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Heritage-Crystal Clean, Inc.  
Form 10-Q  
August 01, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the quarterly period ended June 18, 2011  
OR  
☐ 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	(I.R.S. Employer
Incorporation	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 ☒ 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 (§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 ☒ No ☐

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 ☐  
Non-accelerated filer ☒

Accelerated Filer ☐  
Smaller reporting company ☐

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

Number of shares outstanding of registrant's class of common stock as of July 18, 2011: 14,325,589

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PART I - FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

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

	June 18, 2011	January 1, 2011
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$7,423	\$21,757
Accounts receivable - net	17,017	13,478
Income tax receivables	23	27
Inventory - net	17,682	11,647
Deferred income taxes	604	731
Other current assets	2,590	2,154
Total Current Assets	45,339	49,794
Property, plant and equipment - net	57,852	37,051
Goodwill	1,137	—
Software and intangible assets - net	3,509	2,727
Total Assets	\$107,837	\$89,572
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$12,718	\$10,058
Accrued salaries, wages, and benefits	2,511	2,242
Taxes payable	1,136	913
Current maturities of long-term debt	553	—
Other accrued expenses	1,333	1,139
Total Current Liabilities	18,251	14,352
Term Loan	10,000	—
Long-term debt, less current maturities	1,591	—
Deferred income taxes	1,952	1,676
Total Liabilities	31,794	16,028
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock - 18,000,000 shares authorized at \$0.01 par value, 14,322,053 and 14,220,321 shares issued and outstanding at June 18, 2011 and January 1, 2011, respectively	143	142
Additional paid-in capital	70,973	69,532
Retained earnings	4,927	3,870
Total Stockholders' Equity	76,043	73,544
Total Liabilities and Stockholders' Equity	\$107,837	\$89,572

See accompanying notes to financial statements.



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

	Second Quarter Ended,		First Half Ended,	
	June 18, 2011	June 19, 2010	June 18, 2011	June 19, 2010
Sales	\$31,968	\$25,338	\$60,707	\$49,343
Operating expenses -				
Operating costs	24,729	18,323	47,241	35,941
Selling, general, and administrative expenses	4,815	4,285	9,356	8,503
Depreciation and amortization	1,215	1,055	2,325	2,084
Loss (gain) on disposal of fixed assets – net	(12)	) 39	(12)	) 39
Operating income	1,221	1,636	1,797	2,776
Interest expense – net	10	—	14	—
Income before income taxes	1,211	1,636	1,783	2,776
Provision for income taxes	492	705	726	1,183
Net income	\$719	\$931	\$1,057	\$1,593
Net income per share: basic	\$0.05	\$0.09	\$0.07	\$0.15
Net income per share: diluted	\$0.05	\$0.08	\$0.07	\$0.15
Number of weighted average shares outstanding: basic	14,306	10,909	14,277	10,811
Number of weighted average shares outstanding: diluted	14,750	10,973	14,583	10,871

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
Balance, January 1, 2011	14,220,321	\$ 142	\$69,532	\$3,870	\$73,544
Net income	—	—	—	1,057	1,057
Issuance of common stock – Warrior acquisition	64,516	1	799	—	800
Issuance of common stock – ESPP	9,513	—	114	—	114
Conversion of restricted shares to common stock	26,492	—	166	—	166
Exercise of stock options	1,211	—	16	—	16
Share-based compensation	—	—	346	—	346
Balance, June 18, 2011	14,322,053	\$ 143	\$70,973	\$4,927	\$76,043

See accompanying notes to financial statements.

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

	First Half Ended,	
	June 18, 2011	June 19, 2010
Cash flows from Operating Activities:		
Net income	\$1,057	\$1,593
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,325	2,084
Bad debt provision	268	418
Share-based compensation	511	264
Deferred rent	22	24
Non-cash interest expense	14	—
Deferred taxes	403	(111)
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	(3,729)	(2,016)
Decrease (increase) in income tax receivables	4	350
Decrease (increase) in inventory	(6,035)	(1,465)
Decrease (increase) in prepaid and other current assets	(437)	(298)
Increase (decrease) in accounts payable	1,144	1,994
Increase (decrease) in accrued expenses	676	229
Cash provided by (used in) operating activities	(3,777)	3,066
Cash flows from Investing Activities:		
Capital expenditures	(19,197)	(3,465)
Software and intangible asset expenditures	(316)	(40)
Business acquisitions, net of cash acquired	(921)	—
Cash used in investing activities	(20,434)	(3,505)
Cash flows from Financing Activities:		
Proceeds from issuance of common stock	114	22,076
Proceeds from the exercise of stock options	13	—
Tax benefit from the exercise of stock options	4	—
Proceeds from term loan	10,000	—
Repayments of note payable - affiliates	(254)	—
Cash provided by financing activities	9,877	22,076
Net increase (decrease) in cash and cash equivalents	(14,334)	21,637
Cash and cash equivalents, beginning of period	21,757	1,090
Cash and cash equivalents, end of period	\$7,423	\$22,727
Supplemental disclosure of cash flow information:		
Income taxes paid	201	954
Supplemental disclosure of non-cash information:		
Payables for construction in process	4,910	759
Business acquisitions, liabilities assumed	15	—



