CARBO CERAMICS INC
Form 10-Q
October 27, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2006

or

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

For the transition period from _____ to _____.

Commission File No. 0-28178

CARBO CERAMICS INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**72-1100013**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

6565 MacArthur Boulevard
Suite 1050
Irving, Texas 75039
(Address of principal executive offices)

(972) 401-0090
(Registrant s telephone number)

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 þ No o

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 þ Accelerated Filer o Non-Accelerated Filer o

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes o No o

As of October 23, 2006, 24,391,102 shares of the registrant s Common Stock, par value $.01 per share, were outstanding.

CARBO CERAMICS INC.
Index to Quarterly Report on Form 10-Q

		PAGE
PART I. FINANCIAL INFORMATION		
Item 1.	Financial Statements	
	Consolidated Balance Sheets - September 30, 2006 (Unaudited) and December 31, 2005	3
	Consolidated Statements of Income (Unaudited) - Three and nine months ended September 30, 2006 and 2005	4
	Consolidated Statements of Cash Flows (Unaudited) - Nine months ended September 30, 2006 and 2005	5
	Notes to Consolidated Financial Statements (Unaudited)	6-10
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	11-15
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	15
Item 4.	Controls and Procedures	15
PART II. OTHER INFORMATION		
Item 1.	Legal proceedings	16
Item 1A.	Risk factors	16
Item 2.	Unregistered sales of equity securities and use of proceeds	16
Item 3.	Defaults upon senior securities	16
Item 4.	Submission of matters to a vote of security holders	16
Item 5.	Other information	16
Item 6.	Exhibits	16
Signatures		17
Exhibit Index		18

Rule 13a-14(a)/15d-14(a) Certification by Gary A. Kolstad
Rule 13a-14(a)/15d-14(a) Certification by Paul G. Vitek
Certification Pursuant to Section 906

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CARBO CERAMICS INC.
CONSOLIDATED BALANCE SHEETS
($ in thousands)

	September 30, 2006 (Unaudited)	December 31, 2005 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,511	$ 19,695
Short-term investments	21,690	41,975
Trade accounts receivable, net	62,664	53,918
Inventories:		
Finished goods	28,078	17,981
Raw materials and supplies	8,605	8,490
Total inventories	36,683	26,471
Prepaid expenses and other current assets	3,125	2,433
Deferred income taxes	4,472	3,795
Total current assets	143,145	148,287
Property, plant and equipment:		
Land and land improvements	2,812	2,812
Land-use and mineral rights	6,089	5,271
Buildings	26,935	15,051
Machinery and equipment	211,125	154,785
Construction in progress	54,313	72,074
Total	301,274	249,993
Less accumulated depreciation	84,061	70,493
Net property, plant and equipment	217,213	179,500
Goodwill	21,840	21,840
Intangible and other assets, net	7,096	6,169
Total assets	$ 389,294	$ 355,796
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 6,460	$ 11,277
Accrued payroll and benefits	6,506	6,941
Accrued freight	2,151	1,356
Accrued utilities	3,071	3,389
Accrued income taxes	7,765	9,998
Retainage related to construction in progress	158	337

Other accrued expenses	5,451	3,011
Total current liabilities	31,562	36,309
Deferred income taxes	27,764	26,121
Shareholders equity:		
Preferred stock, par value $0.01 per share, 5,000 shares authorized, none outstanding		
Common stock, par value $0.01 per share, 40,000,000 shares authorized; 24,391,102 and 24,286,388 shares issued and outstanding at September 30, 2006 and December 31, 2005, respectively	244	243
Additional paid-in capital	104,274	102,536
Unearned stock compensation		(2,135)
Retained earnings	223,704	192,196
Accumulated other comprehensive income	1,746	526
Total shareholders equity	329,968	293,366
Total liabilities and shareholders equity	$ 389,294	$ 355,796

The accompanying notes are an integral part of these statements.

Table of Contents

CARBO CERAMICS INC.
CONSOLIDATED STATEMENTS OF INCOME
($ in thousands, except per share data)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 77,410	$ 64,104	$ 225,173	$ 189,106
Cost of sales	48,545	39,155	141,552	113,704
Gross profit	28,865	24,949	83,621	75,402
Selling, general and administrative expenses	8,408	6,491	24,674	20,317
Start-up costs	28	219	449	473
Loss on disposal of assets				95
Operating profit	20,429	18,239	58,498	54,517
Other income (expense):				
Net interest income	394	430	1,318	1,340
Earnings in equity-method investee	21	21	51	116
Other, net	232	(119)	889	(127)
	647	332	2,258	1,329
Income before income taxes	21,076	18,571	60,756	55,846
Income taxes	7,624	6,119	21,458	19,623
Net income	$ 13,452	$ 12,452	$ 39,298	$ 36,223
Earnings per share:				
Basic	$ 0.55	$ 0.52	$ 1.62	$ 1.51
Diluted	$ 0.55	$ 0.51	$ 1.61	$ 1.50
Other information:				
Dividends declared per common share	$ 0.12	$ 0.10	$ 0.32	$ 0.26

The accompanying notes are an integral part of these statements.

