," which excludes FAS 13, "Accounting for Leases" ("FAS 13"), as well as other accounting pronouncements that address fair value measurements on lease classification or measurement under FAS 13. The provisions of FAS 157 for financial assets and liabilities and nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) were effective for the Company for the fiscal year beginning August 1, 2008. The Company accordingly adopted the provisions of FAS 157 for these items on August 1, 2008, which did not have a material impact on its consolidated financial statements.

The Company elected to apply the deferral under FSP FAS 157-2, and accordingly, will not apply FAS 157 to its goodwill, indefinite-lived intangibles and non-financial assets measured at fair value for annual impairment assessment, until fiscal year 2010. We do not expect that the application of the deferred portion of FAS No. 157 will have a material impact on the Company's consolidated financial statements.

2. ACQUISITIONS

On December 31, 2007, the Company acquired the high-purity wet process chemicals business of Air Products and Chemicals, Inc. ("Air Products"). That business sells high purity wet process chemicals to the semiconductor industry. Its products are used primarily to clean and etch silicon wafers in the production of semiconductors. In the purchase of the electronic chemicals business, the Company acquired accounts receivable, inventory, property, plant and equipment, and intangible assets. The Company also assumed certain accrued liabilities.

The cost of the electronic chemicals business acquisition was approximately $75.7 million, which included $25.8 million for net working capital. The Company also agreed to pay retention bonuses of approximately $1.0 million in the aggregate to certain employees within one year of the acquisition date. As contemplated by the purchase agreement and to facilitate the transition of certain international customers, the purchase of approximately $4.4 million of accounts receivable and inventory, in the aggregate, was delayed until after the initial closing of the acquisition of the business, including $2.9 million in the first quarter of fiscal year 2009.

The Company financed the acquisition with available cash, an amended and restated credit facility and a note purchase agreement. The Company operates its electronic chemicals business in the United States and in Europe through two subsidiaries, KMG Electronic Chemicals, Inc. and KMG Italia S.r.l.

The following table summarizes the cost of the acquisition (in thousands).

Cash paid to seller	$ 71,863
Employee retention bonus accrual	1,014
Other costs of acquisition	2,849
Total	$ 75,726

The acquisition of the electronic chemicals business included working capital, a 215,000 square foot manufacturing and warehouse facility in Pueblo, Colorado, as well as a manufacturing facility and additional warehouse near Milan, Italy. The Company entered into a manufacturing agreement with Air Products under which they will continue to manufacture certain products at their Dallas, Texas facility as was done before the acquisition. The Company assumed certain accrued liabilities associated with the business, including $473,000 for property taxes and $1.6 million for accrued payroll related liabilities in Italy.

The following table summarizes the purchase price allocation for the acquisition (in thousands).

Accounts receivable, net of allowance	$ 14,250
Inventory, net of allowance	13,650
Property, plant and equipment	48,771
Intangible assets:	
Non-compete agreement	93
Patent	72
Trademarks	47
Manufacturing agreement	919
Total intangible assets	1,131
Assumed liabilities	(2,076)
Total acquired assets, net of assumed liabilities	$ 75,726

The pro forma effect of the acquisition and the associated financing on the Company's historical results for the years ending July 31, 2008 and 2007 are presented in the following table as if the transaction had occurred as of the beginning of the years presented (in thousands, except earnings per share). The unaudited pro forma financial information is not necessarily indicative of what our consolidated results of operations would have been had we completed the acquisition as of the dates indicated.

	(Unaudited) Year Ended July 31,	
	2008	2007
Revenues	$ 193,841	$ 181,105
Operating income	15,573	22,125
Net income	7,449	10,539
Basic earnings per share	$ 0.68	$ 1.00

In February 2006, the Company purchased certain assets of the animal health pesticides business of Boehringer Ingelheim Vetmedica, Inc. The assets we purchased included pesticide registrations for pesticides used on cattle, swine, poultry and livestock premises, a manufacturing and warehouse facility in Elwood, Kansas and related equipment. The Company also purchased the insecticides finished goods, raw materials and packaging inventory on hand at closing. The pesticides registrations acquired in the transaction are for the United States, Canada, Mexico, Australia and several countries in Latin America. The new pesticides include insecticidal ear tags for cattle and several liquid and dust formulations for livestock and their premises. Through the end of fiscal year 2006, Boehringer Ingelheim marketed the purchased pesticides as the Company's sole distributor in the United States pursuant under a transition agreement. The purchase price was approximately $8.9 million, including $2.7 million of inventory. The acquisition was financed entirely with available cash.

3. INVENTORIES, NET

Inventories are summarized as follows at July 31, 2009 and 2008 (in thousands):

	2009	2008
Raw materials and supplies	$ 5,865	$ 5,244
Finished products	22,693	19,860
	28,558	25,104
Less reserve for inventory obsolescence	(395)	(484)
Inventories, net	$ 28,163	$ 24,620

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment and related accumulated depreciation and amortization are summarized as follows at July 31, 2009 and 2008 (in thousands):

	2009	2008
Land	$ 8,946	$ 9,110
Buildings and improvements	30,546	30,617
Equipment	26,679	24,663
Leasehold improvements	153	132
	66,324	64,522
Less accumulated depreciation and amortization	(12,605)	(8,220)
	53,719	56,302
Construction-in-progress	1,115	1,457
Property, plant and equipment, net	$ 54,834	$ 57,759

5. DISCONTINUED OPERATIONS

In the first quarter of fiscal year 2008, the Company discontinued operation of its herbicide product line (MSMA), which had comprised the agricultural chemical segment. MSMA market conditions deteriorated at the end of fiscal year 2006, and regulatory actions by the U.S. EPA adversely affected the product line. Impairments of MSMA assets of $15,000 and $102,000 were recognized in fiscal years 2009 and 2008, respectively. Sales of MSMA products for the fiscal years 2009, 2008 and 2007 reported in discontinued operations were $0, $1.3 million and $3.6 million respectively. The Company had a net loss from discontinued operations of approximately $21,000 in fiscal year 2009, $281,000 in fiscal year 2008 and $314,000 in fiscal year 2007.