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Business acquisitions, notes issued	2,384	—
Issuance of common stock – Warrior acquisition	800	—

See accompanying notes to financial statements.

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

June 18, 2011  
(Unaudited)

(1) BASIS OF PRESENTATION

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 unaudited interim financial statements included herein have been prepared by the Company in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and in accordance with Rule 10-01 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Operating results for interim periods are not necessarily indicative of results that may be expected for the year as a whole. In the opinion of the Company's management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. These financial statements and notes thereto should be read in conjunction with the Company's audited financial statements for the fiscal year ended January 1, 2011 included in the Company's Annual Report on Form 10-K for fiscal year 2010 filed with the United States Securities and Exchange Commission on March 4, 2011. The balance sheet data at January 1, 2011 included in this Form 10-Q was derived from the Company's audited financial statements, but does not include all disclosures required by GAAP.

The Company's fiscal year ends on the Saturday closest to December 31. The most recent fiscal year ended on January 1, 2011. Each of our first three fiscal quarters consists of twelve weeks while our last fiscal quarter consists of sixteen or seventeen weeks. Interim results are presented for the twelve-week and twenty-four week periods ended June 18, 2011 and June 19, 2010, each referred to as "second quarter ended" or "second fiscal quarter of 2011" or "second fiscal quarter of 2010" and "first half of fiscal 2011" and "first half of fiscal 2010", respectively.

The Company, in the first quarter of fiscal 2011, began reporting its operations as two reportable segments: "Environmental Services" and "Oil Business". The Company began segment reporting during the first fiscal quarter of 2011 as the projected results included in the fiscal 2011 budget presented to the board of directors and the chief operating decision maker were divided into these segments (see Note 12 on Segment Information for further details).

Reclassifications

The Company, in the first quarter of fiscal 2011, began reporting its consolidated statements of operations in a different format. The Company has combined cost of sales and operating costs into a single category named operating costs within the heading of operating expenses. Additionally, depreciation and amortization expenses are now removed from the previously presented operating costs and selling, general and administrative expenses categories and presented separately within the operating expenses group. The Company has decided to make these changes so that the Company's presentation is consistent with that of its peers and believes that the new presentation, along with segment reporting, will provide a better understanding of the Company's operating results.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with 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 and valuation of inventory at lower of cost or market. Actual results could differ from those estimates.

#### Operating Costs

Within operating costs are cost of sales. Cost of sales includes the costs of the materials the Company sells and provides in its services, such as solvent and other chemicals, depreciation on the parts cleaning machines the Company owns and provides

to customers, cleaning machines sold to customers, transportation of solvents and waste, and payments to other 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 its net realizable value.

Operating costs include the Company's costs of operating its branch system and hubs, including personnel costs (including commissions), facility rent, and truck leases, fuel and maintenance.

#### 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, trade receivables, trade payables and notes payable. As of June 18, 2011 and January 1, 2011, the carrying values of cash, trade receivables, trade payables, and notes payable are considered to be representative of their respective fair values.

#### Acquisitions

The Company accounts for acquired businesses using the purchase method of accounting, which requires that the assets acquired, liabilities assumed, contractual contingencies 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 has recorded a preliminary purchase price allocation for its acquisition. The Company will finalize the purchase price allocation as additional information, relative to the fair values of the assets acquired becomes known.

#### Identifiable Intangible Assets

The fair value of identifiable intangible assets are 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.

## 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 will test goodwill for impairment annually and in interim periods if changes in circumstances indicate that the carrying amount of goodwill may not be recoverable.

