KMG CHEMICALS INC
Form 10-Q
June 09, 2009

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 April 30, 2009

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: 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 West Sam Houston Parkway South, Suite 600 **Houston, Texas**	**77099**
(Address of principal executive offices)	(Zip Code)

(713) 600-3800

(Registrant s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 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 (Do not check if a smaller reporting company)	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

As of June 8, 2009, there were 11,101,345 shares of the registrant s common stock outstanding.

Part I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands except for share and per share data)

		April 30, 2009 (unaudited)		July 31, 2008
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$	1,815	$	2,605
Accounts receivable:				
Trade, net of allowances of $476 and $342 at April 30, 2009 and July 31, 2008, respectively		26,860		37,126
Other		2,761		2,060
Inventories, net		29,251		24,620
Current deferred tax asset		325		325
Prepaid expenses and other current assets		2,143		1,449
Total current assets		63,155		68,185
PROPERTY, PLANT AND EQUIPMENT, net		54,570		57,759
DEFERRED TAX ASSET		1,924		1,295
GOODWILL		3,778		3,778
INTANGIBLE ASSETS, net		20,398		21,918
RESTRICTED CASH		294		343
OTHER ASSETS, net		2,654		2,520
TOTAL ASSETS	$	146,773	$	155,798
LIABILITIES & STOCKHOLDERS EQUITY				
CURRENT LIABILITIES:				
Accounts payable	$	15,436	$	23,016
Accrued liabilities		7,488		6,658
Current deferred tax liability		35		35
Current portion of long-term debt		6,337		7,500
Total current liabilities		29,296		37,209
LONG-TERM DEBT, net of current portion		51,329		53,516
OTHER LONG-TERM LIABILITIES		1,222		1,386
Total liabilities		81,847		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, 11,092,595 shares issued and outstanding at April 30, 2009 and 11,034,795 shares issued and outstanding at July 31, 2008		111		110
Additional paid-in capital		23,096		22,525

Accumulated other comprehensive income (loss)		(2,835)		1,134
Retained earnings		44,554		39,918
Total stockholders equity		64,926		63,687
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	146,773	$	155,798

See notes to consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in thousands except for per share data)

	Three Months Ended April 30, 2009	Three Months Ended April 30, 2008	Nine Months Ended April 30, 2009	Nine Months Ended April 30, 2008
NET SALES	$ 45,869	$ 50,259	$ 142,309	$ 103,034
COST OF SALES	30,519	35,180	97,693	71,010
Gross Profit	15,350	15,079	44,616	32,024
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	9,910	11,205	33,144	22,572
Operating income	5,440	3,874	11,472	9,452
OTHER INCOME (EXPENSE):				
Interest income	1	16	7	435
Interest expense	(732)	(1,010)	(2,396)	(1,791)
Other, net	(15)	(15)	(295)	(44)
Total other expense, net	(746)	(1,009)	(2,684)	(1,400)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	4,694	2,865	8,788	8,052
Provision for income taxes	(1,902)	(1,051)	(3,473)	(2,997)
INCOME FROM CONTINUING OPERATIONS	2,792	1,814	5,315	5,055
DISCONTINUED OPERATIONS				
Loss from discontinued operations, before income taxes	(15)	(219)	(22)	(402)
Income tax benefit	5	84	8	151
Loss from discontinued operations	(10)	(135)	(14)	(251)
NET INCOME	$ 2,782	$ 1,679	$ 5,301	$ 4,804
EARNINGS PER SHARE:				
Basic				
Income from continuing operations	$ 0.25	$ 0.16	$ 0.48	$ 0.46
Loss from discontinued operations		(0.01)		(0.02)
Net income	$ 0.25	$ 0.15	$ 0.48	$ 0.44
Diluted				
Income from continuing operations	$ 0.25	$ 0.16	$ 0.47	$ 0.45
Loss from discontinued operations		(0.01)		(0.02)
Net income	$ 0.25	$ 0.15	$ 0.47	$ 0.43
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	11,090	10,990	11,080	10,968