6. INCOME TAXES

The geographical sources of income (loss) from continuing operations before income taxes for each of the three years ended July 31 (in thousands):

	2009	2008	2007
United States	$ 17,833	$ 9,548	$ 14,346
Foreign	(349)	(342)	393
Income from continuing operations before income taxes	$ 17,484	$ 9,206	$ 14,739

The components of income tax expense (benefit) from continuing operations for the years ended July 31 consisted of the following (in thousands):

	2009	2008	2007
Current:			
Federal	$ 5,279	$ 3,398	$ 5,108
Foreign	242	395	227
State	758	461	625
	6,279	4,254	5,960
Deferred:			
Federal	628	(262)	(220)
Foreign	288	(419)	(144)
State	53	(23)	(20)
	969	(704)	(384)
Total	$ 7,248	$ 3,550	$ 5,576

Deferred income taxes are provided on all temporary differences between financial and taxable income. The following table presents the components of the Company's deferred tax assets and liabilities at July 31, 2009 and 2008 (in thousands):

	2009	2008
Deferred tax assets:		
Current deferred tax assets:		
Bad debt expense	$ 114	$ 18
Inventory	642	321
Accrued liabilities	310	139
Less: valuation allowance	(78)	—
Other	—	82
Total current deferred tax assets	$ 988	$ 560
Non-current deferred tax assets		
Net operating loss	$ 1,715	$ 356
Difference in depreciable basis of property	678	1,109
Deferred compensation	507	370
Less: valuation allowance	(1,431)	—
Total non-current deferred tax assets	$ 1,469	$ 1,835
Deferred tax liabilities:		
Current deferred tax liabilities:		
Prepaid assets	$ (618)	$ (270)
Non-current deferred tax liabilities:		
Inventory	(44)	(81)
Difference in amortization basis of intangibles	(770)	(459)
Other	(606)	—
Total non-current deferred tax liabilities	(1,420)	(540)
Net current deferred tax asset	$ 370	$ 290
Net non-current deferred tax asset (liability)	$ 49	$ 1,295

The Company adopted FASB Interpretation No. 48 "Accounting for Uncertainty in Income Taxes" ("FIN 48"), effective August 1, 2007. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. Based on an evaluation of tax years that remain open and subject to potential examination, the Company determined that it had no significant unrecognized tax benefits and no interest or penalties accrued at the date of adoption of FIN 48 or as of July 31, 2009 and 2008. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. Fiscal years subsequent to 2005 remain open and subject to examination of United States federal taxes and subsequent to fiscal year 2004 for state tax jurisdictions. In Mexico tax years subsequent to 2002, and in Italy tax years beginning with our acquisition of the electronic chemicals business in December 2007, remain open and subject to examination.

One of the Company's foreign subsidiaries operates in Italy. Italy recently enacted legislation that reduces tax rates effective for the Company's fiscal year 2009 from 33% to 27.5%. This foreign subsidiary has incurred a net operating loss of approximately $3.9 million and $2.3 million for the fiscal years ended July 31, 2009 and 2008, respectively. The net operating loss is available to offset future income indefinitely. However, a valuation allowance of $1.5 million has been provided as the Company does not believe that it is more likely than not that the net deferred tax asset will be realized based on current projections.

Undistributed earnings of the Company's Mexico subsidiary amounted to approximately $4.9 million at July 31, 2009. Those earnings are considered to be permanently reinvested; accordingly, no provision for United States federal and/or state income taxes has been provided thereon. Upon repatriation of those earnings, in the form of dividends or otherwise, the Company will be subject to both United States income taxes (subject to an adjustment for foreign tax credits) and potentially withholding taxes payable to the foreign country. Determination of the amount of unrecognized deferred United States income tax liability is not practicable due to the complexities associated with its hypothetical calculation.

The following table accounts for the differences between the actual tax provision, and the amounts obtained by applying the applicable statutory United States federal income tax rate of 35%, 34% and 34%, to earnings before income taxes for the years ended July 31, 2009, 2008, and 2007, respectively (in thousands).

	2009	2008	2007
Income taxes at the federal statutory rate	$ 6,119	$ 3,130	$ 5,011
Effect of foreign operations	91	91	(5)
Valuation allowance	1,509	—	—
Currency exchange loss	(949)	—	—
State income taxes, net of federal income tax effect	548	292	459
Other	(70)	37	111
Total	$ 7,248	$ 3,550	$ 5,576

7. INTANGIBLE ASSETS

Intangible assets at July 31, 2009 and 2008 are summarized as follows:

	2009 Carrying Amount	2008 Carrying Amount
Intangible assets not subject to amortization:		
Creosote product registrations	$ 5293	$ 5,293
Other creosote related assets	46	46
Penta product registrations	8,765	8,765
Total Intangible Assets not subject to amortization	14,104	14,104

Intangible assets subject to amortization: (range of useful life)

	Original Cost	Accumulated Amortization	Intangible Assets, net	Original Cost	Accumulated Amortization	Intangible Assets, net
Creosote supply contract (10 years)	4,000	(3,422)	578	4,000	(3,156)	844
Other creosote related assets (5 years)	131	(129)	2	131	(109)	22
Penta supply contract and other related assets (3-5 years)	7,288	(7,273)	15	7,288	(6,478)	810
MSMA product registrations and related assets (discontinued operations) Animal health trademarks (4-5 years)	364	(349)	15	364	(340)	24
Animal health product registrations and other related assets (5-20 years)	6,165	(1,328)	4,837	6,165	(989)	5,176
Electronic chemicals-related contracts (3-5 years)	1,014	(516)	498	1,014	(188)	826
Electronic chemicals-related trademarks and patents (10-15 years)	117	(17)	100	117	(5)	112
Total Intangible Assets subject to amortization	19,079	(13,034)	6,045	19,079	(11,265)	7,814
Total intangible assets, net			20,149			21,918

Intangible assets subject to amortization are amortized over their estimated useful lives which are between 5 and 20 years. Amortization expense was approximately $1.8 million, $2.9 million and $2.7 million for fiscal years 2009, 2008 and 2007. The estimated amortization expense is projected to be approximately $966,000, $766,000, $409,000, $354,000 and $328,000 for fiscal years 2010 through 2014, respectively.

8. LONG-TERM OBLIGATIONS

The Company's debt as of July 31, 2009 and July 31, 2008 consisted of the following (in thousands):

	July 31, 2009	July 31, 2008
Senior Secured Debt:		
Note Purchase Agreement, maturing on December 31, 2014, interest rate of 7.43%	$ 20,000	$ 20,000
Secured Debt:		
Term Loan Facility, maturing on December 31, 2012, variable interest rates based on LIBOR plus 2.50% (3.04% at July 31, 2009)	26,292	31,792
Revolving Loan Facility, maturing on December 31, 2012, variable interest rates based on LIBOR plus 2.50% (3.04% at July 31, 2009)	—	5,224
Other Debt:		
Unsecured Loan, payable in five equal annual installments of $2.0 million maturing on June 8, 2010, plus interest of 4.0% per annum, original face value of $10.0 million	—	4,000
Total debt	46,292	61,016
Current portion of long-term debt	(6,966)	(7,500)
Long-term debt, net of current portion	$ 39,326	$ 53,516

To finance the acquisition of the electronic chemicals business, the Company entered into an amended and restated credit agreement and a note purchase agreement. The new credit agreement replaced and refinanced the Company's existing credit agreement with Wachovia Bank, National Association, a subsidiary of Wells Fargo & Co. The new credit facility included a revolving loan facility of $35.0 million and a term loan facility of $35.0 million. The amended and restated facility was entered into with Wachovia Bank, National Association, Bank of America, N.A., The Prudential Insurance Company of America, and Pruco Life Insurance Company. Advances under the revolving loan and the term loan mature December 31, 2012. They each bear interest at varying rate of LIBOR plus a margin based on our funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA").

