

HAWKINS INC
Form 10-Q
February 08, 2018

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

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

For the quarterly period ended December 31, 2017

Commission file number 0-7647

HAWKINS, INC.

(Exact name of registrant as specified in its charter)

MINNESOTA 41-0771293
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
2381 ROSEGATE, ROSEVILLE, MINNESOTA 55113
(Address of principal executive offices, including zip code)
(612) 331-6910
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

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

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| CLASS | Shares Outstanding at February 2, 2018 |
|---|--|
| Common Stock, par value \$.05 per share | 10,695,184 |

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HAWKINS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share data)

| | December 31, 2017 | April 2, 2017 |
|--|----------------------|------------------|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 7,635 | \$6,861 |
| Trade receivables — less allowance for doubtful accounts: \$526 as of December 31, 2017 and \$468 as of April 2, 2017 | 57,867 | 57,298 |
| Inventories | 62,736 | 51,249 |
| Income taxes receivable | — | 1,273 |
| Prepaid expenses and other current assets | 4,818 | 4,238 |
| Total current assets | 133,056 | 120,919 |
| PROPERTY, PLANT, AND EQUIPMENT: | | |
| Less accumulated depreciation | 235,742 | 221,518 |
| Net property, plant, and equipment | 110,649 | 99,978 |
| 125,093 | 125,093 | 121,540 |
| OTHER ASSETS: | | |
| Goodwill | 97,556 | 97,556 |
| Intangible assets, net | 72,603 | 76,883 |
| Other | 2,436 | 1,686 |
| Total other assets | 172,595 | 176,125 |
| Total assets | \$ 430,744 | \$418,584 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable — trade | \$ 28,077 | \$29,756 |
| Dividends payable | — | 4,466 |
| Accrued payroll and employee benefits | 6,992 | 9,979 |
| Income tax payable | 46 | — |
| Current portion of long-term debt | 9,864 | 7,989 |
| Due to sellers of acquired business | — | 341 |
| Container deposits | 1,233 | 1,174 |
| Other current liabilities | 2,335 | 1,967 |
| Total current liabilities | 48,547 | 55,672 |
| LONG-TERM DEBT, LESS CURRENT PORTION | | |
| | 104,228 | 94,626 |
| PENSION WITHDRAWAL LIABILITY | | |
| | 5,728 | 5,968 |
| DEFERRED INCOME TAXES | | |
| | 25,315 | 42,040 |
| OTHER LONG-TERM LIABILITIES | | |
| | 3,634 | 2,450 |
| Total liabilities | 187,452 | 200,756 |
| COMMITMENTS AND CONTINGENCIES | | |
| | — | — |
| SHAREHOLDERS' EQUITY: | | |
| Common stock; authorized: 30,000,000 shares of \$0.05 par value; 10,631,992 and 10,582,596 shares issued and outstanding as of December 31, 2017 and April 2, 2017, respectively | 531 | 529 |
| Additional paid-in capital | 53,016 | 51,104 |
| Retained earnings | 189,386 | 165,897 |
| Accumulated other comprehensive income | 359 | 298 |

| | | |
|--|------------|-----------|
| Total shareholders' equity | 243,292 | 217,828 |
| Total liabilities and shareholders' equity | \$ 430,744 | \$418,584 |
| See accompanying notes to condensed consolidated financial statements. | | |

HAWKINS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In thousands, except share and per-share data)

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|------------|-------------------|------------|
| | December 31, | January 1, | December 31, | January 1, |
| | 2017 | 2017 | 2017 | 2017 |
| Sales | \$ 118,053 | \$ 112,351 | \$ 377,179 | \$ 364,975 |
| Cost of sales | (99,213) | (91,439) | (308,225) | (288,815) |
| Gross profit | 18,840 | 20,912 | 68,954 | 76,160 |
| Selling, general and administrative expenses | (14,139) | (14,916) | (44,733) | (44,913) |
| Operating income | 4,701 | 5,996 | 24,221 | 31,247 |
| Interest expense, net | (857) | (634) | (2,423) | (1,977) |
| Income before income taxes | 3,844 | 5,362 | 21,798 | 29,270 |
| Income tax benefit (expense) | 13,299 | (1,811) | 6,386 | (10,925) |
| Net income | \$ 17,143 | \$ 3,551 | \$ 28,184 | \$ 18,345 |
| Weighted average number of shares outstanding - basic | 10,609,078 | 10,538,328 | 10,599,232 | 10,529,259 |
| Weighted average number of shares outstanding - diluted | 10,648,232 | 10,595,140 | 10,641,578 | 10,592,550 |
| Basic earnings per share | \$ 1.62 | \$ 0.34 | \$ 2.66 | \$ 1.74 |
| Diluted earnings per share | \$ 1.61 | \$ 0.34 | \$ 2.65 | \$ 1.73 |
| Cash dividends declared per common share | \$— | \$— | \$ 0.44 | \$ 0.42 |

See accompanying notes to condensed consolidated financial statements.

HAWKINS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In thousands)

| | Three Months Ended December 31, 2017 | | Nine Months Ended December 31, 2017 | |
|---|---|----------|--|-----------|
| Net income | \$17,143 | \$ 3,551 | \$28,184 | \$ 18,345 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized gain on interest rate swap | 124 | 393 | 61 | 277 |
| Total comprehensive income | \$17,267 | \$ 3,944 | \$28,245 | \$ 18,622 |

See accompanying notes to condensed consolidated financial statements.

HAWKINS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)

| | Nine Months Ended | |
|---|-------------------|------------------|
| | December 31, | January 1, |
| | 2017 | 2017 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$28,184 | \$ 18,345 |
| Reconciliation to cash flows: | | |
| Depreciation and amortization | 16,759 | 15,453 |
| Amortization of debt issuance costs | 102 | 102 |
| Gain on deferred compensation assets | (99) | — |
| Deferred income taxes | (16,765) | 171 |
| Stock compensation expense | 1,209 | 1,650 |
| Gain from property disposals | (17) | (61) |
| Changes in operating accounts providing (using) cash: | | |
| Trade receivables | (471) | 7,275 |
| Inventories | (11,487) | (2,537) |
| Accounts payable | (990) | (7,456) |
| Accrued liabilities | (1,057) | (1,928) |
| Income taxes | 977 | 848 |
| Other | (1,785) | (869) |
| Net cash provided by operating activities | 14,560 | 30,993 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of property, plant, and equipment | (17,002) | (15,811) |
| Acquisitions, net of cash acquired | — | (2,199) |
| Other | 298 | 264 |
| Net cash used in investing activities | (16,704) | (17,746) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Cash dividends paid | (9,161) | (8,683) |
| New shares issued | 704 | 553 |
| Net proceeds from (payments on) revolver borrowings | 17,000 | (13,000) |
| Payments on term loan borrowings | (5,625) | (3,750) |
| Net cash provided by (used in) financing activities | 2,918 | (24,880) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 774 | (11,633) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 6,861 | 20,014 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$7,635 | \$ 8,381 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| Cash paid for income taxes | \$9,064 | \$9,976 |
| Cash paid for interest | \$2,229 | \$ 1,746 |
| Noncash investing activities - capital expenditures in accounts payable | \$269 | \$ 1,076 |
| See accompanying notes to condensed consolidated financial statements. | | |

HAWKINS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1 – Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, accordingly, do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended April 2, 2017, previously filed with the Securities and Exchange Commission (“SEC”). In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly our financial position and the results of our operations and cash flows for the periods presented. All adjustments made to the interim condensed consolidated financial statements were of a normal recurring nature. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting policies we follow are set forth in Note 1 – Nature of Business and Significant Accounting Policies to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended April 2, 2017, previously filed with the SEC. There has been no significant change in our accounting policies since the end of fiscal 2017.

