Heritage-Crystal Clean, Inc.
Form 10-Q
May 02, 2013

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 March 23, 2013
	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 001-33987

HERITAGE-CRYSTAL CLEAN, INC.
(Exact name of registrant as specified in its charter)

Delaware	26-0351454
State or other jurisdiction of Incorporation	(I.R.S. Employer Identification No.)

2175 Point Boulevard
Suite 375
Elgin, IL 60123
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (847) 836-5670

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 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 (§232.405 of this chapter) 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, or a non-accelerated filer. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

On April 30, 2013, there were outstanding 18,232,617 shares of Common Stock, $0.01 par value, of Heritage-Crystal Clean, Inc.

Table of Contents

PART I

ITEM 1. FINANCIAL STATEMENTS

Heritage-Crystal Clean, Inc.
Consolidated Balance Sheets
(In Thousands, Except Share and Par Value Amounts)
(Unaudited)

	March 23, 2013	December 29, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$44,476	$47,766
Accounts receivable - net	24,612	23,338
Inventory - net	28,033	27,231
Deferred income taxes	759	759
Income tax receivables - current	698	648
Other current assets	3,598	2,821
Total Current Assets	102,176	102,563
Property, plant and equipment - net	73,604	72,246
Equipment at customers - net	18,215	17,946
Software and intangible assets - net	5,978	4,555
Goodwill	3,680	1,801
Total Assets	$203,653	$199,111
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$19,158	$16,509
Accrued salaries, wages, and benefits	2,965	2,544
Taxes payable	1,122	1,066
Current maturities of long-term debt and term loan	1,968	1,803
Other accrued expenses	2,613	2,512
Total Current Liabilities	27,826	24,434
Term loan, less current maturities	19,000	18,250
Long-term debt, less current maturities	1,053	828
Contingent consideration, less current portion	340	451
Deferred income taxes	5,358	5,757
Total Liabilities	$53,577	$49,720
STOCKHOLDERS' EQUITY:		
Common stock - 22,000,000 shares authorized at $0.01 par value, 18,120,696 and 18,068,852 shares issued and outstanding at March 23, 2013 and December 29, 2012, respectively	$181	$181
Additional paid-in capital	141,883	141,612
Retained earnings	7,158	7,598
Total Heritage-Crystal Clean, Inc. Stockholders' Equity	149,222	149,391
Noncontrolling Interest	854	—
Total Equity	150,076	149,391
Total Liabilities and Stockholders' Equity	$203,653	$199,111

See accompanying notes to financial statements.

Heritage-Crystal Clean, Inc.
Consolidated Statements of Operations
(In Thousands, Except per Share Amounts)
(Unaudited)

	For the First Quarters Ended,	
	March 23, 2013	March 24, 2012
Revenues		
Product revenues	$26,558	$21,215
Service revenues	33,449	29,294
Total revenues	$60,007	$50,509
Operating expenses		
Operating costs	$52,286	$42,337
Selling, general, and administrative expenses	6,591	5,756
Depreciation and amortization	1,859	1,772
Other (income) expense - net	(8)	1
Operating (loss) income	(721)	643
Interest expense – net	106	187
(Loss) income before income taxes	(827)	456
(Benefit) Provision for income taxes	(407)	186
Net (loss) income	(420)	270
Income attributable to noncontrolling interest	20	—
Net (loss) income attributable to Heritage-Crystal Clean, Inc. common stockholders	$(440)	$270
Net (loss) income per share: basic	$(0.02)	$0.02
Net (loss) income per share: diluted	$(0.02)	$0.02
Number of weighted average shares outstanding: basic	18,113	14,486
Number of weighted average shares outstanding: diluted	18,113	14,962

See accompanying notes to financial statements.

Heritage-Crystal Clean, Inc.
Consolidated Statement of Stockholders' Equity
(In Thousands, Except Share Amounts)
(Unaudited)

	Shares	Par Value Common	Paid–in Capital	Retained Earnings	Total Heritage-Crystal Clean, Inc. Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance, December 29, 2012	18,068,852	$181	$141,612	$7,598	$ 149,391	$ —	$149,391
Mirachem Acquisition	—	—	—	—	—	834	834
Net (loss) income	—	—	—	(440)	(440)	20	(420)
Issuance of common stock – ESPP	7,382	—	112	—	112	—	112
Exercise of stock options	5,631	—	65	—	65	—	65
Share-based compensation	38,831	—	94	—	94	—	94
Balance, March 23, 2013	18,120,696	$181	$141,883	$7,158	$ 149,222	$ 854	$150,076

See accompanying notes to financial statements.