Ratio of Funded Debt to EBITDA	Margin
Equal to or greater than 3.0 to 1.0	2.75%
Equal to or greater than 2.5 to 1.0, but less than 3.0 to 1.0	2.50%
Equal to or greater than 2.0 to 1.0, but less than 2.5 to 1.0	2.25%
Equal to or greater than 1.5 to 1.0, but less than 2.0 to 1.0	2.00%
Less than 1.5 to 1.0	1.75%

Currently advances bear interest at LIBOR plus 2.50%. The new facility refinanced $7.4 million of indebtedness then outstanding under the Company's existing term loan facility with Wachovia Bank. For the first 24 months of the term facility, principal payments are $458,333 per month and will then become $666,667 per month for the balance of the term prior to maturity. At July 31, 2009, the amount outstanding on the revolving facility was $0 and the amount outstanding on the term loan was $26.3 million.

The financing of the acquisition of the electronic chemicals business included a $20.0 million note purchase agreement with the Prudential Insurance Company of America. Advances under the note purchase agreement mature December 31, 2014, and bear interest at 7.43% per annum. Principal is payable at maturity. At July 31, 2009, $20.0 million was outstanding under the note purchase agreement.

Loans under the amended and restated credit facility and the note purchase agreement are secured by the Company's assets, including inventory, accounts receivable, equipment, intangible assets, and real property. The credit facility and the note purchase agreement have restrictive covenants, including that the Company must maintain a fixed charge coverage ratio of 1.25 to 1 through July 31, 2008 and 1.5 to 1.0 thereafter, and a ratio of funded debt to EBITDA of 3.5 to 1.0 through January 31, 2009, 3.25 to 1.0 from February 1, 2009 through April 30, 2009 and 3.0 to 1.0 thereafter. The credit facility and note purchase agreement were amended effective January 30, 2009, primarily to increase the debt to EBITDA ratio requirement covering the Company's second and third fiscal quarters. The Company is also obligated to maintain a debt to capitalization ratio of not more than 60% through April 30, 2009, 50% from then until April 30, 2010, and 45% thereafter. For purposes of calculating these financial covenant ratios, the Company uses a pro forma EBITDA, but adds back extraordinary or non-recurring expense or loss as may be approved by our lenders. Our lenders have approved adding back approximately $1.0 million in integration costs incurred in the first quarter of fiscal year 2009 in connection with our acquisition of the electronic chemicals business. On July 31, 2009, the Company was in compliance with all of its debt covenants.

The Company's purchase of certain pentachlorophenol assets from Basic Chemical Company in fiscal 2006 was financed in part by a $10.0 million loan from the seller. The indebtedness is payable in five equal annual installments of $2.0 million plus interest at 4% per annum. The indebtedness was paid in full on October 30, 2008.

Principal payments due under long-term debt agreements for the years ended July 31 are as follows (in thousands):

	Total	2010	2011	2012	2013	2014	Thereafter
Long-term debt	$ 46,292	$ 6,966	$ 8,000	$ 8,000	$ 3,326	$ 0	$ 20,000

9. COMMITMENTS AND CONTINGENCIES

Contractual Obligations — The Company has non-cancelable operating leases for its office and warehouse facilities and certain transportation equipment and purchase obligations. Our obligations to make future payments under certain contractual obligations as of July 31, 2009 are summarized in the following table (in thousands).

	Total	2010	2011	2012	2013	2014	Thereafter
Operating leases	$ 5,390	$ 1,468	$ 1,210	$ 1,101	$ 890	$ 698	$ 23
Purchase obligations (1)	189,536	33,291	27,273	25,135	22,656	22,655	58,526
Total	$ 194,926	$ 34,759	$ 28,483	$ 26,236	$ 23,546	$ 23,353	$ 58,549

(1) Consists primarily of raw materials purchase contracts. These are typically not fixed prices arrangements. The prices are based on the prevailing market prices.

Rent expense relating to the operating leases was approximately $1.6 million, $1.4 million and $1.1 million in fiscal years 2009, 2008 and 2007, respectively.

Environmental — The Company's operations are subject to extensive federal, state and local laws, regulations and ordinances in the United States and abroad relating to the generation, storage, handling, emission, transportation and discharge of certain materials, substances and waste into the environment, and various other health and safety matters. Governmental authorities have the power to enforce compliance with their regulations, and violators may be subject to fines, injunctions or both. The Company must devote substantial financial resources to ensure compliance, and it believes that it is in substantial compliance with all the applicable laws and regulations.

Certain licenses, permits and product registrations are required for the Company's products and operations in the United States, Mexico and other countries in which it does business. The licenses, permits and product registrations are subject to revocation, modification and renewal by governmental authorities. In the United States in particular, producers and distributors of chemicals such as penta, creosote, tetrachlorvinphos and MSMA are subject to registration and notification requirements under federal law (including under the Federal Insecticide Fungicide and Rodenticide Act ("FIFRA"), and comparable state law) in order to sell those products in the United States. Compliance with these requirements has had, and in the future will continue to have, a material effect on our business, financial condition and results of operations.

The Company incurred expenses in connection with FIFRA research and testing programs of approximately $880,000, $1.3 million and $1.5 million in fiscal year 2009, 2008 and 2007, respectively. These costs are included in selling, general, and administrative expenses.

Litigation — The Company has been a defendant since 2007 in *John Bailey, et al vs Cleveland G. Meredith et al* in Superior Court, Fulton County, Georgia (Atlanta). The plaintiffs live near the wood treating facility of one of our customers, and complain that emissions from the wood treating facility have caused harm to their property and person, and claim that we are also responsible because we sold wood treating chemicals to the facility. Given the inherent uncertainties of litigation, the ultimate outcome cannot be predicted at this time, nor can the amount of any potential loss be reasonably estimated.

We have discontinued the operation of our agricultural herbicide product line, referred to as MSMA, but in connection with that product line we were a member of the MSMA task force. An entity related to the MSMA task force, Arsonate Herbicide Products, Limited) ("AHP"), was sued by Albaugh, Inc. in 2007 claiming that AHP overbilled it for certain task force expenses. Although Albaugh Inc. had agreed to reimburse AHP for certain task force expenses for MSMA studies and registration support costs, it now claims that it was overbilled for many years by at least $900,000. The case is in the U.S. District Court for the So. District of Iowa, and styled as *Albaugh, Inc. vs. Arsonate Herbicide Products, Limited.* AHP has responded that the billings were proper and as agreed. Given the inherent uncertainties of litigation, the ultimate outcome cannot be predicted at this time, nor can the amount of any potential loss be reasonably estimated.

Suit was filed in 1998 against KMEX, a Company subsidiary, by plaintiffs who claimed that their title to the land on which our Matamoros facility was built was superior to the person from whom our subsidiary bought the land. The lawsuit is styled *Adolfo Cazares Rosas, et al vs. KMG de Mexico and Guillermo Villarreal.* The plaintiffs seek to have our purchase overturned and to recover the land or its value. In January 2008, the case was sent by the appeals court back to the lower court to obtain additional factual information, and the plaintiffs were required to re-file their case in 2009. The ultimate outcome of this litigation cannot be determined at this time, nor can the amount of any potential loss be reasonably estimated.