Table of Contents

CARBO CERAMICS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
($ in thousands)
(Unaudited)

	Nine months ended September 30,	
	2006	**2005**
Operating activities		
Net income	$ 39,298	$ 36,223
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	13,558	9,467
Amortization	584	499
Provision for doubtful accounts	490	506
Deferred income taxes	966	2,148
Excess tax benefits from stock-based compensation	(400)	
Loss on disposal of assets		95
Foreign currency transaction (gain) loss	(826)	100
Stock compensation expense	2,257	681
Earnings in equity-method investee	(51)	(116)
Changes in operating assets and liabilities:		
Trade accounts receivable	(8,980)	(12,773)
Inventories	(10,097)	(1,244)
Prepaid expenses and other current assets	(650)	(1,440)
Other long-term assets	108	(1,233)
Accounts payable	(4,856)	(1,468)
Accrued payroll and benefits	(441)	85
Accrued freight	792	267
Accrued utilities	(320)	23
Accrued income taxes	(1,639)	1,101
Other accrued expenses	2,442	93
Net cash provided by operating activities	32,235	33,014
Investing activities		
Capital expenditures, net	(51,292)	(44,873)
Investment in equity-method investee		(611)
Purchases of short-term investments	(26,765)	(77,425)
Proceeds from maturities of short-term investments	47,050	78,000
Net cash used in investing activities	(31,007)	(44,909)
Financing activities		
Proceeds from exercise of stock options	1,022	1,779
Dividends paid	(7,790)	(6,348)
Excess tax benefits from stock-based compensation	400	
Net cash used in financing activities	(6,368)	(4,569)

Net decrease in cash and cash equivalents	(5,140)	(16,464)
Effect of exchange rate changes on cash	(44)	(50)
Cash and cash equivalents at beginning of period	19,695	33,990
Cash and cash equivalents at end of period	$ 14,511	$ 17,476
Supplemental cash flow information		
Interest paid	$	$ 9
Income taxes paid	$ 22,132	$ 16,361

The accompanying notes are an integral part of these statements.

Table of Contents

CARBO CERAMICS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
($ in thousands, except per share data)
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of CARBO Ceramics Inc. have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation have been included. The results of the interim periods presented herein are not necessarily indicative of the results to be expected for any other interim period or the full year. The consolidated balance sheet as of December 31, 2005 has been derived from the audited financial statements at that date. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2005 included in the Company s annual report on Form 10-K for the year ended December 31, 2005.

The consolidated financial statements include the accounts of CARBO Ceramics Inc. and its operating subsidiaries (the Company). The significant operating subsidiaries include: CARBO Ceramics (China) Company Limited, CARBO Ceramics (Eurasia) LLC, and Pinnacle Technologies, Inc. The consolidated financial statements also include a 49% interest in a fracture-related services company in Canada, acquired in April 2005, that is reported under the equity method of accounting. All significant intercompany transactions have been eliminated.

2. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Numerator for basic and diluted earnings per share:				
Net income	$ 13,452	$ 12,452	$ 39,298	$ 36,223
Denominator:				
Denominator for basic earnings per share				
Weighted-average shares	24,294,421	24,013,691	24,270,965	23,979,355
Effect of dilutive securities:				
Employee stock options	88,742	188,965	106,609	183,612
Nonvested stock awards	19,827	2,425	18,568	7,400
Dilutive potential common shares	108,569	191,390	125,177	191,012
Denominator for diluted earnings per share				
Adjusted weighted-average shares	24,402,990	24,205,081	24,396,142	24,170,367
Basic earnings per share	$ 0.55	$ 0.52	$ 1.62	$ 1.51
Diluted earnings per share	$ 0.55	$ 0.51	$ 1.61	$ 1.50

During the nine months ended September 30, 2006, employees exercised stock options to acquire 49,736 common shares at a weighted-average exercise price of $20.55 per share and restrictions lapsed on 27,311 nonvested shares. The Company recognized a related income tax benefit, of which $595 was credited directly to additional paid-in

capital within shareholders equity.