The results of operations for the nine months ended December 31, 2017 are not necessarily indicative of the results that may be expected for the full year.

References to fiscal 2017 refer to the fiscal year ended April 2, 2017 and references to fiscal 2018 refer to the fiscal year ending April 1, 2018.

Recently Issued Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (ASU) 2016-02, which provides new accounting guidance requiring lessees to recognize most leases as assets and liabilities on the balance sheet. This guidance will be effective for annual periods beginning after December 15, 2018 (our fiscal year ending March 30, 2020) and interim periods within those annual periods. We are currently evaluating the impact of this accounting pronouncement on our results of operations and financial position.

In January 2016, the FASB issued ASU 2016-01, which provides guidance that addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This guidance will be effective for annual reporting periods beginning after December 15, 2017 (our fiscal year ending March 31, 2019), and interim periods within those annual periods. Early adoption is not permitted. We are currently evaluating the impact that this guidance will have on our results of operations and financial position.

In May 2014, the FASB issued ASU 2014-09, which provides new accounting requirements for recognition of revenue from contracts with customers. The requirements of the new standard will be effective for annual reporting periods beginning after December 15, 2017 (our fiscal year ending March 31, 2019), and interim periods within those annual periods. We have performed a preliminary evaluation of the effect of adoption on our consolidated financial statements, and we do not currently expect a material impact on our results of operations, cash flows or financial position. The majority of our revenue arrangements generally consist of a single performance obligation to transfer promised goods or services. In limited circumstances, we manufacture products for customers that are unique to their specifications. We anticipate we will expand our consolidated financial statement disclosures to comply with the ASU. We plan to adopt these standards beginning with the first quarter of fiscal 2019 using the modified retrospective approach.

Recently Adopted Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, which provides accounting guidance intended to improve the accounting for share-based payment transactions. This guidance outlines new provisions intended to simplify various aspects related to accounting for share-based payments and their presentation in the financial statements. We adopted this guidance in the first quarter of fiscal 2018. We will continue to estimate forfeitures as we determine compensation cost each period. The primary impact on our consolidated financial statements is the recognition of excess tax benefits in the provision for income taxes rather than additional paid-in capital, which may result in increased volatility in the reported amounts of income tax expense and net income.

In July 2015, the FASB issued ASU 2015-11, which requires companies to change the measurement principal for inventory measured using the first-in, first-out (“FIFO”) or average cost method from the lower of cost or market to the lower of cost and net realizable value. Treatment of inventory valued under the last-in, last-out (“LIFO”) method is unchanged by this guidance.

We adopted this guidance in the first quarter of fiscal 2018 and there was no impact to our financial position or results of operations.

Note 2 – Earnings per Share

Basic earnings per share (“EPS”) are computed by dividing net earnings by the weighted-average number of common shares outstanding. Diluted EPS includes the incremental shares assumed to be issued as performance units and restricted stock. Basic and diluted EPS were calculated using the following:

| | Three Months Ended December 31, | | Nine Months Ended December 31, | |
|---|------------------------------------|------------|-----------------------------------|------------|
| | 2017 | 2017 | 2017 | 2017 |
| Weighted-average common shares outstanding—basic | 10,609,078 | 10,538,328 | 10,599,232 | 10,529,259 |
| Dilutive impact of performance units and restricted stock | 39,154 | 56,812 | 42,346 | 63,291 |
| Weighted-average common shares outstanding—diluted | 10,648,232 | 10,595,140 | 10,641,578 | 10,592,550 |

For each of the three and nine months ended December 31, 2017 and January 1, 2017, there were no shares excluded from the calculation of weighted-average common shares for diluted EPS.

Note 3 – Derivative Instruments

On September 20, 2016, we entered into an interest rate swap agreement to manage the risk associated with a portion of our variable-rate long-term debt. We do not utilize derivative instruments for speculative purposes. The interest rate swap involves the exchange of fixed-rate and variable-rate payments without the exchange of the underlying notional amount on which the interest payments are calculated. The new swap agreement began September 1, 2017 and will terminate concurrently with the expiration of our credit facility on December 23, 2020. The notional amount of the swap agreement is \$40 million from September 1, 2017 through August 31, 2018, \$30 million from September 1, 2018 through August 31, 2019 and \$20 million from September 1, 2019 through December 23, 2020. We have designated this swap as a cash flow hedge and have determined that it qualifies for hedge accounting treatment. For so long as the hedge is effective, changes in fair value of the cash flow hedge are recorded in other comprehensive income (net of tax) until income or loss from the cash flows of the hedged item is realized.

For each of the three and nine months ended December 31, 2017, we recorded \$0.1 million in other comprehensive income related to unrealized gains (net of tax) on the cash flow hedge described above. For the three months and nine months ended January 1, 2017 we recorded \$0.4 million and \$0.3 million, respectively, in other comprehensive income related to unrealized gains (net of tax) on the cash flow hedge. Included in other long-term assets on our condensed consolidated balance sheet was \$0.6 million as of December 31, 2017 and \$0.5 million as of April 2, 2017 related to the cash flow hedge. Unrealized gains and losses will be reflected in net income when the related cash flows or hedged transactions occur and offset the related performance of the hedged item.

By their nature, derivative instruments are subject to market risk. Derivative instruments are also subject to credit risk associated with counterparties to the derivative contracts. Credit risk associated with derivatives is measured based on the replacement cost should the counterparty with a contract in a gain position to us fail to perform under the terms of the contract. We do not anticipate nonperformance by the counterparty.

Note 4 – Fair Value Measurements

Our financial assets and liabilities are measured at fair value at 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 (exit price). We classify the inputs used to measure fair value into the following hierarchy:

Level 1: Quoted prices in active markets for identical assets or liabilities.

Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets

Level 2: or liabilities in markets that are not active, or inputs other than quoted prices that are observable or can be corroborated by observable market data for the asset or liability.