## New Accounting Pronouncements

### Business Combinations: Disclosure of Supplementary Pro Forma Information

In December 2010, the FASB issued ASU No. 2010-29, "Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations (a consensus of the FASB Emerging Issues Task Force)," which amends authoritative guidance on business combinations regarding how public entities disclose supplemental pro forma information for business combinations that occur during the year. Entities that present comparative financial statements for business combinations must disclose the revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the prior annual reporting period. The authoritative guidance also expanded the disclosures for entities to provide the nature and amount of material, nonrecurring pro forma adjustments directly related to the business combination that is included in the reported pro forma revenue and earnings. The authoritative guidance is effective for business combinations completed in the periods beginning after December 15, 2010 and is applied prospectively as of the date of adoption. The Company adopted the authoritative guidance on January 2, 2011. The Company has determined that the asset purchase as described in Note 3 Business Combination was immaterial from a financial statement perspective and therefore has not presented pro forma financial information.

### Fair Value Measurements and Disclosures

In May 2011, the FASB issued Accounting Standards Update No. 2011-04 ("ASU 2011-04"), Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. This update provides guidance that is expected to result in common fair value measurement and disclosure requirements between U.S. GAAP and IFRS, and changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. This update is not intended to result in a change in the application of the requirements in Topic 820. The amendments in this update include those that clarify the FASB's intent about the application of existing fair value measurement requirements and those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this update are effective for interim and annual periods beginning after December 15, 2011, and are to be applied prospectively. The Company does not expect the adoption of ASU 2011-04 to have a material effect on its consolidated financial results.

### (3) BUSINESS COMBINATION

On February 23, 2011, the Company acquired certain assets and liabilities of Warrior Oil Service, Inc., JBS Oil, Inc., C&J Recovery, LLC, and affiliates, a group of related companies (collectively, "Warrior Group") in exchange for \$0.9 million in cash, \$0.8 million of the Company's common stock, and \$2.6 million in subordinated notes. The preliminary purchase price allocation resulted in allocating \$2.1 million to property, plant and equipment, \$1.1 million to goodwill, \$0.8 million to intangible assets, and \$0.1 million to inventory for a total of \$4.1 million. The difference between the consideration of \$4.3 million and the allocation of \$4.1 million is due to the non-interest bearing promissory notes being recorded at their net present value which is \$0.2 million less than the face value of the notes. The Company has recorded expense of less than \$0.1 million in transaction costs related to this acquisition.

The Company is continuing to evaluate the initial purchase price allocations for the acquisition and will adjust the allocations if additional information, relative to the fair values of the assets and liabilities becomes known. The Company acquired the Warrior Group to add used oil collection volume primarily in the states of Indiana, Illinois, and Kentucky. The operating results of the Warrior Group acquisition are included in the Company's consolidated results of operations and also in the Oil Business segment from the date of acquisition. In addition, the Company has allocated the assets acquired, including goodwill, to the Oil Business segment.

In the second fiscal quarter and first half of 2011, the Company also acquired small tuck-in acquisitions that have been immaterial to the financial statements.





(4) ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following (in thousands):

	June 18, 2011	January 1, 2011
Trade	\$17,319	\$13,914
Less allowance for doubtful accounts	(641)	(647)
Trade - net	16,678	13,267
Trade - affiliates	174	102
Other	165	109
Total accounts receivable - net	\$17,017	\$13,478

The following table provides the changes in the Company's allowance for doubtful accounts for the first half ended June 18, 2011 and the fiscal year ended January 1, 2011 (in thousands):

	June 18, 2011	January 1, 2011
Balance at beginning of period	\$647	\$601
Provision for bad debts	268	767
Accounts written off, net of recoveries	(274)	(721)
Balance at end of period	\$641	\$647

## (5) INVENTORY

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

	June 18, 2011	January 1, 2011
Machines	\$2,362	\$2,502
Solvents	8,111	5,622
Oil	4,877	1,175
Drums	1,146	1,350
Accessories	1,356	1,183
Total inventory	17,852	11,832
Less reserves	(170	) (185
Total inventory - net	\$17,682	\$11,647

Inventory consists primarily of new and used solvents and used oil, new and refurbished parts cleaning machines, drums, accessories and absorbents and repair parts. 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) OTHER ASSETS

Other current assets consisted of the following (in thousands):

	June 18, 2011	January 1, 2011
Prepaid and other current assets	\$2,590	\$1,798
Prepaid income taxes	—	356
Total other current assets	\$2,590	\$2,154

## (7) PROPERTY, PLANT AND EQUIPMENT

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

	June 18, 2011	January 1, 2011
Land <sup>(a)</sup>	\$414	\$183
Buildings and storage tanks <sup>(a)</sup>	4,168	3,602
Leasehold improvements <sup>(a)</sup>	632	600
In-service equipment	34,438	32,213
Machinery, vehicles and equipment <sup>(a)</sup>	13,922	12,553
Construction in progress	30,329	12,010
Total property, plant and equipment	83,903	61,161
Less accumulated depreciation	(26,051)	(24,110)
Property, plant and equipment - net	\$57,852	\$37,051

<sup>(a)</sup> Includes preliminary fair values of assets acquired in the acquisition described in Note 3 that may be adjusted as additional information becomes known.