During the nine months ended September 30, 2005, employees exercised stock options to acquire 79,739 common shares at a weighted-average exercise price of $22.32 per share and restrictions lapsed on 9,021 nonvested shares. The Company recognized a related income tax benefit, of which $987 was credited directly to additional paid-in capital within shareholders equity.

Table of Contents

3. Stock-Based Compensation

The Company has three stock-based compensation plans: a restricted stock plan and two stock option plans. The restricted stock plan provides for granting shares of Common Stock in the form of restricted stock awards to employees and non-employee directors of the Company. Under the restricted stock plan, the Company may issue up to 375,000 shares, plus (i) the number of shares that are forfeited, and (ii) the number of shares that are withheld from the participants to satisfy tax withholding obligations. No more than 75,000 shares may be granted to any single employee. One-third of the shares subject to award vest (i.e., transfer and forfeiture restrictions on these shares are lifted) on each of the first three anniversaries of the grant date. All unvested shares granted to an individual vest when the individual reaches age 62. The stock option plans provide for granting options to purchase shares of the Company s Common Stock to employees and non-employee directors. Under the stock option plans, the Company may grant options for up to 2,175,000 shares. The exercise price of each option generally is equal to the market price on the date of grant. The maximum term of an option is ten years and options generally become exercisable (i.e., vest) proportionately on each of the first four anniversaries of the grant date. As of September 30, 2006, 252,357 shares were available for issuance under the restricted stock plan and 52,650 shares were available for issuance under the stock option plans.

Prior to January 1, 2006 the Company accounted for its stock-based compensation plans using the intrinsic value method under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25), and related interpretations as permitted by FASB Statement No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). Under the intrinsic value method, compensation expense was recognized in the income statement to the extent the exercise price of the award was less than the market value of the underlying common stock. Since the Company historically has granted stock options with an exercise price equal to the market price on the date of grant, stock option awards had no intrinsic value and, therefore, no compensation expense was recognized. Because restricted stock awards had no exercise price, the resulting intrinsic value was equal to the market price on the date of grant and recognized as compensation expense on a straight-line basis over the vesting period of each award. Pro forma disclosures were provided to illustrate the effects on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS 123 and recognized expense for both restricted stock awards and stock option awards.

Effective January 1, 2006 the Company adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment* (SFAS 123(R)), which is a revision of SFAS 123 and supersedes APB 25. SFAS 123(R) requires the Company to recognize compensation expense in the income statement for all share-based payments to employees. Pro forma disclosure is no longer an alternative. The Company elected to adopt SFAS 123(R) using the modified prospective transition method, under which compensation expense includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 used in the Company s pro forma disclosures adjusted for estimated forfeitures, and (b) compensation cost for all share-based payments granted on or after January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Results for prior periods have not been restated as permitted under the modified prospective approach; therefore pro forma disclosures will continue to be provided for periods prior to January 1, 2006.

Under SFAS 123(R), the cost of employee services received in exchange for stock is measured based on the grant-date fair value. The Company recognizes that cost on a straight-line basis over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The fair value of stock options is estimated using a Black-Scholes option-pricing model and the fair value of restricted stock is determined based on the market price of the Company s Common Stock on the date of grant. Compensation expense is recognized only for share based payments expected to vest; therefore the Company estimates forfeitures at the time of grant based on historical forfeiture rates and future expectations and reduces compensation expense accordingly. Forfeiture rates are revised, if necessary, in subsequent periods, with the Company ultimately recognizing expense only on awards that actually vest. Excess tax benefits, as defined in SFAS 123(R), are recognized as additions to paid-in capital.

As a result of adopting SFAS 123(R), the Company s income before income taxes for the three and nine months ended September 30, 2006 was lower by $25 and $231, respectively, than it would have been if the Company had

continued to account for stock-based compensation under APB 25. Net income for the three and nine months ended September 30, 2006 was lower by $16 and $146, respectively. Basic and diluted earnings per share were unchanged by the adoption of SFAS 123(R) for the three months ended September 30, 2006 but were each lower by $0.01 per share for the nine months ended September 30, 2006. Prior to adoption of SFAS 123(R), the Company presented all tax benefits of deductions resulting from stock compensation as operating

Table of Contents

cash flows in the statement of cash flows. SFAS 123(R) requires the cash flows from tax benefits resulting from tax deductions in excess of compensation cost recognized in the income statement (excess tax benefits) to be classified as financing cash flows. The $400 excess tax benefit classified as a financing cash inflow for the nine months ended September 30, 2006 would have been classified as an operating cash inflow if the Company had not adopted SFAS 123(R). Under SFAS 123(R), the Company s unearned stock compensation balance of $2,135 included in shareholders equity at December 31, 2005 was reclassified to additional paid-in capital during the quarter ended March 31, 2006.