Heritage-Crystal Clean, Inc.
Consolidated Statements of Cash Flows
(In Thousands)
(Unaudited)

	For the First Quarters Ended, March 23, 2013	March 24, 2012
Cash flows from Operating Activities:		
Net (loss) income	$(420)	$270
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,859	1,772
Bad debt provision	(66)	204
Share-based compensation	95	96
Deferred taxes	(399)	(180)
Other, net	10	43
Changes in operating assets and liabilities:		
Increase in accounts receivable	(1,207)	(7,860)
(Increase) decrease in income tax receivables	(50)	658
Increase in inventory	(327)	(7,390)
Increase in other current assets	(777)	(646)
Increase in accounts payable	2,614	8,791
Increase (decrease) in accrued expenses	659	(80)
Cash provided by (used in) operating activities	$1,991	$(4,322)
Cash flows from Investing Activities:		
Capital expenditures	$(3,156)	$(8,936)
Software and intangible asset expenditures	—	(279)
Business acquisitions, net of cash acquired	(2,405)	—
Cash used in investing activities	$(5,561)	$(9,215)
Cash flows from Financing Activities:		
Proceeds from Term Loan	$750	$—
Payments on Term Loan	(250)	—
Payments of notes payable	(206)	(138)
Payments of contingent consideration	(191)	—
Proceeds from issuance of common stock	112	98
Proceeds from the exercise of stock options	65	123
Borrowings under revolving credit facility	—	20,780
Payments on revolving credit facility	—	(8,780)
Cash provided by financing activities	$280	$12,083
Net decrease in cash and cash equivalents	(3,290)	(1,454)
Cash and cash equivalents, beginning of period	47,766	2,186
Cash and cash equivalents, end of period	$44,476	$732
Supplemental disclosure of cash flow information:		
Income taxes paid	$8	$4
Cash paid for interest, net of capitalized interest of $30 and $18, respectively	103	164

Supplemental disclosure of non-cash information:		
Payables for construction in progress	$247	$3,920
Business acquisition, liabilities assumed	139	—
Business acquisition, note issued	835	—

See accompanying notes to financial statements.

HERITAGE-CRYSTAL CLEAN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

March 23, 2013

(1) ORGANIZATION AND NATURE OF OPERATIONS

Heritage-Crystal Clean, Inc., a Delaware corporation and its subsidiaries (collectively the “Company”), provides parts cleaning and hazardous and non-hazardous waste services to small and mid-sized customers in both the manufacturing and vehicle service sectors. The Company's service programs include parts cleaning, containerized waste management, used oil collection, and vacuum truck services. The Company also owns and operates a used oil re-refinery where it re-refines used oils and sells high quality base oil for lubricants and byproducts. The Company's locations are in the United States. The Company conducts its primary business operations through Heritage-Crystal Clean, LLC, its wholly owned subsidiary, and all intercompany balances have been eliminated in consolidation.

The Company’s fiscal year ends on the Saturday closest to December 31. The most recent fiscal year ended on December 29, 2012. Each of the Company's first three fiscal quarters consists of twelve weeks while the last fiscal quarter consists of sixteen or seventeen weeks.

In the Company's Environmental Services segment, product revenues include sales of solvent, machines, and accessories to customers, and service revenues include drum waste removal services, servicing of parts cleaning machines, vacuum truck services, and other services. In the Company's Oil Business segment, product revenues include sales of re-refined base oil, byproducts, and used oil, and service revenues include revenues from collecting and disposing of waste water. Due to the Company's integrated business model, it is impracticable to separately present costs of tangible products and costs of services.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles ("GAAP") requires the use of certain estimates by management in determining the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the reporting period. Significant items subject to such estimates and assumptions are the allowance for doubtful accounts receivable, valuation of inventory at lower of cost or market, valuation of goodwill and other intangible assets, and income taxes. Actual results could differ from those estimates.

Revenue Recognition

The Company derives its sales primarily from the services it performs and from the sale of processed oil from its used oil re-refinery. Parts cleaning and other service revenues are recognized as the service is performed. Product revenues are recognized at the time risk of loss passes to the customer. The risk of loss passes to customers at various times depending on the particular terms of the sales contract in force with each individual customer. Common thresholds for when risk of loss passes to the customer are at the time that product is loaded onto the shipping vessel or at the time that product is offloaded at the customer’s receiving location. Sales are recognized only if collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed or determinable.

Operating Costs

Within operating costs are cost of sales. Cost of sales in the Environmental Services segment includes the costs of the materials the Company sells and provides in its services, such as solvents and other chemicals, cleaning machines sold to customers, transportation of inventory and waste, and payments to third parties to recycle or dispose of the waste materials that the Company collects. The Company’s used solvent that it retrieves from customers in its product reuse program is accounted for as a reduction in net cost of solvent under cost of sales, whether placed in inventory or sold to a purchaser for reuse. If the used solvent is placed in inventory it is recorded at lower of cost or net realizable value. Cost of sales in the Oil Business include the costs paid to customers for used oil, transportation, and costs to operate the used oil re-refinery, including personnel costs and utilities.