Unobservable inputs for the asset or liability that are supported by little or no market activity. These fair

Level 3: values are determined using pricing models for which the assumptions utilize management's estimates or market participant assumptions.

Assets and Liabilities Measured at Fair Value on a Recurring Basis. The fair value hierarchy requires the use of observable market data when available. In instances where inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability.

Our financial assets that are measured at fair value on a recurring basis are an interest rate swap and assets held in a deferred compensation retirement plan. Both of these assets are classified as other long-term assets on our balance sheet, with the portion of the deferred compensation retirement plan assets expected to be paid within twelve months reclassified to current assets. The fair value of the interest rate swap is determined by the respective counterparties based on interest rate changes. Interest rate swaps are valued based on observable interest rate yield curves for similar instruments. The deferred compensation plan assets relate to contributions made to a non-qualified compensation plan, established in fiscal 2017, on behalf of certain employees who are classified as "highly compensated employees" as determined by IRS guidelines. The assets are part of a rabbi trust and the funds are held in mutual funds. The fair value of the deferred compensation is based on the quoted market prices for the mutual funds at the end of the period.

The following table summarizes the balances of assets measured at fair value on a recurring basis as of December 31, 2017 and April 2, 2017.

| (In thousands) | December 31, 2017 | | | |
|-----------------------------------|-------------------|---------|---------|-------|
| | Level 1 | Level 2 | Level 3 | Total |
| Interest rate swap | \$ 604 | — | 604 | — |
| Deferred compensation plan assets | \$ 1,460 | \$1,460 | — | — |

| (In thousands) | April 2, 2017 | | | |
|-----------------------------------|---------------|---------|---------|-------|
| | Level 1 | Level 2 | Level 3 | Total |
| Interest rate swap | \$502 | — | \$502 | — |
| Deferred compensation plan assets | — | — | \$— | — |

Note 5 – Inventories

Inventories at December 31, 2017 and April 2, 2017 consisted of the following:

| (In thousands) | December 31, 2017 | | April 2, 2017 | |
|------------------------|-------------------|----------|---------------|------|
| | 2017 | 2017 | 2017 | 2017 |
| Inventory (FIFO basis) | \$ 65,597 | \$52,735 | | |
| LIFO reserve | (2,861 |) | (1,486 |) |

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Net inventory \$ 62,736 \$51,249

The FIFO value of inventories accounted for under the LIFO method was \$42.7 million at December 31, 2017 and \$37.0 million at April 2, 2017. The remainder of the inventory was valued and accounted for under the FIFO method.

The LIFO reserve increased \$0.7 million during the three months ended December 31, 2017 and decreased \$0.4 million during the three months ended January 1, 2017. During the nine months ended December 31, 2017, the LIFO reserve increased \$1.4 million, while it decreased \$0.8 million for the nine months ended January 1, 2017. The valuation of LIFO inventory for interim periods is based on our estimates of year-end inventory levels and costs.

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Note 6 – Goodwill and Intangible Assets

The carrying amount of goodwill was \$97.6 million as of December 31, 2017 and April 2, 2017, of which \$84.1 million was related to our Health and Nutrition segment. The annual goodwill impairment test we performed in fiscal 2017 indicated the excess fair value of this reporting unit was \$7.4 million, or 4.8%.

A summary of our intangible assets as of December 31, 2017 and April 2, 2017 is as follows:

| (In thousands) | December 31, 2017 | | | April 2, 2017 | | |
|-------------------------------------|-------------------|--------------------------|----------|---------------|--------------------------|----------|
| | Gross Amount | Accumulated Amortization | Net | Gross Amount | Accumulated Amortization | Net |
| Finite-life intangible assets | | | | | | |
| Customer relationships | \$78,383 | \$ (11,278) | \$67,105 | \$78,383 | \$ (7,854) | \$70,529 |
| Trademarks and trade names | 6,045 | (2,315) | 3,730 | 6,045 | (1,790) | 4,255 |
| Other finite-life intangible assets | 3,648 | (3,107) | 541 | 3,648 | (2,776) | 872 |
| Total finite-life intangible assets | 88,076 | (16,700) | 71,376 | 88,076 | (12,420) | 75,656 |
| Indefinite-life intangible assets | 1,227 | — | 1,227 | 1,227 | — | 1,227 |
| Total intangible assets | \$89,303 | \$ (16,700) | \$72,603 | \$89,303 | \$ (12,420) | \$76,883 |

Note 7 – Debt

Debt at December 31, 2017 and April 2, 2017 consisted of the following:

| (In thousands) | December 31, 2017 | April 2, 2017 |
|---|-------------------|---------------|
| Senior secured term loan | \$ 87,500 | \$93,125 |
| Senior secured revolving loan | 27,000 | 10,000 |
| Total debt | 114,500 | 103,125 |
| Less: unamortized debt issuance costs | (408) | (510) |
| Total debt, net of debt issuance costs | 114,092 | 102,615 |
| Less: current portion of long-term debt | (9,864) | (7,989) |
| Total long-term debt | \$ 104,228 | \$94,626 |

Note 8 – Income Taxes

On December 22, 2017 the Tax Cuts and Jobs Act of 2017 (the “Act”), was signed into law. The Act includes a number of provisions, including the lowering of the U.S. corporate tax rate from 35% to 21% effective January 1, 2018. Because our fiscal 2018 ends April 1, 2018, our tax provision for the current year will be calculated utilizing a blended statutory federal rate of 31.5%. In future years, we expect our statutory federal rate to be 21%. Under generally accepted accounting principles, deferred tax assets and liabilities are required to be revalued during the period in which new tax legislation is enacted. As such, during the three months ended December 31, 2017, we revalued our net deferred tax liabilities to reflect the impact of the Act and recorded a one-time benefit of \$13.2 million. Pursuant to SEC Staff Accounting Bulletin 118 (regarding the application of ASC 740 associated with the enactment of the Act), the tax benefit we recorded in the current quarter is provisional. The final impact of the Act may differ due to and among other things, changes in interpretations, assumptions made by the Company and the issuance of additional guidance that may be provided. Specifically, no adjustment was recorded during the three months ended December 31, 2017 related to the impact of the Act on state taxes, as we could not reasonably estimate the impact and do not expect any such impact to be material to our financial statements.

We are subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. The tax years prior to our fiscal year ended April 3, 2016 are closed to examination by the Internal Revenue Service. Our federal tax return filed for our fiscal year ended March 29, 2015 was examined by the Internal Revenue Service with no adjustments.

For state and local income tax jurisdictions, the tax years prior to our fiscal year ended March 29, 2015 are closed to examination, with few exceptions.