The following table illustrates the pro forma effect on prior year net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS 123 to the Company s stock-based employee compensation during those periods:

	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net income, as reported	$ 12,452	$ 36,223
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	144	429
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(259)	(964)
Pro forma net income	$ 12,337	$ 35,688
Earnings per share:		
Basic as reported	$ 0.52	$ 1.51
Basic pro forma	$ 0.51	$ 1.49
Diluted as reported	$ 0.51	$ 1.50
Diluted pro forma	$ 0.51	$ 1.48

A summary of stock option activity and related information for the nine months ended September 30, 2006 is presented below:

	Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Outstanding at January 1, 2006	291,248	$ 22.16	
Granted			
Exercised	(49,736)	$ 20.55	
Forfeited			
Outstanding at September 30, 2006	241,512	$ 22.49	$ 3,270
Exercisable at September 30, 2006	209,883	$ 21.24	$ 3,104

As of September 30, 2006, there was $243 of total unrecognized compensation cost related to stock options granted under the plans. The weighted-average remaining contractual term of options outstanding at September 30, 2006 is

5.3 years. There have been no stock options granted since 2004.

A summary of restricted stock activity and related information for the nine months ended September 30, 2006 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	58,634	$ 47.03
Granted	57,510	$ 57.52
Vested	(27,311)	$ 50.05
Forfeited	(2,522)	$ 50.26
Nonvested at September 30, 2006	86,311	$ 52.97

As of September 30, 2006, there was $3,108 of total unrecognized compensation cost related to restricted shares granted under the plan. That cost is expected to be recognized over a weighted-average period of 2.0 years.

Table of Contents

4. Segment Information

The Company has two operating segments: 1) Proppant and 2) Fracture and Reservoir Diagnostics. Services and software sold by the Fracture and Reservoir Diagnostics segment are provided through the Company s wholly-owned subsidiary Pinnacle Technologies, Inc. (Pinnacle).

Goodwill totaling $21,840 arising from the Company s acquisition of Pinnacle is not assigned to an operating segment because that information is not used by the Company s chief operating decision maker in allocating resources. An intersegment note receivable totaling $16,608 at September 30, 2006 and the costs of the Company s corporate offices are reported in the Proppant segment. Intersegment sales are not material.

Summarized financial information for the Company s reportable segments is shown in the following table:

	Proppant	Fracture and Reservoir Diagnostics	Total
Three Months Ended September 30, 2006			
Revenues from external customers	$ 69,290	$ 8,120	$ 77,410
Income before income taxes	19,949	1,127	21,076
Three Months Ended September 30, 2005			
Revenues from external customers	$ 57,357	$ 6,747	$ 64,104
Income before income taxes	17,685	886	18,571
Nine Months Ended September 30, 2006			
Revenues from external customers	$ 201,960	$ 23,213	$ 225,173
Income before income taxes	58,400	2,356	60,756
Segment assets as of September 30, 2006	350,948	33,114	384,062
Nine Months Ended September 30, 2005			
Revenues from external customers	$ 169,650	$ 19,456	$ 189,106
Income before income taxes	54,107	1,739	55,846

5. Dividends Paid

On July 18, 2006, the Board of Directors declared a cash dividend of $0.12 per common share payable to shareholders of record on July 31, 2006. The dividend was paid on August 15, 2006.

6. Comprehensive Income

Comprehensive income, which includes net income and all other changes in equity during a period except those resulting from investments by and distributions to owners, was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Net income	$ 13,452	$ 12,452	$ 39,298	$ 36,223
Foreign currency translation adjustment	397	543	1,220	517
Comprehensive income	$ 13,849	$ 12,995	$ 40,518	$ 36,740

7. New Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). 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. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 31, 2006. The Company is evaluating FIN 48 and has not yet determined the impact of adoption.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company is evaluating SFAS 157 and has not yet determined the impact of adoption.