## (8) SOFTWARE AND OTHER INTANGIBLE ASSETS

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

	June 18, 2011			January 1, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Software	\$ 3,527	\$ 2,225	\$ 1,302	\$ 3,345	\$ 2,071	\$ 1,274
Patents	1,048	158	890	1,007	109	898
Non-competes <sup>(a)</sup>	617	311	306	455	269	186
Other <sup>(a)</sup>	1,115	104	1,011	440	71	369
Total software and intangible assets	\$ 6,307	\$ 2,798	\$ 3,509	\$ 5,247	\$ 2,520	\$ 2,727

<sup>(a)</sup> Includes 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 \$0.3 million for the first half ended June 18, 2011 and \$0.5 million for fiscal year ended January 1, 2011. The weighted average useful lives of software, patents, non-competes and other intangibles was 9 years, 15 years, 5 years and 8 years, respectively. The expected amortization expense for fiscal years 2011, 2012, 2013, 2014 and 2015 is \$0.6 million, \$0.5 million, \$0.4 million, \$0.3 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.

(9) ACCOUNTS PAYABLE

Accounts payable consisted of the following (in thousands):

	June 18, 2011	January 1, 2011
Accounts payable	\$12,698	\$9,886
Accounts payable - affiliates	20	172
Total accounts payable	\$12,718	\$10,058

(10) OTHER ACCRUED EXPENSES

Other accrued expenses consisted of the following (in thousands):

	June 18, 2011	January 1, 2011
Workers compensation	\$474	\$381
Other	859	758
Total other accrued expenses	\$1,333	\$1,139

## (11) DEBT AND FINANCING ARRANGEMENTS

### Bank Credit Facility

In March 2011, the Company amended its secured bank credit facility to allow for up to \$40 million in borrowings, of which \$20 million is available as a term loan having a maturity date of March 15, 2016. The remaining \$20 million is available as a revolving loan which expires on December 14, 2012. On June 9, 2011, the Company borrowed \$10 million under the term loan. The Company did not have any amounts outstanding under the credit facility during fiscal year 2010. Under the terms of the credit facility, interest is payable monthly at the prime rate plus 25 basis points, unless the total leverage ratio is greater than or equal to 2.75 to 1. The allowed total leverage ratio is on a graduated scale that allows for maximum total leverage ratios from 3.25 to 1 to 4.0 to 1. The credit facility also includes an excess cash flow provision that requires additional principal payments on the term loan if the excess earnings before interest, taxes, depreciation and amortization ("EBITDA") for the fiscal year exceeds the formula rate set forth in the credit facility. Amounts borrowed under the credit facility are secured by substantially all of the Company's tangible and intangible assets. As of June 18, 2011, and January 1, 2011, we were in compliance with all covenants under the credit facility. As of June 18, 2011, and January 1, 2011, the Company had \$0.3 million and \$0.2 million of standby letters of credit issued, respectively, and \$29.7 million and \$29.8 million was available for borrowing under the bank credit facility, respectively.

### Notes Payable

On February 23, 2011, the Company executed promissory notes with each of the three entities of the Warrior Group with a combined face value of \$2.6 million in conjunction with the acquisition of the Warrior Group. The three principals of the Warrior Group are currently employees of the Company. Each of the promissory notes are non-interest bearing and are subordinated to the Company's secured bank credit facility. The promissory notes require quarterly principal payments and have maturity dates of February 1, 2014 and November 1, 2015. The promissory notes are recorded at the net present value of the notes of approximately \$2.1 million as of June 18, 2011 of which \$0.6 million is recorded as current maturities of long-term debt. In the first half of 2011, the Company made principal payments of \$0.3 million on the notes. In the second quarter and first half of 2011, the Company accrued imputed interest expense on these notes of \$10,078 and \$13,798, respectively.