As of December 31, 2017 and April 2, 2017, our balance sheet included a long-term liability for uncertain tax positions of \$0.2 million and \$0.8 million, respectively, which arose from tax positions taken by Stauber on its tax returns for periods prior to our acquisition. Because the Stauber acquisition agreement provides us with indemnification by the prior owners for any tax liabilities relating to pre-acquisition tax returns, we have also recorded an offsetting, long-term receivable of \$0.2 million as of December 31, 2017 and \$0.8 million as of April 2, 2017. As a result, any change in the unrecognized tax benefit will not impact our effective tax rate in future periods. We expect these uncertain income tax amounts to decrease as the applicable examination periods for the relevant taxing authorities expire.

Note 9 – Share-Based Compensation

Performance-Based Restricted Stock Units. Our Board of Directors (the “Board”) approved a performance-based equity compensation arrangement for our executive officers during the first quarters of each of fiscal 2018 and fiscal 2017. These performance-based arrangements provide for the grant of performance-based restricted stock units that represent a possible future issuance of restricted shares of our common stock based on a pre-tax income target for the applicable fiscal year. The actual number of restricted shares to be issued to each executive officer is determined when our final financial information becomes available after the applicable fiscal year and will be between zero shares and 57,855 shares in the aggregate for fiscal 2018. The restricted shares issued will fully vest two years after the last day of the fiscal year on which the performance is based. We are recording the compensation expense for the outstanding performance share units and the converted restricted stock over the life of the awards.

The following table represents the restricted stock activity for the nine months ended December 31, 2017:

| | Shares | Weighted- Average Grant Date Fair Value |
|---------------------------------|----------|---|
| Unvested at beginning of period | 28,853 | \$ 43.10 |
| Granted | 35,075 | 47.50 |
| Forfeited or expired | (9,220) | 45.45 |
| Unvested at end of period | 54,708 | \$ 45.52 |

We recorded compensation expense related to performance share units and restricted stock of \$0.2 million and \$0.7 million for the three and nine months ended December 31, 2017, respectively. We recorded compensation expense related to performance share units and restricted stock of \$0.4 million and \$1.1 million for the three and nine months ended January 1, 2017, respectively. Substantially all of the compensation expense was recorded in selling, general and administrative expenses in the condensed consolidated statements of income.

Restricted Stock Awards. As part of their retainer, each non-employee director receives an annual grant of restricted stock for their Board of Director services. The restricted stock awards are expensed over the requisite vesting period, which is one year from the date of issuance, based on the market value on the date of grant. As of December 31, 2017, there were 8,484 shares of restricted stock with a grant date fair value of \$41.25 outstanding under this program. Compensation expense for the three months ended December 31, 2017 and January 1, 2017 related to restricted stock awards to the Board was \$0.1 million. Compensation expense for the nine months ended December 31, 2017 and January 1, 2017 related to restricted stock awards to the Board was \$0.3 million and \$0.2 million, respectively.

Note 10 – Share Repurchase Program

We have in place a share repurchase program approved by our Board of up to 300,000 shares of our outstanding common stock. Under the program, we are authorized to repurchase shares for cash on the open market or in privately negotiated transactions subject to applicable securities laws and regulations. Upon repurchase of the shares, we reduce our common stock for the par value of the shares with the excess applied against additional paid-in capital.

No shares were repurchased during the nine months ended December 31, 2017 or during fiscal 2017. As of December 31, 2017, 112,546 shares remained available to be repurchased under the share repurchase program.

Note 11 – Litigation, Commitments and Contingencies

Litigation — There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which we or any of our subsidiaries are a party or of which any of our property is the subject. Legal fees associated with such matters are expensed as incurred.

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Note 12 – Segment Information

We have three reportable segments: Industrial, Water Treatment, and Health and Nutrition. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in our fiscal 2017 Annual Report on Form 10-K.

We evaluate performance based on profit or loss from operations before income taxes not including nonrecurring gains and losses. Reportable segments are defined primarily by product and type of customer. Segments are responsible for the sales, marketing and development of their products and services. Other than our Health and Nutrition segment, the segments do not have separate accounting, administration, customer service or purchasing functions. We allocate certain corporate expenses to our operating segments. There are no intersegment sales and no operating segments have been aggregated. No single customer's revenues amounted to 10% or more of our total revenue. Sales are primarily within the United States and all assets are located within the United States.

| (In thousands) | Industrial | Water Treatment | Health and Nutrition | Total |
|---|------------|--------------------|----------------------------|-----------|
| Three months ended December 31, 2017: | | | | |
| Sales | \$60,337 | \$30,866 | \$26,850 | \$118,053 |
| Gross profit | 7,091 | 7,393 | 4,356 | 18,840 |
| Selling, general, and administrative expenses | 4,992 | 4,643 | 4,504 | 14,139 |
| Operating income | 2,099 | 2,750 | (148) | 4,701 |
| Three months ended January 1, 2017: | | | | |
| Sales | \$57,083 | \$28,098 | \$27,170 | \$112,351 |
| Gross profit | 8,371 | 7,242 | 5,299 | 20,912 |
| Selling, general, and administrative expenses | 5,467 | 4,808 | 4,641 | 14,916 |
| Operating income | 2,904 | 2,434 | 658 | 5,996 |
| Nine months ended December 31, 2017: | | | | |
| Sales | \$183,053 | \$107,307 | \$86,819 | \$377,179 |
| Gross profit | 24,372 | 29,624 | 14,958 | 68,954 |
| Selling, general and administrative expenses | 16,043 | 14,942 | 13,748 | 44,733 |
| Operating income | 8,329 | 14,682 | 1,210 | 24,221 |
| Nine months ended January 1, 2017: | | | | |
| Sales | \$176,717 | \$100,590 | \$87,668 | \$364,975 |
| Gross profit | 28,978 | 28,943 | 18,239 | 76,160 |
| Selling, general and administrative expenses | 16,254 | 14,825 | 13,834 | 44,913 |
| Operating income | 12,724 | 14,118 | 4,405 | 31,247 |

No significant changes to identifiable assets by segment occurred during the nine months ended December 31, 2017.

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

The following is a discussion and analysis of our financial condition and results of operations for the three and nine months ended December 31, 2017 as compared to the similar periods ended January 1, 2017. This discussion should be read in conjunction with the condensed consolidated financial statements and notes to condensed consolidated financial statements included in this quarterly report on Form 10-Q and Item 8 of our Annual Report on Form 10-K for the fiscal year ended April 2, 2017 ("fiscal 2017"). References to "fiscal 2018" refer to the fiscal year ending April 1, 2018.

Overview

We derive substantially all of our revenues from the sale of chemicals and specialty ingredients to our customers in a wide variety of industries. We began our operations primarily as a distributor of bulk chemicals with a strong customer focus. Over the years, we have maintained the strong customer focus and have expanded our business by increasing our sales of value-added chemical and specialty ingredients, including manufacturing, blending, and repackaging certain products.