Operating costs also include the Company's costs of operating its branch system and hubs. These costs include personnel costs (including commissions), facility rent and utilities, truck leases, fuel, and maintenance. Operating costs are not presented separately for products and services.

Acquisitions

The Company accounts for acquired businesses using the purchase method of accounting, which requires that the assets acquired, liabilities assumed, and contingent consideration be recorded at the date of acquisition at their respective fair values. It further requires that acquisition-related costs be recognized separately from the acquisition and expensed as incurred and restructuring costs to be expensed in periods subsequent to the acquisition date. The Company records a preliminary purchase price allocation for its acquisitions and finalizes purchase price allocations as additional information relative to the fair values of the assets acquired becomes known.

Identifiable Intangible Assets

The fair value of identifiable intangible assets is based on significant judgments made by management. The Company may engage third party valuation appraisal firms to assist the Company in determining the fair values and useful lives of the assets acquired. Such valuations and useful life determinations require the Company to make significant estimates and assumptions. These estimates and assumptions are based on historical experience and information obtained from the management of the acquired companies and also include, but are not limited to, future expected cash flows to be earned from the continued operation of the acquired business and discount rates applied in determining the present value of those cash flows. Unanticipated events and circumstances may occur that could affect the accuracy or validity of such assumptions, estimates, or actual results. Acquisition-related finite lived intangible assets are amortized on a straight-line basis over their estimated economic lives. The Company evaluates the estimated benefit periods and recoverability of its intangible assets when facts and circumstances indicate that the lives may not be appropriate and/or the carrying value of the asset may not be recoverable. If the carrying value is not recoverable, impairment is measured as the amount by which the carrying value exceeds its estimated fair value.

Fair Value of Financial Instruments

The Company uses a three-tier fair value hierarchy to classify and disclose all assets and liabilities measured at fair value on a recurring basis, as well as assets and liabilities measured at fair value on a non-recurring basis, in periods subsequent to their initial measurement. These tiers include: Level 1, defined as quoted market prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, model-based valuation techniques for which all significant assumptions are observable in the market, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and Level 3, defined as unobservable inputs that are not corroborated by market data.

The Company’s financial instruments consist primarily of cash and cash equivalents, trade receivables, trade payables, notes payable, contingent consideration, and term debt. As of March 23, 2013 and December 29, 2012, the carrying values of cash and cash equivalents, trade receivables, trade payables, notes payable, and contingent consideration, are considered to be representative of their respective fair values due to the short maturity of these instruments. Term debt is representative of its fair value due to the interest rates being applied.

Goodwill

Goodwill is measured as a residual amount as of the acquisition date, which in most cases results in measuring goodwill as an excess of the purchase consideration transferred plus the fair value of any noncontrolling interest in the acquiree over the fair value of the net assets acquired, including any contingent consideration. The Company tests goodwill for impairment annually in the fourth quarter and in interim periods if changes in circumstances indicate that the carrying amount of goodwill may not be recoverable. The Company's determination of fair value requires certain assumptions and estimates, such as margin expectations, growth expectations, expected changes in working capital, etc., regarding future profitability and cash flows of acquired businesses and market conditions. In the fourth quarter of fiscal 2012, the Company tested goodwill for impairment and determined goodwill not to be impaired. However, due to the inherent uncertainties associated with using these assumptions, impairment charges could occur in future periods.

The change in the carrying amount of goodwill by segment from December 29, 2012 to March 23, 2013 is as follows (in thousands):

	Oil Business	Environmental Services	Total
Balance at December 29, 2012	$1,801	$—	$1,801
Mirachem Acquisition	—	1,879	1,879
Balance at March 23, 2013	$1,801	$1,879	$3,680

(3) BUSINESS COMBINATIONS

On December 31, 2012, the Company, through a new Delaware subsidiary, Mirachem, LLC, purchased substantially all of the operating assets of Mirachem Corporation. Since 2004, Mirachem Corporation had provided the Company with the cleaning chemistry used in the Company's aqueous parts cleaning service. The Company made an initial payment of approximately $2.5 million in cash at the time of closing and provided a note payable for an additional $0.8 million over two years.

In a separate transaction, the Company acquired from a third party additional aqueous technologies in exchange for a 20% interest in Mirachem, LLC. The Company has an option to repurchase this 20% interest, and the holder of this 20% interest has a right to sell the interest to the Company, after January 1, 2016, at a price based on the trailing EBITDA of Mirachem, LLC, subject to potential modifications.

The Company completed these transactions in order to secure the supply of its aqueous parts cleaning chemistry which, together with the Company's patented aqueous parts cleaning equipment, should provide the Company with a strong platform from which to compete in the aqueous parts cleaning market.