## (12) SEGMENT INFORMATION

Beginning in the first quarter of fiscal 2011, the Company began reporting its operations as two reportable segments: "Environmental Services" and "Oil Business". The Company began segment reporting during the first quarter of fiscal 2011 as the projected results included in the fiscal 2011 budget presented to the board of directors and the chief operating decision maker were divided into these segments. The Company's chief operating decision maker uses profit before corporate selling, general and administrative expenses ("SG&A") as a key measure of segment profitability. The Company defines profit before SG&A as sales less operating costs and depreciation and amortization.

The Environmental Services segment consists of the Company's parts cleaning, containerized waste management and vacuum truck service activities. The Oil Business segment consists of the Company's used oil collection and used oil re-refining activities. All of the Company's operations are derived domestically in the United States. There were no intersegment sales and no single customer accounted for more than 10% of the Company's consolidated sales.





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Operating segment results for the second quarter and first half ended June 18, 2011 and June 19, 2010 were as follows (in thousands):

Second Quarter Ended,  
June 18, 2011

	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Sales	\$ 27,641	\$ 4,327	\$ —	\$ 31,968
Operating expenses				
Operating costs	20,051	4,678	—	24,729
Operating depreciation and amortization	959	89	—	1,048
Profit (loss) before corporate selling, general, and administrative expenses	6,631	(440 )		6,191
Selling, general, and administrative expenses	—	—	4,815	4,815
Depreciation and amortization from SG&A	—	—	167	167
Total selling, general, and administrative expenses			4,982	4,982
Loss (gain) from disposal of fixed assets	—	—	(12 )	(12 )
Operating income				1,221
Interest expense - net	—	—	10	10
Income before income taxes				1,211
Provision for income taxes	—	—	492	492
Net income				\$ 719

Second Quarter Ended,  
June 19, 2010

	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Sales	\$ 24,132	\$ 1,206	\$ —	\$ 25,338
Operating expenses				
Operating costs	16,609	1,714	—	18,323
Operating depreciation and amortization	896	9	—	905
Profit (loss) before corporate selling, general, and administrative expenses	6,627	(517 )		6,110
Selling, general, and administrative expenses	—	—	4,285	4,285

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Depreciation and amortization from SG&A	—	—	150	150
Total selling, general, and administrative expenses			4,435	4,435
Loss (gain) from disposal of fixed assets	—	—	39	39
Operating income				1,636
Interest expense - net	—	—	—	—
Income before income taxes				1,636
Provision for income taxes	—	—	705	705
Net income				\$931

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First Half Ended,  
June 18, 2011

	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Sales	\$53,753	\$6,954	\$—	\$60,707
Operating expenses				
Operating costs	39,197	8,044	—	47,241
Operating depreciation and amortization	1,894	127	—	2,021
Profit (loss) before corporate selling, general, and administrative expenses	12,662	(1,217	)	11,445
Selling, general, and administrative expenses	—	—	9,356	9,356
Depreciation and amortization from SG&A	—	—	304	304
Total selling, general, and administrative expenses			9,660	9,660
Loss (gain) from disposal of fixed assets	—	—	(12	) (12
Operating income				1,797
Interest expense - net	—	—	—	14
Income before income taxes				1,783
Provision for income taxes	—	—	726	726
Net income				\$1,057

First Half Ended,  
June 19, 2010

	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Sales	\$46,896	\$2,447	\$—	\$49,343
Operating expenses				
Operating costs	32,731	3,210	—	35,941
Operating depreciation and amortization	1,771	17	—	1,788
Profit (loss) before corporate selling, general, and administrative expenses	12,394	(780	)	11,614
Selling, general, and administrative expenses	—	—	8,503	8,503
Depreciation and amortization from SG&A	—	—	296	296

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Total selling, general, and administrative expenses			8,799	8,799
Loss (gain) from disposal of fixed assets	—	—	39	39
Operating income				2,776
Interest expense - net	—	—	—	—
Income before income taxes				2,776
Provision for income taxes	—	—	1,183	1,183
Net income				\$ 1,593

Total assets by segment as of June 18, 2011 and January 1, 2011 were as follows (in thousands):

	June 18, 2011	January 1, 2011
Total Assets:		
Environmental Services	\$ 29,681	\$ 26,498
Oil Business	39,468	13,261
Unallocated corporate assets	38,688	49,813
Total^	\$ 107,837	\$ 89,572

^Allocations of assets between segments at January 1, 2011 have been adjusted from those previously reported to reflect the Company's increased investment in the used oil re-refinery. Total assets reported as of January 1, 2011 have not changed.