Financial Results

We focus on total profitability dollars when evaluating our financial results. We believe that gross profit dollars is the best measure of our profitability from product sales because a significant portion of our raw material purchases are impacted by commodity pricing. When commodity prices rise or fall, the changes can cause fluctuations in gross profit as a percentage of sales.

We use the last in, first out ("LIFO") method for valuing the majority of our inventory in our Industrial and Water Treatment segments, which causes the most recent product costs for those products to be recognized in our income statement. The valuation of LIFO inventory for interim periods is based on our estimates of fiscal year-end inventory levels and costs. The LIFO inventory valuation method and the resulting cost of sales are consistent with our business practices of pricing to current chemical raw material prices. We recorded an increase in our LIFO reserve of \$0.7 million for the three months ended December 31, 2017 and \$1.4 million for the nine months ended December 31, 2017, which decreased our reported gross profit for those periods. We recorded a decrease in our LIFO reserve of \$0.4 million for the three months ended January 1, 2017 and \$0.8 million for the nine months ended January 1, 2017, which increased our reported gross profit for those periods. Inventories in the Health and Nutrition segment are valued using the first-in, first-out ("FIFO") method.

Our Industrial and Water Treatment segments sell bulk commodity products. We disclose the sales of our bulk commodity products as a percentage of total sales dollars within each of those segments. Our definition of bulk commodity products includes products that we do not modify in any way, but receive, store, and ship from our facilities, or direct ship to our customers in large quantities. We review our sales reporting on a periodic basis to ensure we are including all products that meet this definition.

Results of Operations

The following table sets forth the percentage relationship of certain items to sales for the period indicated:

| | Three months ended | | Nine months ended | |
|---------------|--------------------|-----------------|-------------------|-----------------|
| | December 31, 2017 | January 1, 2017 | December 31, 2017 | January 1, 2017 |
| Sales | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| Cost of sales | (84.0) % | (81.4) % | (81.7) % | (79.1) % |

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| | | | | | | | | |
|--|--------|----|--------|----|--------|----|--------|----|
| Gross profit | 16.0 | % | 18.6 | % | 18.3 | % | 20.9 | % |
| Selling, general and administrative expenses | (12.0) |)% | (13.3) |)% | (11.9) |)% | (12.3) |)% |
| Operating income | 4.0 | % | 5.3 | % | 6.4 | % | 8.6 | % |
| Interest expense, net | (0.7) |)% | (0.6) |)% | (0.6) |)% | (0.5) |)% |
| Income before income taxes | 3.3 | % | 4.7 | % | 5.8 | % | 8.1 | % |
| Income tax benefit (expense) | 11.3 | % | (1.6) |)% | 1.7 | % | (3.0) |)% |
| Net income | 14.6 | % | 3.1 | % | 7.5 | % | 5.1 | % |

Three Months Ended December 31, 2017 Compared to Three Months Ended January 1, 2017

Sales

Sales increased \$5.7 million, or 5.1%, to \$118.1 million for the three months ended December 31, 2017, as compared to \$112.4 million reported for the same period of the prior year.

Industrial Segment. Industrial segment sales were \$60.3 million for the three months ended December 31, 2017, an increase of \$3.3 million, or 5.7%, from \$57.1 million for the same period of the prior year. Sales of bulk commodity products in the Industrial segment were approximately 21% of sales dollars for the three months ended December 31, 2017 and 20% of sales for the same period in the prior year. Overall sales volumes decreased slightly, while sales dollars increased as a result of more sales of certain specialty products with higher per-unit selling prices, as well as higher selling prices on certain products resulting from increased costs on one of our major commodities.

Water Treatment Segment. Water Treatment segment sales increased \$2.8 million, or 9.9%, to \$30.9 million for the three months ended December 31, 2017, as compared to \$28.1 million for the same period of the prior year. Sales of bulk commodity products in the Water Treatment segment were approximately 17% of sales dollars in the both the three months ended December 31, 2017 and the same period a year ago. Sales dollars increased as a result of increased sales across many product lines.

Health & Nutrition Segment. Health and Nutrition segment sales were \$26.9 million for the three months ended December 31, 2017, a decrease of \$0.3 million, or 1.2%, from \$27.2 million the same period of the prior year. Increased sales of distributed products were offset by decreased sales of our manufactured products. The decline in sales of our manufactured products was due to reduced demand from certain customers and temporarily refocused efforts as we made investments to upgrade the facility to generate future growth.

Gross Profit

Gross profit was \$18.8 million, or 16.0% of sales, for the three months ended December 31, 2017, a decrease of \$2.1 million from \$20.9 million, or 18.6% of sales, for the same period of the prior year. As a result of raw material price increases and projected increases in year-end inventory levels, the LIFO reserve reduced gross profit by \$1.1 million year over year. Gross profit was further negatively impacted by competitive pricing pressures and decreased sales of manufactured products in our Health & Nutrition segment.

Industrial Segment. Gross profit for the Industrial segment decreased \$1.3 million to \$7.1 million, or 11.8% of sales, for the three months ended December 31, 2017, as compared to \$8.4 million, or 14.7% of sales, for the same period of the prior year. Raw material cost increases negatively impacted the quarter's results with the LIFO method of valuing inventory decreasing gross profit by \$0.5 million in the current year while increasing gross profit by \$0.3 million for the same period of the prior year. Although we were able to address increased costs on one of our major commodities through higher selling prices, competitive pricing pressures limited our ability to pass all cost increases on to our customers, driving the lower year-over-year gross profit and gross profit percentage.

Water Treatment Segment. Gross profit for the Water Treatment segment increased \$0.2 million to \$7.4 million, or 24.0% of sales, for the three months ended December 31, 2017, as compared to \$7.2 million, or 25.8% of sales, for the same period of the prior year. Raw material cost increases negatively impacted the quarter's results with the LIFO method of valuing inventory decreasing gross profit by \$0.1 million in the current year, while it increased gross profit by \$0.1 million in the previous year. In spite of the negative year-over-year LIFO impact, gross profit increased as a result of increased sales volumes compared to a year ago. Gross profit as a percentage of sales decreased compared to a year ago due to the LIFO impact as well as a product mix shift.

Health and Nutrition Segment. Gross profit for our Health and Nutrition segment decreased \$0.9 million to \$4.4 million, or 16.2% of sales, for the three months ended December 31, 2017, as compared to \$5.3 million, or 19.5% of sales, for the same period of the prior year. Gross profit and gross profit as a percentage of sales declined primarily as a result of lower sales of our manufactured products, which typically carry higher per-unit margins than distributed products, as compared to a year ago.

Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses were \$14.1 million, or 12.0% of sales, for the three months ended December 31, 2017, a decrease of \$0.8 million from \$14.9 million, or 13.3% of sales, for the same period of the prior year. SG&A costs were lower in all segments as a result of management efforts to control costs, including

delaying or suspending the filling of open positions as well as a decline in certain other variable expenses.

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Operating Income

Operating income was \$4.7 million for the three months ended December 31, 2017, as compared to \$6.0 million for the same period of the prior year. Operating income in our Industrial segment decreased by \$0.8 million driven by lower gross profits, partially offset by reduced SG&A expenses. Operating income in our Water Treatment segment increased by \$0.3 million due to higher gross profits and slightly lower SG&A expenses. Operating income in our Health and Nutrition Segment decreased by \$0.8 million driven by lower gross profits compared to the comparable period in the prior year, partially offset by lower SG&A expenses.

Interest Expense, Net

Interest expense was \$0.9 million for the three months ended December 31, 2017 compared to \$0.6 million for the same period of the prior year due primarily to increased outstanding borrowings in the current quarter to fund working capital requirements.

Income Tax Provision

On December 22, 2017 the Tax Cuts and Jobs Act of 2017 (the "Act"), was signed into law. The Act includes a number of provisions, including the lowering of the U.S. corporate tax rate from 35% to 21% effective January 1, 2018. Because our fiscal 2018 ends April 1, 2018, our tax provision for the current year will be calculated utilizing a blended statutory federal rate of 31.5%. In future years, we expect our statutory federal rate to be 21%.

Under generally accepted accounting principles, deferred tax assets and liabilities are required to be revalued during the period in which new tax legislation is enacted. As such, during the three months ended December 31, 2017, we revalued our net deferred tax liabilities to reflect the impact of the Act and recorded a one-time benefit of \$13.2 million. As a result of this adjustment, our effective tax rate for the three months ended December 31, 2017 was not meaningful. Our effective income tax rate was 33.8% for the three months ended January 1, 2017. The effective tax rate is impacted by projected levels of annual taxable income, permanent items, and state taxes.

Nine Months Ended December 31, 2017 Compared to Nine Months Ended January 1, 2017

Sales

Sales increased \$12.2 million, or 3.3%, to \$377.2 million for the nine months ended December 31, 2017, as compared to \$365.0 million reported for the same period of the prior year.

Industrial Segment. Industrial segment sales were \$183.1 million for the nine months ended December 31, 2017, an increase of \$6.3 million, or 3.6%, as compared to \$176.7 million for the same period of the prior year. Sales of bulk commodity products in the Industrial segment were approximately 19% of sales dollars for the nine months ended December 31, 2017 and for the same period in the prior year. Overall sales volumes were relatively flat year over year, while sales dollars increased as a result of more sales of certain specialty products with higher per-unit selling prices, as well as higher selling prices on certain products resulting from increased costs on one of our major commodities.

Water Treatment Segment. Water Treatment segment sales increased \$6.7 million, or 6.7%, to \$107.3 million for the nine months ended December 31, 2017, as compared to \$100.6 million for the same period of the prior year. Sales of bulk commodity products in the Water Treatment segment were approximately 15% of sales dollars in both the nine months ended December 31, 2017 and the same period a year ago. Sales dollars increased as a result of increased sales across many product lines.

Health & Nutrition Segment. Health and Nutrition segment sales were \$86.8 million for the nine months ended December 31, 2017, a decrease of \$0.8 million, or 1.0%, from \$87.7 million for the same period of the prior year. Increased sales of distributed products were offset by decreased sales of our manufactured products. The decline in sales of our manufactured products was due to reduced demand from certain customers and temporarily refocused efforts as we made investments to upgrade the facility to generate future growth.

Gross Profit

Gross profit was \$69.0 million, or 18.3% of sales, for the nine months ended December 31, 2017, a decrease of \$7.2 million compared to \$76.2 million, or 20.9% of sales, for the same period of the prior year. As a result of raw material price increases and projected increases in year-end inventory levels, the current year increase in the LIFO reserve reduced gross profit by \$2.1 million year over year. In addition, the decrease in gross profit was due to planned

increases in personnel and other investments to drive future growth, including accelerated depreciation of \$0.7 million, as well as a \$0.5 million reclassification from SG&A expenses, product mix changes and continued competitive pricing pressures.

Industrial Segment. Gross profit for the Industrial segment decreased \$4.6 million to \$24.4 million, or 13.3% of sales, for the nine months ended December 31, 2017, as compared to \$29.0 million, or 16.4% of sales, for the same period of the prior year. Raw material cost increases negatively impacted year-to-date results with the LIFO method of valuing inventory decreasing gross profit by \$1.1 million in the current year while increasing gross profit by \$0.6 million for the same period of the prior year. In addition, the decrease in gross profit and gross profit as a percentage of sales was driven by increased operating costs as we invest for future growth and to comply with increased regulatory requirements as well as lower margins on certain commodity products with rising material costs, driven by competitive pricing pressures. The impact was offset somewhat by higher profits on sales of certain specialty products with higher per-unit margins.

Water Treatment Segment. Gross profit for the Water Treatment segment increased \$0.7 million to \$29.6 million, or 27.6% of sales, for the nine months ended December 31, 2017, as compared to \$28.9 million, or 28.8% of sales, for the same period of the prior year. Gross profit dollars increased due to increased sales volumes. Raw material cost increases negatively impacted year-to-date results with the LIFO method of valuing inventory decreasing gross profit by \$0.3 million in the current year while increasing gross profit by \$0.2 million for the same period of the prior year. In spite of the negative year-over-year LIFO impact, gross profit increased as a result of increased sales volumes compared to a year ago.

Health and Nutrition Segment. Gross profit for our Health and Nutrition segment decreased \$3.3 million to \$15.0 million, or 17.2% of sales, for the nine months ended December 31, 2017, as compared to \$18.2 million, or 20.8% of sales, for the same period of the prior year. Decreased sales of our manufactured products, which carry higher per-unit margins, contributed to the decline in gross profit and gross profit as a percentage of sales. The decrease in gross profit and gross profit as a percentage of sales was also driven by planned cost increases including accelerated depreciation expense of \$0.7 million related to manufacturing equipment that we removed to make upgrades to current equipment and to make room for more efficient equipment, as well as the reclassification of \$0.5 million of costs that were recorded as SG&A expenses in the prior year to operating overhead in the current year to conform to our presentation.

Selling, General and Administrative Expenses

SG&A expenses were \$44.7 million, or 11.9% of sales, for the nine months ended December 31, 2017, a decrease of \$0.2 million from \$44.9 million, or 12.3% of sales, for the same period of the prior year. Expenses decreased primarily as a result of the reclassification of \$0.5 million of expenses in our Health & Nutrition segment from SG&A to operating overhead to conform to our presentation.