Diluted	11,208	11,227	11,217	11,220

See notes to consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Nine Months Ended April 30, 2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 5,301	$ 4,804
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,704	4,043
Amortization of loan costs included in interest expense	66	60
Impairment on assets of discontinued operations	15	102
Inventory valuation adjustment	364	
Bad debt expense (recovery)	134	(59)
Stock-based compensation	416	563
Deferred rental income	(48)	(66)
Deferred income taxes	(693)	(569)
Excess tax benefit from stock-based awards	(37)	(151)
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable - trade	10,706	(17,707)
Accounts receivable - other	(857)	33
Inventories	(4,234)	(2,296)
Prepaid expenses and other current assets	(815)	(1,396)
Accounts payable	(7,056)	17,903
Accrued liabilities	1,062	4,037
Net cash provided by operating activities	9,028	9,301
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property, plant and equipment	(2,442)	(1,686)
Cash used in connection with the electronic chemicals acquisition	(3,257)	(69,816)
Net cash used in investing activities	(5,699)	(71,502)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Deferred financing cost		(466)
Net borrowings under revolver credit agreement	4,777	4,000
Borrowings on term loan		55,000
Principal payments on borrowings on term loan	(8,125)	(9,957)
Proceeds from exercise of stock options	119	412
Excess tax benefit from stock-based awards	37	151
Payment of dividends	(665)	(657)
Net cash (used in) provided by financing activities	(3,857)	48,483
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(262)	
NET DECREASE IN CASH AND CASH EQUIVALENTS	(790)	(13,718)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,605	16,004
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,815	$ 2,286
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for interest	$ 2,360	$ 1,435
Cash paid during the period for income taxes	$ 917	$ 2,784

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(1) Basis of Presentation. The (a) consolidated balance sheet as of July 31, 2008, which has been derived from audited consolidated financial statements, and (b) the unaudited consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting. As permitted under those requirements, certain footnotes or other financial information that are normally required by generally accepted accounting principles in the United States of America (GAAP) have been condensed or omitted. The Company believes that the disclosures made are adequate to make the information not misleading and in the opinion of management reflect all adjustments, including those of a normal recurring nature, that are necessary for a fair presentation of financial position and results of operations for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of results of operations to be expected for the full year. The unaudited consolidated financial statements included herein should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended July 31, 2008.

These consolidated financial statements are prepared using certain estimates by management and include the accounts of KMG Chemicals, Inc. and its subsidiaries (collectively, the Company). All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior consolidated financial statements to conform to the current period presentation.

(2) Recent Accounting Standards.

Recent Accounting Standards Not Yet Adopted.

In November 2008, the Financial Accounting Standards Board (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 will adopt EITF 08-7 on August 1, 2009 and apply the requirements prospectively to intangible assets acquired on or after that date. The impact of adoption on the Company s consolidated financial statements cannot be currently evaluated and will depend on the nature and significance of any future acquisitions.

In April 2008, the FASB issued FASB Staff Position (FSP) Statement of Financial Accounting Standards (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 is currently evaluating the impact, if any, that FSP FAS 142-3 will have on its consolidated financial statements.

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 will adopt FAS 141(R) and FSP FAS 141(R)-1 on August 1, 2009 and apply the requirements prospectively to business combinations that occur after the date of adoption. The impact of adoption on the Company s consolidated financial statements cannot be currently evaluated and will depend on the nature and significance of any future acquisitions.

Recently Adopted Accounting Standards.

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 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 an 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.

(3) 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 potentially dilutive common shares. The following table presents information necessary to calculate basic and diluted earnings per share for periods indicated:

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2009	**2008**	**2009**	**2008**
	(Amounts in thousands, except per share data)			
Income from continuing operations	$ 2,792	$ 1,814	$ 5,315	$ 5,055
Loss from discontinued operations	(10)	(135)	(14)	(251)
Net income	$ 2,782	$ 1,679	$ 5,301	$ 4,804
Weighted average shares outstanding	11,090	10,990	11,080	10,968
Dilutive effect of options/warrants and stock awards	118	237	137	252
Weighted average shares outstanding, as adjusted	11,208	11,227	11,217	11,220
BASIC EARNINGS PER SHARE:				
Basic earnings per share from continuing operations	$ 0.25	$ 0.16	$ 0.48	$ 0.46
		(0.01)		(0.02)

Basic earnings per share on loss from discontinued operations								
Basic earnings per share	$	0.25	$	0.15	$	0.48	$	0.44
DILUTED EARNINGS PER SHARE:								
Diluted earnings per share from continuing operations	$	0.25	$	0.16	$	0.47	$	0.45
Diluted earnings per share on loss from discontinued operations				(0.01)				(0.02)
Diluted earnings per share	$	0.25	$	0.15	$	0.47	$	0.43

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, 78,347 outstanding stock based awards were not included for the third quarter calculation and for the nine months ended April 30, 2009 there was an average of 56,400 shares that were not included. Potentially dilutive common shares for the nine month ended period are determined by calculating a weighted average of the incremental shares outstanding for each quarter during the period. There were no potentially dilutive securities not included in the computation of diluted earnings per share for the respective periods ended April 30, 2008.

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(4) Acquisition. 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 acquisition was approximately $75.7 million, which included $25.8 million for 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 acquired 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 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