The Company is and may become a party in routine legal actions or proceedings in the ordinary course of its business. Management does not believe that the outcome of any of these routine matters will have a material adverse effect on the Company's consolidated financial position or results of operations.

10. EMPLOYEE BENEFIT PLANS

The Company has a defined contribution 401(k) plan covering substantially all of its U.S. employees. The Company makes matching contributions under this plan of up to 3% of the participant's compensation. Company contributions to the plan totaled approximately$282,000, $195,000 and $88,000 in fiscal years 2009, 2008 and 2007, respectively. Fiscal year 2009 included a full year of matching contributions for participating employees associated with our electronic chemicals business as compared to fiscal year 2008 which reflected only seven months of contributions for those respective employees due to the timing of the acquisition.

In July 2001, the Company adopted a supplemental executive retirement plan. Only persons specifically designated by the company may be participants in the plan. The plan is unfunded and amounts payable to participants are general obligations of the company. The plan provides that a participant will be paid a supplemental retirement benefit for 10 years equal to a percentage of the participant's three-year average base salary at normal retirement. The benefit payable to participants is reduced by the equivalent actuarial value of the Company's other pension plan payments to the participant, if any, the Company's 401(k) plan and one-half social security benefits. Normal retirement is the earlier of age 65 and completion of 10 years credited service or age 60 with 30 years credited service. One executive was designated as a participant in August 2001, which resulted in approximately $93,000, $84,000 and $76,000 of expenses for fiscal years 2009, 2008 and 2007, respectively. As of July 31, 2009, and 2008, the liability under this plan was approximately $541,000 and $448,000, respectively.

11. EARNINGS PER SHARE

Basic earnings per share have been computed by dividing net income by the weighted average shares outstanding. Diluted earnings per share have been computed by dividing net income by the weighted average shares outstanding plus dilutive potential common shares. The following table presents information necessary to calculate basic and diluted earnings per share for periods indicated:

	Year Ended		
	2009	2008	2007
	(Amounts in thousands, except per share data)		
Income from continuing operations	$ 10,236	$ 5,656	$ 9,163
Loss from discontinued operations	(21)	(281)	(314)
Net income	$ 10,215	$ 5,375	$ 8,849
Weighted average shares outstanding	11,085	10,978	10,573
Dilutive effect of options/warrants and stock awards	145	254	461
Weighted average shares outstanding, as adjusted	11,230	11,232	11,034
BASIC EARNINGS PER SHARE:			
Basic earnings per share from continuing operations	$ 0.92	$ 0.52	$ 0.87
Basic earnings per share on loss from discontinued operations	—	(0.03)	(0.03)
Basic earnings per share	$ 0.92	$ 0.49	$ 0.84
DILUTED EARNINGS PER SHARE:			
Diluted earnings per share from continuing operations	$ 0.91	$ 0.50	$ 0.83
Diluted earnings per share on loss from discontinued operations	—	(0.02)	(0.03)
Diluted earnings per share	$ 0.91	$ 0.48	$ 0.80

Outstanding stock-based awards are not included in the computation of diluted earnings per share under the treasury stock method, if including them would be anti-dilutive. Consequently, in fiscal year 2009 there was an average of 53,700 shares that were not included. There were no potentially dilutive securities that were not included in the computation of pro forma diluted earnings per share for fiscal years 2008 and 2007.

12. STOCK-BASED COMPENSATION

Stock-Based Incentive Plans

The Company adopted a 2009 Long-Term Incentive Plan in October 2009, which will be submitted for approval by the shareholders at the annual meeting on December 8, 2009, and adopted a 2004 Long-Term Incentive Plan in October 2004 which was approved by the shareholders at the Company's annual meeting in November 2005.

The LTI Plans permit the granting of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards, dividend equivalent rights, and other awards. They are administered by the Board of Directors or a committee appointed by the Board of Directors. The Board has designated the Compensation Committee as the administrator of the LTI Plans. Subject to the terms of the LTI Plans, the committee has the sole discretion to select the persons eligible to receive awards, the type and amount of incentives to be awarded, and the terms and conditions of awards. The committee also has the authority to interpret the LTI Plans, and establish and amend regulations necessary or appropriate for their administration. Any employee of the Company or a subsidiary of the Company or a director of the Company whose judgment, initiative, and efforts contributed or may be expected to contribute to the successful performance of the Company is eligible to participate. The maximum number of shares of the Company's common stock that may be delivered pursuant to awards granted is 750,000 shares under the 2009 Long-Term Incentive Plan and 375,000 shares under the 2004 Long-Term

Incentive Plan. Under the 2004 Long-Term Plan no executive officer may receive in any calendar year stock options or stock appreciation rights relating to more than 250,000 shares of common stock, or awards that are subject to the attainment of performance goals relating to more than 100,000 shares of common stock. Under the 2009 Long-Term Plan no executive officer may receive in any calendar year stock options or stock appreciation rights, or awards that are subject to the attainment of performance goals relating to more than 200,000 shares of common stock. At July 31, 2009, there were approximately 50,608 shares available for future grants under the 2004 Long-Term Incentive Plans.

The Company adopted the 1996 Stock Option Plan (the "1996 Stock Plan") on October 15, 1996, but it terminated by expiration of its original term on July 31, 2007. Options previously issued under the 1996 Stock Plan remain in effect. The 1996 Stock Plan is administered either by the Company's Board of Directors or by a committee of two or more non-employee directors. Options are exercisable during the period specified in each option agreement and in accordance with a vesting schedule designated by the Board of Directors or the committee. Any option agreement may provide that options become immediately exercisable in the event of a change or threatened change in control of the Company and in the event of certain mergers and reorganizations of the Company. Options may be subject to early termination within a designated period following the option holder's cessation of service with the Company.

Accounting for Stock-Based Compensation

The Company recognized stock-based compensation costs of approximately $391,000, $751,000 and $510,000, respectively, for the fiscal years ended July 31, 2009, 2008 and 2007, and the related tax benefits of $149,000, $285,000 and $194,000, respectively, for the fiscal year ended July 31, 2009, 2008 and 2007. Stock-based compensation costs are recorded as selling, general and administrative expenses in the consolidated statements of income and as an increase to additional paid-in capital in the consolidated balance sheets. The Company accounts for stock-based compensation costs at fair value measured on the date of grant of the award using a Black-Scholes option valuation model for stock option awards. Grant date fair value for stock awards is measured using the Company's closing stock price on the date of grant of the stock awards. Stock-based compensation costs are recognized as an expense over the requisite service period, generally the vesting period of the award, using the straight-line method.

As of July 31, 2009, there was approximately $368,000 of unrecognized compensation costs, of which $60,000 was related to outstanding stock options which is expected to be recognized over a weighted-average period of 2.1 years and $308,000 related to unvested performance and time-based stock awards which is expected to be recognized over a weighted-average period of 1.3 years.