Operating Income

Operating income was \$24.2 million for the nine months ended December 31, 2017, as compared to \$31.2 million for the same period of the prior year. Operating income in our Industrial segment decreased by \$4.4 million driven by lower gross profits in that segment partially offset by lower SG&A expenses. Operating income in our Water Treatment segment increased by \$0.6 million due to higher gross profits. Operating income in our Health and Nutrition segment decreased by \$3.2 million driven by lower gross profits compared to the comparable period in the prior year.

Interest Expense, Net

Interest expense was \$2.4 million for the first nine months of fiscal 2018, compared to \$2.0 million for the same period of the prior year due primarily to increased outstanding borrowings in the current year to fund working capital requirements.

Income Tax Provision

On December 22, 2017 the Act was signed into law. The Act includes a number of provisions, including the lowering of the U.S. corporate tax rate from 35% to 21% effective January 1, 2018. Because our fiscal 2018 ends April 1, 2018, our tax provision for the current year will be calculated utilizing a blended statutory federal rate of 31.5%. In future years, we expect our statutory federal rate to be 21%.

Under generally accepted accounting principles, deferred tax assets and liabilities are required to be revalued during the period in which new tax legislation is enacted. As such, during the nine months ended December 31, 2017, we

revalued our net deferred tax liabilities to reflect the impact of the Act and recorded a one-time benefit of \$13.2 million. As a result of this adjustment, our effective tax rate for the nine months ended December 31, 2017 was not meaningful. Without the non-recurring adjustments discussed above, our effective tax rate for the nine months ended December 31, 2017 was 32.5%.

Our effective income tax rate was 37.3% for the nine months ended January 1, 2017. The effective tax rate is impacted by projected levels of annual taxable income, permanent items, and state taxes.

Liquidity and Capital Resources

Cash was \$7.6 million at December 31, 2017, an increase of \$0.7 million as compared with the \$6.9 million available as of April 2, 2017.

Cash provided by operating activities was \$14.6 million for the nine months ended December 31, 2017, compared to cash provided by operating activities of \$31.0 million for the same period of the prior year. The decrease in cash provided by operating activities was primarily driven by lower operating income and a year-over-year change in the amount of cash provided by accounts receivable, driven by high levels of collections in the first nine month of the prior year, as well as a change in the amount of cash utilized to purchase inventory during the first nine months of fiscal 2018 as compared to the same period in the prior year. The large increase in inventory in the first nine months of fiscal 2018 was primarily due to an increase in on-hand and in-transit inventory, along with an increase in the per-unit cost, of one of our major commodities. The decision to increase inventory was driven largely by expectations of future cost increases. Due to the nature of our operations, which includes purchases of large quantities of bulk chemicals, timing of purchases can result in significant changes in working capital investment and the resulting operating cash flow. Typically, our cash requirements increase during the period from April through November as caustic soda inventory levels increase as the majority of barges are received during this period.

Cash used in investing activities was \$16.7 million for the nine months ended December 31, 2017, compared to \$17.7 million for the same period of the prior year. Capital expenditures were \$17.0 million for the nine months ended December 31, 2017, compared to \$15.8 million in the same period of the prior year. Included in capital expenditures for the first nine months of fiscal 2018 was \$6.7 million related to business expansion, inventory storage, and process improvements, including the purchase of three of our previously leased Florida locations, and \$7.4 million related to facility improvements, replacement equipment, new and replacement containers, and Water Treatment trucks. In the previous year, we paid \$2.2 million of additional purchase price for Stauber as closing cash, debt and working capital balances were finalized in early 2017.

Cash provided by financing activities was \$2.9 million for the nine months ended December 31, 2017, compared to cash used in financing activities of \$24.9 million in the same period of the prior year. Included in financing activities were dividend payments of \$9.2 million, debt repayments of \$5.6 million on our Term Loan Facility (as defined below) and net proceeds of \$17.0 million resulting from borrowings on our Revolving Loan Facility (as defined below) which were made in the nine months ended December 31, 2017 to fund working capital requirements. In the first nine months of the prior year, we made dividend payments of \$8.6 million, debt repayments on our Term Loan Facility of \$3.8 million, and repayments of \$13.0 million on our Revolving Loan Facility.

We expect our cash balances and funds available under our credit facility, discussed below, along with cash flows generated from operations, will be sufficient to fund the cash requirements of our ongoing operations for the foreseeable future.

On December 23, 2015, we entered into a credit agreement (the "Credit Agreement") with U.S. Bank National Association ("U.S. Bank") as Sole Lead Arranger and Sole Book Runner and other lenders from time to time party thereto (collectively, the "Lenders"), whereby U.S. Bank is also serving as Administrative Agent. The Credit Agreement provides us with senior secured credit facilities (the "Credit Facility") totaling \$165.0 million, consisting of a \$100.0 million senior secured term loan credit facility (the "Term Loan Facility") and a \$65.0 million senior secured revolving loan credit facility (the "Revolving Loan Facility"). The Term Loan facility requires mandatory quarterly repayments, with the balance due at maturity. The Revolving Loan Facility includes a letter of credit subfacility in the amount of \$5.0 million and a swingline subfacility in the amount of \$8.0 million. The Credit Facility is scheduled to terminate on December 23, 2020. The Credit Facility is secured by substantially all of our personal property assets and those of our subsidiaries.

Borrowings under the Credit Facility bear interest at a variable rate per annum equal to one of the following, plus, in both cases, an applicable margin based upon our leverage ratio: (a) LIBOR for an interest period of one, two, three or six months as selected by us, reset at the end of the selected interest period, or (b) a base rate determined by reference to the highest of (1) U.S. Bank's prime rate, (2) the Federal Funds Effective Rate plus 0.5%, or (3) one-month LIBOR

for U.S. dollars plus 1.0%. The LIBOR margin is 1.125%, 1.25% or 1.5%, depending on our leverage ratio. The base rate margin is either 0.125%, 0.25% or 0.5%, depending on our leverage ratio. At December 31, 2017, the effective interest rate on our borrowings was 2.8%.

On September 20, 2016, we entered into an interest rate swap agreement to manage the risk associated with a portion of our variable-rate long-term debt. We do not utilize derivative instruments for speculative purposes. The interest rate swap involves the exchange of fixed-rate and variable-rate payments without the exchange of the underlying notional amount on which the interest payments are calculated. The new swap agreement began September 1, 2017 and will terminate concurrently with the expiration of our credit facility on December 23, 2020. The notional amount of the swap agreement is \$40 million from September 1, 2017 through August 31, 2018, \$30 million from September 1, 2018 through August 31, 2019 and \$20 million from September 1, 2019 through December 23, 2020. We have designated this swap as a cash flow hedge and have determined that it qualifies for hedge accounting treatment. For so long as the hedge is effective, changes in fair value of the cash flow hedge are recorded in other comprehensive loss (net of tax) until income or loss from the cash flows of the hedged item is realized.