Table of Contents

8. Legal Proceedings

The Company is subject to legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, management does not expect that the ultimate cost to resolve these matters will have a material adverse effect on the Company s consolidated financial position, results of operations, or cash flows.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Business

The Company manufactures ceramic proppant and provides services that are used in the hydraulic fracturing of natural gas and oil wells. Goods and services are provided through two operating segments: 1) Proppant and 2) Fracture and Reservoir Diagnostics. The Company s Proppant segment manufactures and sells ceramic proppants. The Company s Fracture and Reservoir Diagnostics segment provides fracture mapping and reservoir diagnostic services, sells fracture simulation software and provides engineering services to oil and gas companies worldwide. These services and software are provided through the Company s wholly-owned subsidiary, Pinnacle Technologies, Inc.

Critical Accounting Policies

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require the Company to make estimates and assumptions (see Note 1 to the consolidated financial statements included in the annual report on Form 10-K for the year ended December 31, 2005). The Company believes that some of its accounting policies involve a higher degree of judgment and complexity than others. Critical accounting policies for the Company include revenue recognition, estimating the recoverability of accounts receivable, inventory valuation, accounting for income taxes, accounting for long-lived assets and accounting for legal contingencies. Critical accounting policies are discussed more fully in the annual report on Form 10-K for the year ended December 31, 2005 and there have been no changes in the Company s evaluation of its critical accounting policies since the preparation of that report.

Results of Operations

Three Months Ended September 30, 2006

Revenues. Consolidated revenues of $77.4 million for the quarter ended September 30, 2006 set a new quarterly record and represented a 21% increase compared to $64.1 million in revenues for the quarter ended September 30, 2005. The improvement was due to increases of 21% and 20%, respectively, in Proppant segment revenues and Fracture and Reservoir Diagnostics segment revenues.

Proppant segment revenues of $69.3 million for the quarter ended September 30, 2006 surpassed revenues of $57.4 million for the same period in 2005 by 21% as the result of a 16% increase in proppant sales volume and a 4% increase in the average selling price of proppant. Worldwide proppant sales totaled 221 million pounds for the quarter compared to 191 million pounds for the third quarter of 2005. North American proppant sales volume increased 21% compared to the same period last year, driven by continued strength in the U.S. market and an increase in Canadian sales volume despite no change in the Canadian rig count versus last year s third quarter. Overseas sales volume declined 15% compared to last year s third quarter due principally to decreased sales volume in Russia. Excluding results in Russia, sales volume in overseas markets increased 10% from the previous year with the strongest activity in China and North Africa. The average selling price of the Company s ceramic proppant in the third quarter of 2006 was $0.314 per pound, an increase of 4% compared to the third quarter of 2005 average selling price of $0.301 per pound. The higher average selling price was the result of an increase in list prices implemented in November 2005.

Fracture and Reservoir Diagnostics segment revenues of $8.1 million for the quarter ended September 30, 2006 exceeded revenues of $6.7 million for the same period in 2005 by 20% and established a new quarterly record. The increase was primarily due to continued growth in the fracture mapping and reservoir diagnostics businesses, attributable to increased hydraulic fracturing activity in North America, increased use of fracture mapping technology and a price increase instituted in January 2006.

Gross Profit. Consolidated gross profit for the third quarter of 2006 was $28.9 million, or 37% of revenues, compared to $24.9 million, or 39% of revenues, for the third quarter of 2005. Gross profit increased by 16% compared to last year s third quarter as a result of increased revenues in both of the Company s business segments, but declined as a percentage of revenues primarily due to a decrease in the margin on proppant sales.

Table of Contents

Proppant segment gross profit was $25.3 million for the third quarter of 2006 compared to $22.2 million for the third quarter of 2005. The 14% increase in gross profit resulted from increased sales volume and an increase in the average selling price compared to the previous year s third quarter. Gross profit as a percentage of revenues was 37% in the third quarter of 2006, down from 39% in last year s third quarter because sales price increases did not fully offset increases in manufacturing costs, primarily due to higher prices paid for natural gas and raw materials used to manufacture proppant. The Company s spending for natural gas delivered to its U.S. manufacturing facilities during the quarter increased 26% compared to the third quarter of 2005. Third quarter 2006 gross profit margin was also impacted by the effect of reduced production output as throughput at the Company s manufacturing facilities was adjusted to balance the supply of finished goods with the current demand for those products. Manufacturing facilities operated at approximately 89% of capacity in the third quarter of 2006 compared to operating at 100% of capacity during last year s third quarter.

Fracture and Reservoir Diagnostics segment gross profit for the third quarter of 2006 was $3.6 million, or 44% of revenues, compared to $2.7 million, or 40% of revenues, for the third quarter of 2005. The increase in gross profit margin was primarily due to a price increase instituted in January 2006 and increased utilization of staff and equipment.