Segment assets for the Environmental Services and Oil Business segments consist of property, plant, and equipment, intangible assets, and inventories allocated to each segment. Oil Business assets include the preliminary fair values of assets acquired from the Warrior Group, including goodwill. Assets for the Corporate unallocated amounts consist of property, plant, and equipment used at the Corporate headquarters, as well as cash, accounts receivable, and tax assets.

### (13) COMMITMENTS AND CONTINGENCIES

The Company may enter into purchase obligations with certain vendors. These purchase obligations are generally cancelable without notice, without penalty, although certain vendor agreements provide for cancellation fees or penalties depending on the terms of the contract.

The Company has purchase obligations in the form of open purchase orders of \$14.2 million as of June 18, 2011, of which \$6.1 million is related to the construction of the Company's used oil re-refinery. The remaining \$8.1 million is primarily for solvent and machine purchases as well as disposal expense.

The Company may be subject to investigations, claims or lawsuits as a result of operating its business, including matters governed by environmental laws and regulations. When claims are asserted, the Company evaluates the likelihood that a loss will occur and records a liability for those instances when the likelihood is deemed probable and the exposure is reasonably estimable. The Company carries insurance at levels it believes are adequate to cover loss contingencies based on historical claims activity. When the potential loss exposure is limited to the insurance deductible and the likelihood of loss is determined to be probable, the Company accrues for the amount of the required deductible, unless a lower amount of exposure is estimated. As of June 18, 2011 and January 1, 2011, the Company had accrued \$0.2 million and \$0.2 million related to loss contingencies, respectively.

On October 1, 2010, Ecological Services, Inc. ("ESI"), a non-hazardous wastewater treatment facility in Indiana, filed a Chapter 7 Bankruptcy proceeding. The U.S. Environmental Protection Agency ("EPA") has determined that the Company was the third largest Potential Responsible Party ("PRP") of waste to the site over the last six years of ESI's operation and assigned the Company the proportional share of 9.5% of the costs related to the clean up of the ESI site.

On March 30, 2011, the Company signed an Administrative Consent Agreement with the EPA and the other significant PRPs to manage storm water at the site and clean the process residues from tanks (the "Consent Agreement"). Under the Consent Agreement, the PRPs are responsible for the EPA's past and future costs and the cost of removing all waste and chemicals remaining at the ESI site.

The EPA's cost estimate for waste removal and other remediation at the site is \$2.4 million. The Company's best estimate of its proportional share of the total exposure is \$162,000. As of June 18, 2011, the Company had paid \$154,000 in remediation costs to the fund, of which \$95,000 related to costs already incurred, before consideration for

any insurance reimbursement the Company may receive. The Company filed a claim with its insurance carrier for coverage under an existing policy. The Company has also filed a claim under ESI's environmental insurance policy under which it is listed as an additional insured. The Company received \$5,000 from its insurance carrier in the second quarter for its obligation, but the Company's insurance provider has declined to make subsequent payments. The Company intends to challenge its insurance carrier's position regarding coverage and to also pursue insurance coverage under ESI's environmental insurance policy.

# (14) INCOME TAXES

The Company's effective tax rate for the second fiscal quarter of 2011 was 40.6% compared to 43.1% in the second fiscal quarter of 2010. The Company's effective tax rate for the first half of 2011 was 40.7% compared to 42.6% in the first half of 2010. The reduction in the tax rate is due to the Company's non-deductible expenses for income taxes being at a lower percentage of income in the first half of 2011 when compared to the first half of 2010.

The Company has not provided for any valuation allowance as it believes the realization of its deferred tax assets is more likely than not based on the expectation of future taxable income.

# (15) SHARE-BASED COMPENSATION

The aggregate number of shares of common stock which may be issued under the Company's 2008 Omnibus Plan ("Plan") is 1,902,077 plus any common stock that becomes available for issuance pursuant to the reusage provision of the Plan. As of June 18, 2011, the number of shares available for issuance under the Plan was 869,942 shares.

## Stock Option Awards

A summary of stock option activity under this Plan is as follows:

Stock Options	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value as of Date Listed (in thousands)
Outstanding at January 1, 2011	889,654	\$ 10.76	7.39	\$430
Granted	—			
Exercised	(1,211)	) 7.33		
Options outstanding at June 18, 2011	888,443	10.77	6.93	5,441