In addition to paying interest on the outstanding principal under the Credit Facility, we are required to pay a commitment fee on the unutilized commitments thereunder. The commitment fee is 0.25% to 0.3%, depending on our leverage ratio.

Debt issuance costs of \$0.7 million were paid to the lenders and are being amortized as interest expense over the term of the credit facility. As of December 31, 2017, the unamortized balance of these costs was \$0.4 million, and is reflected as a reduction of debt on our balance sheet.

The Credit Agreement requires us to maintain (a) a minimum fixed charge coverage ratio of 1.15 to 1.00 and (b) a maximum total cash flow leverage ratio of 3.0 to 1.0. The Credit Agreement also contains other customary affirmative and negative covenants, including covenants that restrict our ability to incur additional indebtedness, dispose of significant assets, make certain investments, including any acquisitions other than permitted acquisitions, make certain payments, enter into sale and leaseback transactions, grant liens on our assets or enter into rate management transactions, subject to certain limitations. We are permitted to make distributions, pay dividends and repurchase shares so long as no default or event of default exists or would exist as a result thereof. As of December 31, 2017, we were in compliance with all required covenants.

The Credit Agreement contains customary events of default, including failure to make payments under the Term Loan Facility, failure to comply with covenants in the Credit Agreement and other loan documents, cross default to other material indebtedness, failure by us to pay or discharge material judgments, bankruptcy, and change of control. The occurrence of an event of default would permit the lenders to terminate their commitments and accelerate loans under the Credit Facility.

As part of our growth strategy, we have acquired businesses and may pursue acquisitions or other strategic relationships in the future that we believe will complement or expand our existing businesses or increase our customer base. We believe we could borrow additional funds under our current or new credit facilities or sell equity for strategic reasons or to further strengthen our financial position.

Critical Accounting Policies

Our significant accounting policies are set forth in Note 1 to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended April 2, 2017. The accounting policies used in preparing our condensed consolidated financial statements for the first quarter of fiscal 2017 are the same as those described in that Annual Report.

Forward-Looking Statements

The information presented in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These statements are not historical facts, but rather are based on our current expectations, estimates and projections, and our beliefs and assumptions. We intend words such as "anticipate," "expect," "intend," "plan," "believe," "see," "estimate," "will" and similar expressions to identify forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, some of which are beyond our control and are difficult to predict. These factors could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Additional information concerning potential factors that could affect future financial results is included in our Annual Report on Form 10-K for the fiscal year ended April 2, 2017. We

caution you not to place undue reliance on these forward-looking statements, which reflect our management's view only as of the date of this Quarterly Report on Form 10-Q. We are not obligated to update these statements or publicly release the result of any revisions to them to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to the risk inherent in the cyclical nature of commodity chemical prices. However, we do not currently purchase forward contracts or otherwise engage in hedging activities with respect to the purchase of commodity chemicals. We attempt to pass changes in the cost of our materials to our customers. However, there are no assurances that we will be able to pass on the increases in the future.

We are exposed to market risks related to interest rates. Our exposure to changes in interest rates is limited to borrowings under our Credit Facility. A 25 basis point change in interest rates would potentially increase or decrease our annual interest expense by approximately \$0.1 million. In the second quarter of fiscal 2017, we entered into an interest rate swap that converts a portion of our variable-rate debt into a fixed-rate obligation. The new swap agreement began September 1, 2017 and will end concurrently with the expiration of our Credit Facility on December 23, 2020. The notional amount of the swap agreement is \$40 million from September 1, 2017 through August 31, 2018, \$30 million from September 1, 2018 through August 31, 2019 and \$20 million from September 1, 2019 through December 23, 2020. We have designated this swap as a cash flow hedge and have determined that it qualifies for hedge accounting treatment. Changes in fair value of the cash flow hedge are recorded in other comprehensive loss (net of tax) until income or loss from the cash flows of the hedged item is realized.

Other types of market risk, such as foreign currency risk, do not arise in the normal course of our business activities.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, we conducted an evaluation, under supervision and with the participation of management, including the chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15 and 15d-15 of the Exchange Act. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are defined by Rules 13a-15(e) and 15d-15(e) of the Exchange Act as controls and other procedures that are designed to ensure that information required to be disclosed by us in reports filed with the SEC 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 by us in reports filed under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or person performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control

There was no change in our internal control over financial reporting during the third quarter of fiscal 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no material pending legal proceedings, other than ordinary routine litigation incidental to the business, to which we or any of our subsidiaries are a party or of which any of our property is the subject.

ITEM 1A. RISK FACTORS

There have been no material changes to our risk factors from those disclosed in our Annual Report on Form 10-K for the fiscal year ended April 2, 2017.

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

On May 29, 2014, our Board of Directors authorized a share repurchase program of up to 300,000 shares of our outstanding common stock. The shares may be repurchased on the open market or in privately negotiated transactions subject to applicable securities laws and regulations. We did not repurchase any shares of our common stock during the three months ended December 31, 2017. As of December 31, 2017, 112,546 shares remained available to be repurchased under the share repurchase program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not Applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

| Exhibit | Description | Method of Filing |
|---------|---|---------------------------|
| 3.1 | <u>Amended and Restated Articles of Incorporation.</u> | Incorporated by Reference |
| 3.2 | <u>Amended and Restated By-Laws.</u> | Incorporated by Reference |
| 31.1 | <u>Certification by Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act.</u> | Filed Electronically |
| 31.2 | <u>Certification by Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act.</u> | Filed Electronically |
| 32.1 | <u>Section 1350 Certification by Chief Executive Officer.</u> | Filed Electronically |
| 32.2 | <u>Section 1350 Certification by Chief Financial Officer.</u> | Filed Electronically |
| 101 | Financial statements from the Quarterly Report on Form 10-Q of Hawkins, Inc. for the period ended December 31, 2017 filed with the SEC on February 8, 2018 formatted in Extensible Business Reporting Language (XBRL); (i) the Condensed Consolidated Balance Sheets at December 31, 2017 and April 2, 2017, (ii) the Condensed Consolidated Statements of Income for the three and nine months ended December 31, 2017 and January 1, 2017, (iii) the Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended December 31, 2017 and January 1, 2017, (iv) the Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2017 and January 1, 2017, and (v) Notes to Condensed Consolidated Financial Statements. | Filed Electronically |

(1) Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2010, filed on July 29, 2010 (File no. 000-07647).

(2) Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K dated October 28, 2009 and filed November 3, 2009 (File no. 000-07647).

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.

HAWKINS, INC.

By: /s/ Jeffrey P. Oldenkamp

Jeffrey P. Oldenkamp

Vice President, Chief Financial Officer, and Treasurer

(On behalf of the registrant and as principal financial and accounting officer)

Dated: February 8, 2018