Selling, General and Administrative (SG&A) and Other Operating Expenses. Consolidated SG&A expenses were $8.4 million for the third quarter of 2006 compared to $6.5 million for the corresponding period in 2005. As a percentage of revenues, SG&A expenses increased to 10.9% for the quarter ended September 30, 2006 compared to 10.1% for the quarter ended September 30, 2005 mostly due to increased research and development spending in both business segments.

Proppant segment SG&A expenses totaled $6.0 million for the third quarter of 2006 compared to $4.7 million for the corresponding period in 2005. SG&A expenses increased mostly due to increases in research and development activity, marketing activity in international markets and administrative expenses necessary to support higher sales activity. Other operating expenses of $0.2 million in 2005 were primarily related to start-up activities for the Company s new manufacturing facility in Toomsboro, Georgia.

Fracture and Reservoir Diagnostics segment SG&A expenses totaled $2.4 million for the third quarter of 2006 and $1.8 million for the corresponding period in 2005. The increase was primarily due to increased research and development spending and greater marketing and administrative expenses necessary to support higher sales activity.

Income Tax Expense. Consolidated income tax expense was $7.6 million for the quarter ended September 30, 2006 and $6.1 million for quarter ended September 30, 2005. Of the $1.5 million increase in income tax expense, $0.9 million was due to increased taxable income in the third quarter of 2006 and $0.6 million was due to a reduction of estimated state income tax in the third quarter of 2005 resulting from preparation of the 2004 income tax returns.

Nine Months Ended September 30, 2006

Revenues. Consolidated revenues of $225.2 million for the nine months ended September 30, 2006 exceeded revenues of $189.1 million for the same period in 2005 by 19%. The improvement in revenues was due to 19% increases in both of the Company s business segments.

Proppant segment revenues of $202.0 million for the nine months ended September 30, 2006 exceeded revenues of $169.6 million for the nine months ended September 30, 2005 by 19%. The growth was driven primarily by a 9% increase in sales volume along with a 9% increase in the average selling price of proppant. Worldwide proppant sales totaled a nine-month record 634 million pounds in the first nine months of 2006 compared to 582 million pounds for the same period in 2005. The volume of proppant sold in North America increased by 17% compared to the first nine months of 2005 primarily due to an increase in the U.S. natural gas rig count and related fracturing activity and increased utilization of ceramic proppant in Canada. The North American increase was partially offset by a 23% decrease in overseas shipments due to decreased sales volume in Russia. Excluding results in Russia, sales volume in overseas markets increased 11% from the previous year. The average selling price per pound of ceramic proppant for the first nine months of 2006 was $0.319 versus $0.291 for the same period in 2005. The higher average selling price was due to increases in list prices that went into effect in June 2005 and November 2005.

Table of Contents

Fracture and Reservoir Diagnostics segment revenues of $23.2 million for the nine months ended September 30, 2006 exceeded revenues of $19.5 million for the same period in 2005 by 19%. The growth was driven primarily by a 16% increase in fracture mapping revenue, which is attributable to increased hydraulic fracturing activity in North America and a price increase instituted in January 2006. An increase in revenue from the nascent reservoir diagnostics business was also a contributing factor.

Gross Profit. Consolidated gross profit for the nine months ended September 30, 2006 was $83.6 million, or 37% of revenues, compared to $75.4 million, or 40% of revenues, for the same period in 2005. The 11% increase in gross profit was the result of year over year improvements in both the Proppant segment and Fracture and Reservoir Diagnostics segment, while the decline in gross profit as a percentage of revenues was primarily due to a decrease in the margin on proppant sales.

Proppant segment gross profit for the nine months ended September 30, 2006 was $73.8 million, or 37% of revenues, compared to $68.2 million, or 40% of revenues, for the same period in 2005. Gross profit increased 8% due to higher sales volume but decreased as a percentage of revenues because sales price increases did not fully offset increases in manufacturing costs, primarily due to higher prices paid for natural gas and raw materials used to manufacture proppant. 2006 gross profit margin was also impacted by the effect of lower production output at the Company s manufacturing facilities, which operated at approximately 92% of capacity in the first nine months of 2006 compared to operating at 100% of capacity for the same period in 2005.

Fracture and Reservoir Diagnostics segment gross profit for the nine months ended September 30, 2006 was $9.8 million, or 42% of revenues, compared to $7.2 million, or 37% of revenues, for the same period in 2005. The increase in gross profit margin was primarily due to a price increase instituted in January 2006 and increased utilization of staff and equipment.

