OIL DRI CORP OF AMERICA
Form 10-Q
December 08, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

x	Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Quarterly Period Ended October 31, 2016
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 Number 001-12622

OIL-DRI CORPORATION OF AMERICA
(Exact name of the registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	36-2048898 (I.R.S. Employer Identification No.)
410 North Michigan Avenue, Suite 400 Chicago, Illinois (Address of principal executive offices)	60611-4213 (Zip Code)

The registrant's telephone number, including area code: (312) 321-1515

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 at least the past 90 days.
Yes x   No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company 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 x
Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of October 31, 2016.

Common Stock – 5,080,689 Shares and Class B Stock – 2,188,771 Shares

CONTENTS

FORWARD-LOOKING STATEMENTS

Certain statements in this report, including, but not limited to, those under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and those statements elsewhere in this report and other documents that we file with the Securities and Exchange Commission (“SEC”), contain forward-looking statements that are based on current expectations, estimates, forecasts and projections about our future performance, our business, our beliefs and our management’s assumptions. In addition, we, or others on our behalf, may make forward-looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls and conference calls. Words such as “expect,” “outlook,” “forecast,” “would,” “could,” “should,” “project,” “intend,” “plan,” “continue,” “believe,” “seek,” “estima
“assume,” and variations of such words and similar expressions are intended to identify such forward-looking statements, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Such statements are subject to certain risks, uncertainties and assumptions that could cause actual results to differ materially, including those described in Item 1A, Risk Factors, of our Annual Report on Form 10-K for the fiscal year ended July 31, 2016. Should one or more of these or other risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, intended, expected, believed, estimated, projected or planned. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except to the extent required by law, we do not have any intention or obligation to update publicly any forward-looking statements after the distribution of this report, whether as a result of new information, future events, changes in assumptions or otherwise.

TRADEMARK NOTICE

Cat's Pride, Fresh & Light, Fresh & Light Ultimate Care and Oil-Dri are registered trademarks of Oil-Dri Corporation of America.

PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

OIL-DRI CORPORATION OF AMERICA & SUBSIDIARIES
Condensed Consolidated Balance Sheets
(in thousands, except share and per share amounts)

ASSETS	(unaudited) October 31, 2016	July 31, 2016
Current Assets		
Cash and cash equivalents	$ 15,991	$ 18,629
Short-term investments	5,359	10,184
Accounts receivable, less allowance of $801 and $753 at October 31, 2016 and July 31, 2016, respectively	30,971	30,386
Inventories	23,567	23,251
Deferred income taxes	3,884	3,884
Prepaid repairs expense	4,235	3,938
Prepaid expenses and other assets	1,992	901
Total Current Assets	85,999	91,173
Property, Plant and Equipment		
Cost	221,164	218,025
Less accumulated depreciation and amortization	(139,476)	(137,314)
Total Property, Plant and Equipment, Net	81,688	80,711
Other Assets		
Goodwill	9,034	9,034
Trademarks and patents, net of accumulated amortization of $269 and $261 at October 31, 2016 and July 31, 2016, respectively	979	916
Customer list, net of accumulated amortization of $3,745 and $3,460 at October 31, 2016 and July 31, 2016, respectively	4,040	4,325
Deferred income taxes	12,387	12,754
Other	5,940	5,902
Total Other Assets	32,380	32,931
Total Assets	$ 200,067	$ 204,815

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA & SUBSIDIARIES
Condensed Consolidated Balance Sheets
(in thousands, except share and per share amounts)