A summary of activity for stock option and stock-awards is presented below.

Stock Options

Employee Options. A summary of option activity associated with employee compensation for the fiscal year ended July 31, 2009 is presented below.

	Shares	Weighted-Average Exercise Price
Outstanding on August 1, 2008	359,500	3.91
Granted	—	—
Exercised	(20,000)	2.85
Forfeited/Expired	—	—
Outstanding on July 31, 2009	339,500	3.97

The following table summarizes information about stock options outstanding at July 31, 2009 based on fully vested (currently exercisable) stock option awards and stock options awards expected to vest:

	Options Outstanding	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands) (1)
Fully vested and currently exercisable	259,500	3.86	4.74	897
Expected to vest	80,000	4.32	12.54	240
Total outstanding stock options	339,500	3.97	6.58	1,137

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(1) The aggregate intrinsic value is computed based on the closing price of the Company's stock on July 31, 2009.

No options were granted in fiscal years 2009, 2008 or 2007.

The total intrinsic value of options exercised in fiscal years 2009, 2008 and 2007 was approximately $119,000, $700,000, and $6.4 million, respectively. The total fair value of shares vested in fiscal years 2009, 2008 and 2007 was approximately $44,000, $48,000 and $44,000, respectively.

Non-employee options. In connection with an acquisition of certain penta assets in fiscal year 2003, the Company granted an affiliate of the seller an option to acquire 175,000 shares by common stock at an exercise price of $2.50 per share. The option was exercisable for five years. The holder exercised the remaining 25,000 shares during fiscal year 2009.

Performance Shares

There were aggregate awards for 78,450 performance shares granted as of August 1, 2008, and during fiscal year 2009 awards for 91,242 performance shares were granted. As of July 31, 2009, there were awards for 129,942 performance shares outstanding. A summary of the performance based stock awards granted to certain executives as Series 1 and Series 2 awards in fiscal years 2009, 2008 and 2007 is detailed below.

Date of Grant	Series Award	Maximum Award (Shares)	Closing (Fair Value) Stock Price on Grant Date	3-Year Measurement Period Ending	Actual and Expected Percentage of Vesting (1)	Actual Shares Vested and Shares Projected to Vest (1)
02/16/2007	Series 1	23,850	$ 10.16	07/31/2009	80.0%	$ 19,080
02/16/2007	Series 2	15,900	$ 10.16	07/31/2009	100.0%	15,900
		39,750				34,980
03/03/2008	Series 1	23,220	$ 16.76	07/31/2010	52.5%	12,191
03/03/2008	Series 2	15,480	$ 16.76	07/31/2010	0.0%	—
		38,700				12,191
12/2/2008	Series 1	54,745	$ 3.19	07/31/2011	68.75%	37,637
12/2/2008	Series 2	36,497	$ 3.19	07/31/2011	20.0%	7,299
		91,242				44,936
	Total	169,692				$ 92,107

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(1) For performance share grants on February 16, 2007, the above table represents the actual percentage vesting and shares vested as of the end of the measurement period ended July 31, 2009. For the other performance share grants identified in the above table, the information set forth is the expected vesting percentage and the shares projected to vest.

Series 1: Vesting for the 2009, 2008 and 2007 Series 1 awards are subject to a performance requirement composed of certain revenue growth objectives and average annual return on invested capitol or equity objectives measured across a three year period. These objectives are estimated quarterly using the Company's budget, actual results and long term projections. Based on performance through July 31, 2009, 68.75% and 52.5% is projected to be the probable vesting for the fiscal year 2009 and 2008 Series 1 awards, respectively, at the end of their measurement periods. For the Series 1 award for fiscal year 2007, the actual vesting was determined to be 80.0% at the end of the measurement period. Performance shares that have vested are normally issued within 75 days of the end of the fiscal year.

Series 2: Vesting of the 2009, 2008 and 2007 Series 2 awards are subject to performance requirements pertaining to the growth rate in the Company's basic earnings per share over a three year period. The achievement of performance requirements is estimated quarterly using the Company's budget, actual results and long-term projections. Based on performance through July 31, 2009, 20.0% and 0% is projected to be the probable vesting for the 2009 and 2008 Series 2 awards, respectively, at the end of their measurement periods. For the Series 2 award for fiscal year 2007, the actual vesting was determined to be 100% at the end of the measurement period. Performance shares that have vested are normally issued within 75 days of the end of the fiscal year.

The weighted-average grant-date fair value of performance share awards outstanding at the beginning and ending of fiscal year 2009 was $11.87 and $6.09, respectively.

Time-Based Shares

A summary of activity for time-based stock awards for the fiscal year ended July 31, 2009 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Outstanding on August 1, 2008	12,099	$ 16.76
Granted	41,410	$ 3.19
Vested	(21,550)	$ 5.74
Forfeited	—	—
Outstanding on July 31, 2009	31,959	$ 6.61

The awards granted during fiscal year 2009 to certain executives and non-employee directors are as follows:

Date of Grant	Type of Grant	Number of Shares Granted	Vesting Period	Grant Date Fair Value
12/2/2008	Employee	6,410	32 month cliff vesting ending July 31, 2011	$ 3.19
12/2/2008	Non-employee Director	35,000	12 month graded vesting ending November 30, 2009	$ 3.19

During fiscal year 2009 the Company changed the equity portion of compensation for non-employee directors. Each non-employee director will receive 5,000 shares of Common stock for service as a director from December 1, 2008 through November 30, 2009. Twenty-five percent of the shares will be issued on the last trading day of each three month service period ending in February, May, August and November. The issuance will be prorated for any non-employee director starting or ending service during the annual period, based on the number of months during such period that the director served as a director, with any day of service during a month being counted as service for the entire month.

The grant-date fair value of the non-employee director awards will be recognized on a straight-line basis over the twelve month requisite service period ending November 30, 2009.

The total fair value of shares vested in fiscal years 2009, 2008 and 2007 was $124,000, $0 and $0, respectively.

13. SEGMENT INFORMATION

The Company operates in five reportable segments organized around its three product lines: electronic chemicals, wood preserving chemicals and animal health pesticides. The electronic chemicals business sells high purity wet process chemicals to the semiconductor industry. The penta segment manufactures and sells its penta products line, including penta blocks, flakes, solutions, and a byproduct of penta production. Penta is used primarily to treat electric and telephone utility poles, protecting them from mold, mildew, fungus and insects. The creosote segment sells creosote products as a wood preservative for railroad crossties and utility poles. Our creosote suppliers distill coal tar, and creosote is a by-product of that process. The Company supplies industrial users with both penta products and creosote. The animal health segment sells pesticides products under the trade names Rabon, Ravap, Patriot and Annihilator. These pesticide products are used by domestic livestock and poultry growers to protect animals from flies and other pests.