Selling, General and Administrative (SG&A) and Other Operating Expenses. Consolidated SG&A expenses and other operating expenses were $24.7 million and $0.4 million, respectively, for the nine months ended September 30, 2006 compared to $20.3 million and $0.6 million, respectively, for the nine months ended September 30, 2005. As a percentage of revenues, SG&A expenses increased slightly to 11.0% for the first nine months of 2006 compared to 10.7% the same period in 2005.

Proppant segment SG&A expenses totaled $17.5 million for the nine months ended September 30, 2006 compared to $14.9 million for the nine months ended September 30, 2005. SG&A expenses increased mostly because of increased spending for research and development, marketing, and administrative expenses necessary to support higher sales activity and increased stock compensation expense. As a percentage of revenues, SG&A expenses remained relatively unchanged at 8.7% in 2006 compared to 8.8% in 2005. Other operating expenses of $0.4 million in 2006 and $0.6 million in 2005 consisted mostly of start-up costs associated with the new manufacturing facility in Toomsboro, Georgia that began production in January 2006.

Fracture and Reservoir Diagnostics segment SG&A expenses totaled $7.2 million for the nine months ended September 30, 2006 compared to $5.4 million for the nine months ended September 30, 2005. The majority of the increase is due to increased spending on technology development to expand the possible markets and applications which can be monitored. The remainder of the increase was due to greater marketing and administrative expenses necessary to support higher revenues

Income Tax Expense. Consolidated income tax expense was $21.5 million for the nine months ended September 30, 2006 and $19.6 million for the nine months ended September 30, 2005. The $1.9 million net increase in income tax expense was primarily attributable to the increase in taxable income. Income tax expense for the first nine months of 2006 was lowered by a $0.5 million reduction of net deferred income tax liabilities resulting from changes in state taxes, primarily related to a tax law change in Texas which will reduce the Company s future tax liability in that state. Income tax expense for the first nine months of 2005 was lowered by a $0.6 million reduction of estimated state income tax resulting from preparation of the 2004 income tax returns.

Liquidity and Capital Resources

At September 30, 2006, the Company had cash and cash equivalents of $14.5 million and short-term investments of $21.7 million compared to cash and cash equivalents of $19.7 million and short-term investments of $42.0 million at December 31, 2005. The Company generated $32.2 million cash from operations, net of $20.2 million paid in the third

quarter of 2006 for income taxes that previously had been deferred under extensions granted to taxpayers affected by Hurricane Katrina. The Company also received $1.0 million proceeds from employee exercises of stock options, retained $0.4 million cash from excess tax benefits

Table of Contents

relating to stock-based compensation to employees and received $20.3 million for net purchases and maturities of short-term investments. Uses of cash included $51.3 million of capital spending and $7.8 million of cash dividends. Major capital spending included $19.2 million on a new proppant manufacturing facility in Kopeysk, Russia, which is expected to be completed in the fourth quarter of 2006 at an estimated total cost of $42 million, $7.0 million on a new proppant manufacturing facility in Toomsboro, Georgia, which was completed slightly below planned expenditure of $62 million and began operating in the first quarter of 2006, and $12.7 million for a second production line at the Toomsboro facility, which is expected to be completed in the third quarter of 2007 and add 250 million pounds of capacity to that facility at an estimated total cost of $54 million.

The Company believes that the relatively high prices for oil and natural gas in the futures market and the need for increased utilization of technology in the production of oil and gas will continue to spur long-term drilling and fracturing activity worldwide. Consequently, the Company expects demand for its products to remain strong in future years. Recent weakness in near-term natural gas prices in North America suggest that a decline in drilling and fracturing activity could occur in the coming months. While the Company has not seen any decline in the demand for its products as a result of falling natural gas prices, the Company has twelve production lines located at its five manufacturing locations worldwide and will adjust production to meet demand as necessary in future periods.

Subject to its financial condition, the amount of funds generated from operations and the level of capital expenditures, the Company s current intention is to continue to pay quarterly dividends to shareholders of its Common Stock. On July 18, 2006, the Company s Board of Directors approved the payment of a quarterly cash dividend of $0.12 per share to shareholders of the Company s Common Stock on July 31, 2006. The Company has total projected capital expenditures of $15 million to $20 million for the remainder of 2006, including spending to complete its manufacturing facility in Kopeysk, Russia, to expand its Toomsboro, Georgia manufacturing facility, to expand its distribution facilities and to acquire or construct additional fracture mapping tools.