LIABILITIES & STOCKHOLDERS' EQUITY	(unaudited) October 31, 2016	July 31, 2016
Current Liabilities		
Current maturities of notes payable	$ 3,083	$ 3,083
Accounts payable	6,910	6,635
Dividends payable	1,479	1,477
Accrued expenses:		
Salaries, wages and commissions	4,263	8,656
Trade promotions and advertising	3,076	2,855
Freight	1,378	1,579
Other	7,138	6,455
Total Current Liabilities	27,327	30,740
Noncurrent Liabilities		
Notes payable, net of unamortized debt issuance costs of $110 and $118 at October 31, 2016 and July 31, 2016, respectively	9,140	12,215
Deferred compensation	10,778	10,504
Pension and postretirement benefits	32,687	32,492
Other	3,361	3,313
Total Noncurrent Liabilities	55,966	58,524
Total Liabilities	83,293	89,264
Stockholders' Equity		
Common Stock, par value $.10 per share, issued 7,997,166 shares at October 31, 2016 and 7,982,243 shares at July 31, 2016	800	798
Class B Stock, par value $.10 per share, issued 2,513,512 shares at October 31, 2016 and 2,515,735 shares at July 31, 2016	251	252
Additional paid-in capital	34,853	34,294
Retained earnings	150,475	149,945
Accumulated other comprehensive loss:		
Pension and postretirement benefits	(13,598)	(13,867)
Cumulative translation adjustment	(169)	(155)
Total accumulated other comprehensive loss	(13,767)	(14,022)
Less Treasury Stock, at cost (2,916,477 Common and 324,741 Class B shares at October 31, 2016 and 2,912,953 Common and 324,741 Class B shares at July 31, 2016)	(55,838)	(55,716)
Total Stockholders' Equity	116,774	115,551
Total Liabilities & Stockholders' Equity	$ 200,067	$ 204,815

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA & SUBSIDIARIES
Condensed Consolidated Statements of Income and Retained Earnings
(in thousands, except for per share amounts)

	(unaudited) For the Three Months Ended October 31, 2016	2015
Net Sales	$66,612	$67,795
Cost of Sales	(45,887)	(47,142)
Gross Profit	20,725	20,653
Selling, General and Administrative Expenses	(17,679)	(12,877)
Income from Operations	3,046	7,776
Other Income (Expense)		
Interest expense	(251)	(259)
Interest income	8	3
Other, net	(124)	20
Total Other Expense, Net	(367)	(236)
Income Before Income Taxes	2,679	7,540
Income Taxes	(670)	(2,117)
Net Income	2,009	5,423
Retained Earnings:		
Balance at beginning of period	149,945	142,095
Cash dividends declared and treasury stock issuances	(1,479)	(1,438)
Balance at End of Period	$150,475	$146,080
Net Income Per Share		
Basic Common	$0.30	$0.82
Basic Class B Common	$0.23	$0.61
Diluted Common	$0.28	$0.75
Average Shares Outstanding		
Basic Common	5,004	4,975
Basic Class B Common	2,067	2,037
Diluted Common	7,138	7,063
Dividends Declared Per Share		
Basic Common	$0.2200	$0.2100
Basic Class B Common	$0.1650	$0.1575

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA & SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income
(in thousands of dollars)

	(unaudited) For the Three Months Ended October 31,	
	2016	2015
Net Income	$2,009	$5,423
Other Comprehensive Income:		
Pension and postretirement benefits (net of tax)	269	178
Cumulative translation adjustment	(14)	(11)
Other Comprehensive Income	255	167
Total Comprehensive Income	$2,264	$5,590

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA & SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(in thousands)

	(unaudited) For the Three Months Ended October 31,	
CASH FLOWS FROM OPERATING ACTIVITIES	2016	2015
Net Income	$2,009	$5,423
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,159	2,939
Amortization of investment net discount	(2)	—
Non-cash stock compensation expense	431	332
Excess tax benefits for share-based payments	(128)	(17)
Deferred income taxes	165	109
Provision for bad debts and cash discounts	48	(22)
Loss on the sale of fixed assets	161	23
(Increase) Decrease in assets:		
Accounts receivable	(688)	(414)
Inventories	(367)	(126)
Prepaid expenses	(1,057)	(862)
Other assets	(114)	(47)
Increase (Decrease) in liabilities:		
Accounts payable	476	387
Accrued expenses	(3,592)	33
Deferred compensation	274	86
Pension and postretirement benefits	464	432
Other liabilities	86	240
Total Adjustments	(684)	3,093
Net Cash Provided by Operating Activities	1,325	8,516
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(4,295)	(1,765)
Proceeds from sale of property, plant and equipment	1	—
Purchases of short-term investments	(5,119)	(1,690)
Dispositions of short-term investments	9,946	490
Net Cash Provided by (Used in) Investing Activities	533	(2,965)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on notes payable	(3,083)	(3,484)
Dividends paid	(1,477)	(1,377)
Purchase of treasury stock	(122)	(18)
Proceeds from issuance of common stock	—	185
Excess tax benefits for share-based payments	128	17
Net Cash Used in Financing Activities	(4,554)	(4,677)
Effect of exchange rate changes on cash and cash equivalents	58	(1)
Net (Decrease) Increase in Cash and Cash Equivalents	(2,638)	873
Cash and Cash Equivalents, Beginning of Period	18,629	20,138
Cash and Cash Equivalents, End of Period	$15,991	$21,011