	2009	2008	2007
	(Amounts in thousands)		
Sales			
Electronic Chemicals — North America (1)	$ 69,701	$ 47,645	$ —
Electronic Chemicals — International (1)	16,123	13,524	—
Penta	26,189	26,366	28,377
Creosote	67,776	55,207	43,645
Animal Health	10,931	11,652	14,149
Total sales for reportable segments	$ 190,720	$ 154,394	$ 86,171
Depreciation and amortization			
Electronic Chemicals — North America	$ 2,694	$ 1,406	$ —
Electronic Chemicals — International	757	473	—
Penta	1,405	2,525	2,485
Creosote	292	298	297
Animal Health	769	852	899
Discontinued operations	—	15	100
Other — general corporate	251	96	51
Total consolidated depreciation and amortization	$ 6,168	$ 5,665	$ 3,832
Segment income (loss) from operations			
Electronic Chemicals — North America	$ 5,003	$ 3,331	$ —
Electronic Chemicals — International	(1,308)	(1,224)	—
Penta	9,021	6,273	9,135
Creosote	15,645	9,136	8,858
Animal Health	200	816	2,926
Total segment income from operations	$ 28,561	$ 18,332	$ 20,919
Capital expenditures			
Electronic Chemicals — North America	$ 1,741	$ 33,307	$ —
Electronic Chemicals — International	370	18,021	—
Penta	822	307	362
Creosote	52	—	23
Animal Health	4	81	196
Included in acquisition	(324)	(49,576)	—
Discontinued operations	—	—	—
Other — General corporate	344	589	—
Total capital expenditures	$ 3,009	$ 2,729	$ 581
Total assets			
Electronic Chemicals — North America	$ 49,610	$ 62,162	
Electronic Chemicals — International	26,258	32,484	
Penta	20,169	21,230	
Creosote	18,894	16,701	
Animal Health	17,157	17,367	
Total assets for reportable segments	$ 132,088	$ 149,944	

(1) Net of intersegment revenues in fiscal year 2009 of approximately $13,000 and $862,000 and in fiscal year 2008 of $332,000 and $231,000 for Electronic Chemicals — North America and Electronic Chemicals — International, respectively, which were eliminated in consolidated revenues. For fiscal year 2009 and 2008, sales to one customer of our electronic chemicals North America segment represented approximately 14% and 10%, respectively, of the Company's revenue, but no other customers accounted for 10% or more of the Company's revenues. No customer accounted for 10% or more of the Company's revenues in fiscal years 2007.

A reconciliation of total segment to consolidated amounts for fiscal years 2009, 2008 and 2007 is set forth in the table below.

	2009	2008	2007
Assets:			
Total assets for reportable segments	$ 132,088	$ 149,944	
Total assets for discontinued operations (1)	856	1,212	
Cash and cash equivalents	6,613	212	
Prepaid and other current assets	1,070	1,773	
Other	2,881	2,657	
Total assets	$ 143,508	$ 155,798	
Sales:			
Total sales for reportable segments	$ 190,720	$ 154,394	$ 86,171
Net sales	$ 190,720	$ 154,394	$ 86,171
Segment income (loss) from operations:			
Total segment income from operations (2)	$ 28,561	$ 18,332	$ 20,919
Other corporate expense (2)	(7,712)	(6,839)	(5,801)
Operating income	20,849	11,493	15,118
Interest income	7	438	560
Interest expense	(3,032)	(2,670)	(945)
Other expense, net	(340)	(55)	6
Income from continuing operations before income taxes	$ 17,484	$ 9,206	$ 14,739

Geographic Data

	2009	2008	2007
Net sales:			
United States	$ 173,786	$ 140,207	$ 83,581
International	16,934	14,187	2,590
Net sales	$ 190,720	$ 154,394	$ 86,171
Property, plant and equipment, net:			
United States	$ 35,653	$ 37,235	
International	19,181	20,524	
Property, plant and equipment, net	$ 54,834	$ 57,759	

(1) Includes approximately $830,000 and $1.0 million of deferred tax assets as of July 31, 2009 and 2008, respectively, related to discontinued operations.

(2) Certain reclassifications of prior year amounts have been made to conform to current year presentation.

Other corporate expenses as disclosed in the table above represent those expenses that could not be directly identified with a particular business segment. Those expenses include almost all expenses associated with the Company's Houston headquarters, such as executives and other employees, outside legal and accounting services, board compensation, expenses associated with being a publically traded entity, audit expense and fees related to the listing of our stock.

14. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

Quarterly results for the fiscal years ended July 31, 2009 and 2008, except for net income, exclude discontinued operations related to the Company's agricultural chemical products. See note 5 for further detail on discontinued operations.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(Amounts in thousands, except per share data)			
Year Ended July 31, 2009				
Net sales	$ 52,233	$ 44,207	$ 45,869	$ 48,411
Gross profit	15,530	13,736	15,350	19,551
Operating income	3,525	2,507	5,440	9,377
Income from continuing operations before income taxes	2,615	1,479	4,694	8,696
Net income	1,616	903	2,782	4,914
Earnings Per share:				
Income per share from continuing operations				
– basic	$ 0.15	$ 0.08	$ 0.25	$ 0.44
– diluted	0.14	0.08	0.25	0.44
Net income per share				
– basic	0.15	0.08	0.25	0.44
– diluted	0.14	0.08	0.25	0.44
Year Ended July 31, 2008				
Net sales	$ 21,323	$ 31,452	$ 50,259	$ 51,360
Gross profit	6,806	10,139	15,079	14,807
Operating income	2,579	2,999	3,874	2,041
Income from continuing operations before income taxes	2,625	2,563	2,865	1,153
Net income	1,553	1,572	1,679	571
Earnings Per share:				
Income per share from continuing operations				
– basic	$ 0.15	0.14	0.17	0.05
– diluted	0.15	0.14	0.16	0.05
Net income per share				
– basic	0.14	0.14	0.15	0.05
– diluted	0.14	0.14	0.15	0.05

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this annual report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the company, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluations of effectiveness to future periods is subject to the risk that controls may become inadequate in the future period because of changes in conditions, in the degree of compliance with the policies, or because procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive and principal financial officers, we conducted an assessment as of July 31, 2009 of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO Framework"). Based on this assessment, management concluded that its internal control over financial reporting was effective as of July 31, 2009.

This report does not include an attestation report of our independent registered accounting firm regarding internal control over financial reporting. The report was not subject to attestation by our independent registered accounting firm because of temporary rules of the SEC that permit us to provide only our report in this annual report.