The Company has consolidated Mirachem, LLC into its financial statements as part of the Environmental Services segment in fiscal 2013. The Company has determined that the financial results of Mirachem, LLC are not material to the consolidated results of the Company and therefore has not presented pro forma disclosures.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed, net of cash acquired, related to the Mirachem acquisition (in thousands):

Inventory	$476	
Property, Plant, & Equipment	218	
Intangible Assets	1,640	
Goodwill	1,879	
Accounts Payable	(139	)
Non-controlling interest	(834	)
Total purchase price, net of cash acquired	$3,240	
Less: note issued	(835	)
Net cash paid	$2,405	

The Company is continuing to evaluate the purchase price allocation. Purchase price allocations are subject to revision as the Company finalizes appraisals and other analyses. Final determination of the fair values may result in further adjustments to the values presented above.

9

(4) ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following (in thousands):

	March 23, 2013	December 29, 2012
Trade	$24,655	$24,026
Less allowance for doubtful accounts	(1,044)	(1,244)
Trade - net	23,611	22,782
Related parties	835	410
Other	166	146
Total accounts receivable - net	$24,612	$23,338

The following table provides the changes in the Company’s allowance for doubtful accounts for the quarter ended March 23, 2013 and the fiscal year ended December 29, 2012 (in thousands):

	March 23, 2013	December 29, 2012
Balance at beginning of period	$1,244	$698
Bad debt provision	(66)	1,122
Accounts written off, net of recoveries	(134)	(576)
Balance at end of period	$1,044	$1,244

(5) INVENTORY

The carrying value of inventory consisted of the following (in thousands):

	March 23, 2013	December 29, 2012
Oil	$12,042	$11,549
Solvents	10,278	10,076
Machines	2,526	2,470
Drums	1,808	1,859
Accessories	1,600	1,518
Total inventory	28,254	27,472
Less: Machine refurbishing reserve	(221)	(241)
Total inventory - net	$28,033	$27,231

Inventory consists primarily of used oil, processed oil, catalyst, new and used solvents, new and refurbished parts cleaning machines, drums, accessories, and absorbents. Inventories are valued at the lower of first-in, first-out (FIFO) cost or market, net of any reserves for excess, obsolete, or unsalable inventory. The Company continually monitors its inventory levels at each of its locations and evaluates inventories for excess or slow-moving items. If circumstances indicate the cost of inventories exceed their recoverable value, inventories are reduced to net realizable value.

(6) PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consisted of the following (in thousands):

	March 23, 2013	December 29, 2012
Buildings and storage tanks [a]	$47,393	$45,813
Machinery, vehicles, and equipment [a]	28,470	30,040
Leasehold improvements	1,889	3,180
Land	713	414
Construction in progress	7,819	4,658
Total property, plant and equipment	86,284	84,105
Less accumulated depreciation	(12,680)	(11,859)
Property, plant and equipment - net	$73,604	$72,246

	March 23, 2013	December 29, 2012
Equipment at customers	$43,006	$41,884
Less accumulated depreciation	(24,791)	(23,938)
Equipment at customers - net	$18,215	$17,946

[a] Fiscal 2013 numbers include preliminary fair values of assets acquired in the acquisition described in Note 3 that may be adjusted as additional information becomes known.

(7) SOFTWARE AND OTHER INTANGIBLE ASSETS

Following is a summary of software and other intangible assets (in thousands):

	March 23, 2013			December 29, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Software	$4,203	$2,693	$1,510	$4,296	$2,635	$1,661
Customer relationships[a]	2,379	331	2,048	1,729	274	1,455
Patents, formulae, and licenses[a]	1,803	277	1,526	1,059	262	797
Non-competes[a]	987	533	454	777	510	267
Other [a]	623	183	440	539	164	375
Total software and intangible assets	$9,995	$4,017	$5,978	$8,400	$3,845	$4,555

[a] Fiscal 2013 numbers include preliminary fair values of assets acquired in the acquisition described in Note 3 that may be adjusted as additional information becomes known.

Amortization expense was $0.2 million for the first quarter ended March 23, 2013 and $0.2 million for first quarter ended March 24, 2012. The weighted average useful lives of software; customer relationships; patents, formulae, and licenses; non-competes, and other intangibles were 9 years, 9 years, 15 years, 5 years, and 5 years, respectively.

The expected amortization expense for fiscal years 2013, 2014, 2015, 2016, and 2017 is $0.5 million, $0.5 million, $0.5 million, $0.4 million, and $0.3 million, respectively. The preceding expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, disposal of intangible assets, accelerated amortization of intangible assets, and other events.

11

(8) ACCOUNTS PAYABLE

Accounts payable consisted of the following (in thousands):

	March 23, 2013	December 29, 2012
Accounts payable	$18,654	$16,202
Accounts payable - related parties	504	307
Total accounts payable	$19,158	