OIL-DRI CORPORATION OF AMERICA & SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows - Continued
(in thousands)

	(unaudited) For the Three Months Ended October 31,	
	2016	2015
Supplemental disclosure of non-cash investing and financing activities:		
Capital expenditures accrued, but not paid	$821	$192
Cash dividends declared and accrued, but not paid	$1,479	$1,406

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA & SUBSIDIARIES
Notes To Condensed Consolidated Financial Statements
(Unaudited)

1. BASIS OF STATEMENT PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and in compliance with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The financial statements and the related notes are condensed and should be read in conjunction with the Consolidated Financial Statements and related notes for the fiscal year ended July 31, 2016 included in our Annual Report on Form 10-K filed with the SEC.

The unaudited Condensed Consolidated Financial Statements include the accounts of Oil-Dri Corporation of America and its subsidiaries. All significant intercompany transactions are eliminated. Except as otherwise indicated herein or as the context otherwise requires, references to “Oil-Dri,” the “Company,” “we,” “us” or “our” refer to Oil-Dri Corporation of America and its subsidiaries.

The unaudited Condensed Consolidated Financial Statements reflect all adjustments, consisting of normal recurring accruals and reclassifications which are, in the opinion of management, necessary for a fair presentation of the statements contained herein. Operating results for the three months ended October 31, 2016 are not necessarily an indication of the results that may be expected for the fiscal year ending July 31, 2017.

The preparation of the unaudited Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires the use of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. Estimates and assumptions are revised periodically. Actual results could differ from these estimates.

We recognize revenue when risk of loss and title are transferred under the terms of our sales agreements with customers at a fixed and determinable price and collection of payment is probable. Trade promotion reserves are provided for sales incentives made directly to consumers, such as coupons, and sales incentives made to customers, such as slotting, discounts based on sales volume, cooperative marketing programs and other arrangements. Such trade promotion costs are netted against sales. Sales returns and allowances are not material.

Selling, general and administrative expenses include salaries, wages and benefits associated with staff outside the manufacturing and distribution functions, all advertising and marketing-related costs, any miscellaneous trade spending expenses not required to be included in net sales, research and development costs, depreciation and amortization related to assets outside the manufacturing and distribution process and all other non-manufacturing and non-distribution expenses.

We record an allowance for doubtful accounts based on our historical experience and a periodic review of our accounts receivable, including a review of the overall aging of accounts and analysis of specific customer accounts. A customer account is determined to be uncollectible when we have completed our internal collection procedures, including termination of shipments, direct customer contact and formal demand of payment.

We mine sorbent materials on property that we either own or lease as part of our overall operations. A significant part of our overall mining cost is incurred during the process of removing the overburden (non-usable material) from the mine site, thus exposing the sorbent material used in a majority of our production processes. These stripping costs are treated as a variable inventory production cost and are included in cost of sales in the period they are incurred. We defer and amortize the pre-production overburden removal costs associated with opening a new mine.

Additionally, it is our policy to capitalize the purchase cost of land and mineral rights, including associated legal fees, survey fees and real estate fees. The costs of obtaining mineral patents, including legal fees and drilling expenses, are also capitalized. Pre-production development costs on new mines and any prepaid royalties that may be offset against future royalties due upon extraction of the minerals are also capitalized. All exploration related costs are expensed as incurred.

We perform ongoing reclamation activities during the normal course of our overburden removal. As overburden is removed from a mine site, it is hauled to previously mined sites and is used to refill older sites. This process allows us to continuously reclaim older mine sites and dispose of overburden simultaneously, thereby minimizing the costs associated with the reclamation process.