Changes in Internal Control Over Financial Reporting

There were no changes to our internal control over financial reporting identified in conjunction with our management's evaluation of such control that occurred during our fiscal quarter ended July 31, 2009 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

Pursuant to instruction G(3) to Form 10-K, the information required by Items 10-11, a portion of Item 12 and Items 13-14 of Part III is incorporated by reference from our definitive proxy statement relating to our annual meeting of shareholders on December 8, 2009, which will be filed with the Securities and Exchange Commission within 120 days of the end of fiscal year 2009.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

On October 12, 2009, we adopted our 2009 Long-Term Incentive Plan. That plan is to be submitted to the shareholders for approval at our annual meeting of shareholders on December 8, 2009. The plan is attached as Exhibit 10.46 to this report. Our 2004 Long-Term Incentive Plan was adopted and approved by the shareholders in 2004, and has been filed previously as Exhibit 10.21 to our report on Form 10-Q filed on December 15, 2004. Our 1996 Stock Option Plan was adopted and approved by its shareholders in 1996, and has been filed previously as Exhibit 10.4 to the Company's report on Form 10-QSB12G filed on December 6, 1996. The 1996 Stock Option Plan terminated by expiration of its original term as of July 31, 2007, but options previously issued under the plan remain in effect. The following information is provided as of July 31, 2009, and does not include information respecting the 2009 Long Term Incentive Plan.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Plan Category Equity compensation plans approved by security holders	339,500(1)	$ 3.97	50,608
Equity compensation plans not approved by security holders	—	—	—
Total	339,500	$ 3.97	50,608

(1) Includes unvested options to purchase 80,000 shares of common stock.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 10-K

(a) The financial statements filed as part of this report in Item 8 are listed in the Index to Financial Statements contained in that item.

(b) The following documents are filed as exhibits. Documents marked with an asterisk (*) are management contracts or compensatory plans, and portions of documents marked with a dagger (†) have been granted confidential treatment.

3.1	Restated and Amended Articles of Incorporation filed as Exhibit 3(i) to the company's filed as Exhibit 3(i) to the company's Form 10-QSB12G filed December 6, 1996, incorporated in this report.
3.2	Bylaws filed as Exhibit 3(ii) to the company's Form 10-QSB12G filed December 6, 1996, incorporated in this report.
3.3	Articles of Amendment to Restated and Amended Articles of Incorporation, filed December 11, 1997 filed as Exhibit 3 to the company's second quarter 1998 report on Form 10-QSB filed December 12, 1997, incorporated in this report.
4.1	Form of Common Stock Certificate filed as Exhibit 4.1 to the company's Form 10-QSB12G filed December 6, 1996, incorporated in this report.
10.11†	Creosote Supply Agreement dated November 1, 1998 between Rütgers VFT and the company filed as Exhibit 10.20 to the company's second quarter 1999 report on Form 10-QSB filed March 12, 1999, incorporated in this report.
10.12*	1996 Stock Option Plan filed as Exhibit 10.4 to the company's Form 10-QSB12G filed December 6, 1996, incorporated in this report.
10.13*	Stock Option Agreement dated October 17, 1996 with Thomas H. Mitchell filed as Exhibit 10.5 to the company's Form 10-QSB12G filed December 6, 1996, incorporated in this report.
10.15*	Employment Agreement with Thomas H. Mitchell dated July 11, 2001 filed as Exhibit 10.25 to the company's 2001 report on Form 10-K filed October 24, 2001, incorporated in this report.
10.16*	Employment Agreement with John V. Sobchak dated June 26, 2001 filed as Exhibit 10.26 to the company's 2001 report on Form 10-K filed October 24, 2001, incorporated in this report.
10.17*	Employment Agreement with Roger C. Jackson dated August 1, 2002 filed as Exhibit 10.31 to the company's 2003 report on Form 10-K filed October 23, 2003, incorporated in this report.
10.18*	Employment Agreement with J. Neal Butler dated March 8, 2004 filed as Exhibit 10.18 to the company's 2004 report on Form 10-K filed October 15, 2004, and incorporated herein by reference.
10.19*	Supplemental Executive Retirement Plan dated effective August 1, 2001 filed as Exhibit 10.27 to the company's 2001 report on Form 10-K filed October 24, 2001, incorporated in this report.
10.20	Direct Stock Purchase Plan filed as Exhibit 99.1 to the company's report on Form 8 K filed February 14, 2002, incorporated in this report.
10.21*	2004 Long-Term Incentive Compensation Plan filed as Exhibit 10.21 to the company's report on Form 10-Q filed December 15, 2004, incorporated in this report.
10.22	Securities Purchase Agreement dated April 21, 2005 between the company and Tontine Capital Partners, L.P. and Terrier Partners, L.P. filed as Exhibit 10.22 to the company's report on Form 8-K filed April 22, 2005.

10.23 Registration Rights Agreement dated April 21, 2005 between the company and Tontine Capital Partners, L.P. and Terrier Partners, L.P. filed as Exhibit 10.23 to the company's report on Form 8-K filed April 22, 2005.

10.26 Asset Purchase Agreement dated June 7, 2005 between the company and Basic Chemicals Company, LLC. filed as Exhibit 10.26 to the company's report on Form 8-K filed June 13, 2005.

10.28* Performance-Based Restricted Stock Agreement, Series 1 dated September 2, 2005 filed as Exhibit 10.28 to the company's report on Form 8-K filed September 7, 2005.

10.29* Performance-Based Restricted Stock Agreement, Series 2 dated September 2, 2005 filed as Exhibit 10.29 to the company's report on Form 8-K filed September 7, 2005.

10.30 Asset Purchase Agreement dated February 22, 2006 between the company and Boehringer Ingelheim Vetmedica, Inc., filed as Exhibit 10.30 to the company's report on Form 8-K filed February 27, 2006, and incorporated herein by reference.

10.31† Asset Purchase Agreement by and among Wood Protection Products, Inc., KMG-Bernuth, Inc. and James R. Forshaw filed as Exhibit 2.1(v) to the company's report on Form 8-K filed December 19, 2003, and incorporated herein by reference.

10.34† Sales Agreement with Koppers, Inc. dated May 8, 2007, and is incorporated in this report.

10.36 Asset Purchase Agreement dated October 19, 2007 between the company and Air Products and Chemicals, Inc., filed as Exhibit 10.36 to the company's report on Form 8-K filed October 24, 2007, and incorporated herein by this reference.

10.37 Transition Services Agreement with Air Products and Chemicals, Inc. dated December 31, 2007 filed as Exhibit 10.37 to the company's report on Form 8-K filed January 7, 2008, and incorporated herein by this reference.

10.38 Custom Manufacture Agreement with Air Products and Chemicals, Inc. dated December 31, 2007 filed as Exhibit 10.38 to the company's report on Form 8-K filed January 7, 2008, and incorporated herein by this reference.

10.39 Amended and Restated Credit Agreement with Wachovia Bank, National Association dated December 31, 2007 filed as Exhibit 10.39 to the company's report on Form 8-K filed January 7, 2008, and incorporated herein by this reference.

10.40 Note Purchase Agreement with The Prudential Insurance Company of America dated December 31, 2007 filed as Exhibit 10.40 to the company's report on Form 8-K filed January 7, 2008, and incorporated herein by this reference.

10.41† Agreement with Acme Chemical Marketing, LLC dated February 14, 2008 filed as Exhibit 10.41, to the company's report on Form 8-K filed February 21, 2007, and incorporated herein.

10.42* Executive Severance Plan, dated October 10, 2008, by and between the Company and its Eligible Employees filed as Exhibit 10.42, to the company's report on Form 8-K filed October 13, 2008, and incorporated herein by this reference.