The Company maintains an unsecured line of credit of $10.0 million. As of September 30, 2006, there was no outstanding debt under the credit agreement. The Company anticipates that cash on hand and available through liquidation of short-term investments, cash provided by operating activities and funds available under its line of credit will be sufficient to meet planned operating expenses, tax obligations and capital expenditures for the next 12 months. The Company also believes that it could acquire additional debt financing, if needed. Based on these assumptions, we believe that the Company s fixed costs could be met even with a moderate decrease in demand for the Company s products.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements as of September 30, 2006.

Forward-Looking Information

The statements in this Form 10-Q that are not historical statements, including statements regarding our future financial and operating performance, are forward-looking statements within the meaning of the federal securities laws. All forward-looking statements are based on management s current expectations and estimates, which involve risks and uncertainties that could cause actual results to differ materially from those expressed in forward-looking statements. Among these factors are:

changes in overall economic conditions,

changes in the cost of raw materials and natural gas used in manufacturing our products,

changes in demand for our products,

changes in the demand for, or price of, oil and natural gas,

risks of increased competition,

technological, manufacturing and product development risks,

loss of key customers,

changes in foreign and domestic government regulations,

changes in foreign and domestic political and legislative risks,

the risks of war and international and domestic terrorism,

risks associated with foreign operations and foreign currency exchange rates and controls,

weather-related risks and other risks and uncertainties.

Table of Contents

Additional factors that could affect our future results or events are described from time to time in our Securities and Exchange Commission reports. See in particular our Form 10-K for the fiscal year ended December 31, 2005 under the caption Risk Factors and similar disclosures in subsequently filed reports with the Securities and Exchange Commission. We assume no obligation to update forward-looking statements, except as required by law.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company s major market risk exposure is to foreign currency fluctuations that could impact its investments in China and Russia. When necessary, the Company may enter into forward foreign exchange contracts to hedge the impact of foreign currency fluctuations. There were no such foreign exchange contracts outstanding at September 30, 2006. The Company has a $10.0 million line of credit with its primary commercial bank. Under the terms of the revolving credit agreement, the Company may elect to pay interest at either a fluctuating base rate established by the bank from time to time or at a rate based on the rate established in the London inter-bank market. As of September 30, 2006, there was no outstanding debt under the credit agreement. The Company does not believe that it has any material exposure to market risk associated with interest rates.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports filed under the Securities Exchange Act of 1934 is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the quarter ended September 30, 2006, management carried out an evaluation, under the supervision and with the participation of the Company s Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based upon such evaluation and as of the end of the quarter for which this report is made, the Chief Executive Officer and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports the Company files and submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as and when required.

(b) Changes in Internal Control over Financial Reporting

There were no changes in the Company s internal control over financial reporting during the quarter ended September 30, 2006 that materially affected, or are reasonably likely to materially affect, those controls.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable

ITEM 1A. RISK FACTORS

Not applicable

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three month period ended September 30, 2006, the Company credited 721 aggregate shares of Common Stock to bookkeeping accounts for three non-employee directors under the CARBO Ceramics Inc. Director Deferred Fee Plan as a result of such directors prior fee deferral elections. The fees so deferred were denominated in a number of shares of the Company s Common Stock determined by reference to the closing price of a share of Common Stock on the New York Stock Exchange on the day that the fees otherwise would have been paid. Shares of Common Stock equal to the number of shares credited to a non-employee director s account will be issued to the director on the later of (a) a date certain selected by the director on the date of his or her first fee deferral election or (b) the first date on which he or she ceases to be a director. These transactions are exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereof.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

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

Not applicable

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS

The following exhibits are filed as part of this Quarterly Report on Form 10-Q:

31.1 Rule 13a-14(a)/15d-14(a) Certification by Gary A. Kolstad.

31.2 Rule 13a-14(a)/15d-14(a) Certification by Paul G. Vitek.

32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

Pursuant to the requirements 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.

CARBO CERAMICS INC.

/s/ Gary A. Kolstad
Gary A. Kolstad
President and Chief Executive Officer

/s/ Paul G. Vitek
Paul G. Vitek
Sr. Vice President, Finance and Chief Financial Officer

Date: October 27, 2006

Table of Contents

EXHIBIT INDEX

EXHIBIT	DESCRIPTION
31.1	Rule 13a-14(a)/15d-14(a) Certification by Gary A. Kolstad.
31.2	Rule 13a-14(a)/15d-14(a) Certification by Paul G. Vitek.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.