2. NEW ACCOUNTING PRONOUNCEMENTS

Recently Issued Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued guidance under Accounting Standard Codification (“ASC”) 606, Revenue from Contract with Customers, which establishes a single comprehensive revenue recognition model for all contracts with customers and will supersede most existing revenue guidance. This guidance requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to receive in exchange. In March, April and May of 2016, the FASB issued amended guidance that further clarifies the principles for recognizing revenue. Transition options include either a full or modified retrospective approach and early adoption is permitted. The implementation date for this guidance was deferred and will now be effective at the beginning of our first quarter of fiscal year 2019. While we are still in the process of evaluating the financial statement impact of the adoption of this requirement, it is not currently expected to have a material impact on our Consolidated Financial Statements based on the types of products we sell and our arrangements with customers.

In August 2014, the FASB issued guidance under ASC 205, Presentation of Financial Statements - Going Concern, which defines management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. This guidance will be effective for the fourth quarter of fiscal year 2017. This pronouncement requires additional disclosures only in certain circumstances and we do not expect a significant impact on our Consolidated Financial Statements.

In July 2015, the FASB issued guidance under ASC 330, Simplifying the Measurement of Inventory. The new guidance requires inventory to be measured at the lower of cost and net realizable value, which is defined as the estimated selling price in the ordinary course of business less reasonably predictable costs of completion, disposal and transportation. This new guidance is effective for our first quarter of fiscal year 2018 and early adoption is permitted. The guidance must be applied prospectively. We are currently evaluating the impact of the adoption of this requirement on our Consolidated Financial Statements.

In November 2015, the FASB issued guidance under ASC 740, Balance Sheet Classification of Deferred Taxes, which requires deferred tax liabilities and assets to be classified as noncurrent in a classified statement of financial position. This guidance is effective for our first quarter of fiscal year 2018 and early adoption is permitted. The guidance may be applied either prospectively or retrospectively to all periods presented. We are currently evaluating the impact of the adoption of this requirement on our Consolidated Financial Statements.

In January 2016, the FASB issued guidance under ASC 825, Recognition and Measurement of Financial Assets and Financial Liabilities. This guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The provisions relevant to us at this time require the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes, as well as eliminates the requirement to disclose the method and significant assumptions used to estimate the fair value in such disclosure. This guidance is effective for our first quarter of fiscal year 2019 and early adoption is generally not permitted. We are currently evaluating the impact of the adoption of this requirement on our Consolidated Financial Statements.

In February 2016, the FASB issued guidance under ASC 842, Leases, which provides that, for leases with a term greater than 12 months, a lessee must recognize in the statement of financial position both a liability to make lease payments and an asset representing its right to use the underlying asset. Other requirements describe expense recognition, as well as financial statement presentation and disclosure. This guidance is effective for our first quarter of fiscal year 2020 using a modified retrospective approach, which includes a number of optional practical expedients. Early adoption is permitted. We are currently evaluating the impact of the adoption of this requirement on our

Consolidated Financial Statements.
In March 2016, the FASB issued guidance under ASC 718, Compensation-Stock Compensation, which simplifies several aspects of the accounting for share-based payment transactions, including accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. The new guidance also clarifies the statement of cash flows presentation for certain components of share-based awards. This guidance is effective for our first quarter of fiscal year 2018, with early adoption permitted. We are currently evaluating the impact of the adoption of this requirement on our Consolidated Financial Statements.
In June 2016, the FASB issued guidance under ASC 326, Financial Instruments-Credit Losses, which requires companies to utilize an impairment model for most financial assets measured at amortized cost and certain other financial instruments, which include trade and other receivables, loans and held-to-maturity debt securities, to record an allowance for credit risk based on expected losses rather than incurred losses. In addition, this new guidance changes the recognition method for credit losses on available-

for-sale debt securities, which can occur as a result of market and credit risk, as well as additional disclosures. In general, this guidance will require modified retrospective adoption for all outstanding instruments that fall under this guidance. This guidance is effective for our first quarter of fiscal year 2021. We are currently evaluating the impact of the adoption of this requirement on our Consolidated Financial Statements.
There have been no other accounting pronouncements issued but not yet adopted by us which are expected to have a material impact on our Consolidated Financial Statements.