10.43 First Amendment to Amended and Restated Credit Agreement and Amended Pledge Agreement with Wachovia Bank, National Association dated effective January 30, 2009 filed as Exhibit 10.43, to the company's report on Form 10-Q filed on March 12, 2009, and incorporated herein by this reference.

10.44 Amendment No. 1 to Note Purchase Agreement with The Prudential Insurance Company of America dated effective January 30, 2009 filed as Exhibit 10.44, to the company's report on Form 10-Q filed on March 12, 2009, and incorporated herein by this reference.

10.45† Purchase Agreement dated December 31, 2007 with Intel Corporation filed as Exhibit 10.45 to the company's report on Form 8-K filed May 13, 2009, incorporated herein by this reference.

10.46	2009 Long Term Incentive Plan of the Company, filed herewith and incorporated herein by this reference.
21.1	Subsidiaries of the company.
23.1	Consent of UHY LLP.
31	Certificates under Section 302 the Sarbanes-Oxley Act of 2002 of the Chief Executive Officer and the Chief Financial Officer.
32	Certificates under Section 906 of the Sarbanes-Oxley Act of 2002 of the Chief Executive Officer and the Chief Financial Officer.

(c) Schedule II-Valuation and Qualifying Accounts and Reserves is included. All other schedules are omitted because they are not applicable or the required information is contained in the applicable financial statements of notes thereto.

KMG Chemicals, Inc.
Schedule II — Valuation and Qualifying Accounts
Fiscal years ending July 31, 2009, 2008 and 2007

Description	Balance at beginning of period	Charged to costs and expenses	Additions/ Deductions	Balance at end of period
Year ended July 31, 2009:				
Allowance for doubtful accounts	$ 342,000	$ 253,000	$ —	$ 595,000
Inventory obsolescence	484,000	—	(89,000)	395,000
Valuation allowance on deferred tax assets	—	1,509,000	—	1,509,000
Year ended July 31, 2008:				
Allowance for doubtful accounts	$ 48,000	$ —	$ 294,000(1)	$ 342,000
Inventory obsolescence	—	—	484,000(1)	484,000
Valuation allowance on deferred tax assets	—	—	—	—
Year ended July 31, 2007:				
Allowance for doubtful accounts	$ 35,000	$ 13,000	$ —	$ 48,000
Inventory obsolescence	—	—	—	—
Valuation allowance on deferred tax assets	—	—	—	—

(1) Additions to the allowance for doubtful accounts and inventory obsolescence in fiscal year 2008 were due to amounts related to the acquisition of the electronic chemicals business.

SIGNATURES

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

KMG CHEMICALS, INC.

By: /s/ J. Neal Butler
J. Neal Butler, President
and Chief Executive Officer

Date: October 14, 2009

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

By: /s/ John V. Sobchak
John V. Sobchak, Vice President
and Chief Financial Officer

Date: October 14, 2009

By: /s/ David L. Hatcher
David L. Hatcher,
Director and Chairman of the Board

Date: October 14, 2009

By: /s/ Gerald G. Ermentrout
Gerald G. Ermentrout, Director

Date: October 14, 2009

By: /s/ Christopher T. Fraser
Christopher T. Fraser

Date: October 14, 2009

By: /s/ George W. Gilman
George W. Gilman, Director

Date: October 14, 2009

By: /s/ Fred C. Leonard
Fred C. Leonard III, Director

Date: October 14, 2009

By: /s/ Charles L. Mears
Charles L. Mears, Director

Date: October 14, 2009

By: /s/ Stephen A. Thorington
Stephen A. Thorington, Director

Date: October 14, 2009

By: /s/ Richard L. Urbanowski
Richard L. Urbanowski, Director

Date: October 14, 2009

SHAREHOLDER INFORMATION

Transfer Agent and Registrar

Communications concerning the transfer of shares, lost certificates, or changes of address for registered shares should be directed to the transfer agent:

Securities Transfer Corporation
2591 Dallas Parkway, Suite 102, Frisco, Texas 75034
Voice: 469.633.0101 Fax: 469.633.0088
Email: info@stctransfer.com
Website: www.stctransfer.com

Direct Stock Purchase Plan

The Company has a Direct Stock Purchase Plan (DSPP) for registered shareholders. Participants may invest in KMG common stock at current market prices without service fees or brokerage commissions, and automatically reinvest KMG dividends into additional common shares. Participants may also use the plan to make gifts of KMG common stock, deposit existing stock certificates for safekeeping and sell KMG shares.

Securities Transfer Corporation (STC) is the plan administrator. The DSPP prospectus can be obtained from KMG's website, www.kmgchemicals.com, at STC's website, www.stctransfer.com, or by calling 713.600.3814. This is not an offer to sell or a solicitation to buy securities, which are only offered by prospectus.

Shareholder Services

KMG maintains an internal financial mailing list and can email you when news releases are distributed. To sign up, visit the website at www.kmgchemicals.com and click on Investor Relations. You can also request that certain financial information be mailed to you on a one-time basis, by contacting the corporate office.

Code of Business Conduct

KMG's Code of Business Conduct can be viewed and downloaded from the home page of the Company's website at www.kmgchemicals.com.

Copies are also available at no charge by contacting John V. Sobchak, Chief Financial Officer, at the address on the back cover.

Form 10-K

Additional copies of the KMG Chemicals, Inc. Form 10-K, as filed with the Securities and Exchange Commission, can be downloaded from the Company website and are also available upon written request to the corporate offices.

NASDAQ Prices for KMG Common Stock ($ per share)

	High	Low
Q1 ending October 31, 2008	11.92	3.93
Q2 ending January 31, 2009	6.49	2.25
Q3 ending April 30, 2009	5.73	3.75
Q4 ending July 31, 2009	9.01	5.41

As of October 13, 2009, there were 11,112,695 shares of Common Stock outstanding held by approximately 500 shareholders of record, and more than 300 round lot holders.

Independent Accountants

UHY LLP - Houston, Texas

Investor Inquiries on Company Activities

Inquiries about KMG are welcome by email, phone, fax or letter. Please direct them to:

Investor Relations

Melissa Dixon, Sr. Account Executive
The Equity Group Inc.
800 3rd Avenue, 36th Floor
New York, NY 10022
Voice: 212-836-9613
Email: mdixon@equityny.com
Website: www.theequitygroup.com

KMG

The information in this document includes certain forward-looking statements that are based upon assumptions that in the future may prove not to have been accurate and are subject to certain risks and uncertainties, including statements as to the future performance of the company. Although the company believes that the expectations reflected in its forward-looking statements are reasonable, it can give no assurance that such expectations or any of its forward-looking statements will prove to be correct. Factors that could cause results to differ include, but are not limited to, successful performance of internal plans, product development acceptance, the impact of competitive services and pricing and general economic risk and uncertainties.

KMG

KMG Chemicals, Inc., 9555 W. Sam Houston Parkway S., Suite 600, Houston, Texas 77099
Phone: 713.600.3800 Fax: 713.600.3850 NASDAQ: KMGB www.kmgchemicals.com