Recently Adopted Pronouncements

For the first quarter of fiscal 2017, we adopted FASB guidance under ASC 835, Simplifying the Presentation of Debt Issuance Cost, which requires debt issuance costs to be presented as a direct deduction from the associated debt liability rather than as an asset. Amortization of these costs will continue to be reported as interest expense. We adopted this guidance retrospectively, which resulted in a decrease in Other Assets of $118,000 with a corresponding decrease in Noncurrent Liabilities in our Condensed Consolidated Balance Sheets as of July 31, 2016. The new requirements had no impact on our results of operations or cash flows.

3. INVENTORIES

The composition of inventories is as follows (in thousands):

	October 31, 2016	July 31, 2016
Finished goods	$ 13,740	$14,032
Packaging	4,966	4,672
Other	4,861	4,547
Total Inventories	$ 23,567	$23,251

Inventories are valued at the lower of cost (first-in, first-out) or market. Inventory costs include the cost of raw materials, packaging supplies, labor and other overhead costs. We perform a detailed review of our inventory items to determine if an obsolescence reserve adjustment is necessary. The review surveys all of our operating facilities and sales groups to ensure that both historical issues and new market trends are considered. The obsolescence reserve not only considers specific items, but also takes into consideration the overall value of the inventory as of the balance sheet date. The inventory obsolescence reserve values at October 31, 2016 and July 31, 2016 were $826,000 and $806,000, respectively.

4. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The inputs used to measure fair value are prioritized into categories based on the lowest level of input that is significant to the fair value measurement. The categories in the fair value hierarchy are as follows:

Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Observable market-based inputs for similar assets or liabilities or valuation models whose inputs are observable, directly or indirectly.
Level 3: Unobservable inputs.

Cash equivalents of $3,370,000 and $7,626,000 as of October 31, 2016 and July 31, 2016, respectively, were classified as Level 1. These cash instruments are primarily money market mutual funds and are included in cash and cash equivalents on the Condensed Consolidated Balance Sheets.

Short-term investments included U.S. Treasury securities and certificates of deposit. We intend and have the ability to hold our short-term investments to maturity; therefore, these investments were reported at amortized cost, which approximated fair value as of October 31, 2016 and July 31, 2016.

Accounts receivable and accounts payable balances approximated their fair values at October 31, 2016 and July 31, 2016 due to the short maturity and nature of those balances.

Notes payable are reported at the face amount of future maturities. The estimated fair value of notes payable, including current maturities, was $13,224,000 and $16,651,000 as of October 31, 2016 and July 31, 2016, respectively. Our debt does not trade on a daily basis in an active market, therefore the fair value estimate is based on market observable borrowing rates currently available for debt with similar terms and average maturities and is classified as Level 2.

We apply fair value techniques on at least an annual basis associated with: (1) valuing potential impairment loss related to goodwill, trademarks and other indefinite-lived intangible assets and (2) valuing potential impairment loss related to long-lived assets. See Note 5 for further information about goodwill and other intangible assets.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible amortization expense was $305,000 and $363,000 in the first quarter of fiscal 2017 and 2016, respectively. Estimated intangible amortization for the remainder of fiscal 2017 is $918,000. Estimated intangible amortization for the next five fiscal years is as follows (in thousands):

2018	$	1,013
2019	$	827
2020	$	656
2021	$	472
2022	$	323

We have one acquired trademark recorded at a cost of $376,000 that was determined to have an indefinite life and is not amortized.

We performed our annual goodwill impairment analysis in the fourth quarter of fiscal 2016 and no impairment was identified. There have been no triggering events that would indicate a new impairment analysis is needed.

6. PENSION AND OTHER POSTRETIREMENT BENEFITS

The components of net periodic pension and postretirement health benefit costs were as follows:

	Pension Benefits (in thousands) For the Three Months Ended October 31,	
	2016	2015
Service cost	$467	$489
Interest cost	457	483
Expected return on plan assets	(476)	(477)
Amortization of:		
Prior service costs	1	2
Other actuarial loss	429	