

MGP INGREDIENTS INC  
Form 10-Q  
November 01, 2018

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 September 30, 2018  
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: 0-17196

MGP INGREDIENTS, INC.  
(Exact name of registrant as specified in its charter)

KANSAS 45-4082531  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

100 Commercial Street, Atchison, Kansas 66002  
(Address of principal executive offices) (Zip Code)

(913) 367-1480  
(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, a non-accelerated filer, a smaller reporting company, or an "emerging growth company." See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  
 Non-accelerated filer (Do not check if smaller reporting company)  Smaller Reporting Company  
 Emerging growth company

Edgar Filing: MGP INGREDIENTS INC - Form 10-Q

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.

16,856,414 shares of Common Stock, no par value as of October 26, 2018

---

## INDEX

| <u>PART I. FINANCIAL INFORMATION</u>   | Page      |
|--|-----------|
| <u>Item 1. Condensed Consolidated Financial Statements</u>   |           |
| <u>Condensed Consolidated Statements of Income (Unaudited)</u>                                       | <u>3</u>  |
| <u>Condensed Consolidated Statements of Comprehensive Income (Unaudited)</u>                         | <u>4</u>  |
| <u>Condensed Consolidated Balance Sheets (Unaudited)</u>   | <u>5</u>  |
| <u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u>                                   | <u>6</u>  |
| <u>Condensed Consolidated Statement of Changes in Stockholders' Equity (Unaudited)</u>               | <u>7</u>  |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>                                | <u>8</u>  |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | <u>18</u> |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>                            | <u>30</u> |
| <u>Item 4. Controls and Procedures</u>   | <u>30</u> |
| <u>PART II. OTHER INFORMATION</u>  |           |
| <u>Item 1. Legal Proceedings</u>   | <u>31</u> |
| <u>Item 1A. Risk Factors</u>   | <u>31</u> |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>                           | <u>31</u> |
| <u>Item 3. Defaults Upon Senior Securities</u>   | <u>31</u> |
| <u>Item 4. Mine Safety Disclosures</u>   | <u>31</u> |
| <u>Item 5. Other Information</u>   | <u>31</u> |
| <u>Item 6. Exhibits</u>  | <u>32</u> |

## METHOD OF PRESENTATION

Throughout this Report, when we refer to "the Company," "MGP," "we," "us," "our," and words of similar import, we are referring to the combined business of MGP Ingredients, Inc. and its consolidated subsidiaries, except to the extent that the context otherwise indicates. In this document, for any references to Note 1 through Note 10, refer to the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1.

All amounts in this report, except for share, par values, bushels, gallons, pounds, mmbtu, proof gallons, per share, per bushel, per gallon, per proof gallon and percentage amounts, are shown in thousands unless otherwise noted.

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## MGP INGREDIENTS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in thousands, except per share amounts)

|  | Quarter Ended      |                    | Year to Date Ended |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2018 | September 30, 2017 | September 30, 2018 | September 30, 2017 |
| Net sales  | \$95,031           | \$ 86,333          | \$271,239          | \$ 259,255         |
| Cost of sales <sup>(a)</sup>   | 75,432             | 67,708             | 213,248            | 202,764            |
| Gross profit   | 19,599             | 18,625             | 57,991             | 56,491             |
| Selling, general and administrative expenses   | 7,584              | 8,154              | 24,455             | 24,114             |
| Operating income   | 12,015             | 10,471             | 33,536             | 32,377             |
| Gain on sale of equity method investment (Note 3)  | —                  | 11,381             | —                  | 11,381             |
| Equity method investment loss (Note 3)   | —                  | —                  | —                  | (348 )             |
| Interest expense, net  | (334 )             | (224 )             | (830 )             | (934 )             |
| Income before income taxes   | 11,681             | 21,628             | 32,706             | 42,476             |
| Income tax expense (Note 5)  | 2,673              | 7,491              | 7,244              | 13,292             |
| Net income   | \$9,008            | \$ 14,137          | \$25,462           | \$ 29,184          |
| Income attributable to participating securities  | 174                | 414                | 491                | 806                |
| Net income attributable to common shareholders and used in earnings per share calculation (Note 6) | \$8,834            | \$ 13,723          | \$24,971           | \$ 28,378          |
| Share information:   |                    |                    |                    |                    |
| Basic and Diluted weighted average common shares   | 16,872,091         | 16,751,346         | 16,861,700         | 16,735,378         |
| Basic and diluted earnings per common share  | \$0.52             | \$ 0.82            | \$1.48             | \$ 1.70            |
| Dividends and dividend equivalents per common share  | \$0.08             | \$ 0.89            | \$0.24             | \$ 0.97            |

(a) Includes related party purchases of \$0 and \$18,425 for year to date September 30, 2018 and 2017, respectively. There were no related party purchases for the quarters ended September 30, 2018 and 2017.

See accompanying notes to unaudited condensed consolidated financial statements

3

---

MGP INGREDIENTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(Dollars in thousands)

|  | Quarter Ended |               | Year to Date Ended |               |
|--|---------------|---------------|--------------------|---------------|
|  | September 30, | September 30, | September 30,      | September 30, |
|  | 2018          | 2017          | 2018               | 2017          |
| Net income                                     | \$9,008       | \$ 14,137     | \$25,462           | \$ 29,184     |
| Other comprehensive income (loss), net of tax: |               |               |                    |               |
| Change in post-employment benefits             | 14            | (39           | ) 42               | (120          |
| Other comprehensive income (loss)              | 14            | (39           | ) 42               | (120          |
| Comprehensive income                           | \$9,022       | \$ 14,098     | \$25,504           | \$ 29,064     |

See accompanying notes to unaudited condensed consolidated financial statements

4

---

MGP INGREDIENTS, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)  
 (Dollars in thousands)

|  | September 30,<br>2018 | December 31,<br>2017 |
|--|-----------------------|----------------------|
| <b>Current Assets</b>  |                       |                      |
| Cash and cash equivalents  | \$ —                  | \$ 3,084             |
| Receivables (less allowance for doubtful accounts: September 30, 2018 and December 31, 2017 - \$24)  | 49,991                | 34,347               |
| Inventory  | 107,346               | 93,149               |
| Prepaid expenses   | 1,885                 | 2,182                |
| Refundable income taxes  | 2,011                 | 1,980                |
| Total current assets   | 161,233               | 134,742              |
| <b>Property and equipment</b>  |                       |                      |
| Property and equipment   | 282,271               | 267,288              |
| Less accumulated depreciation and amortization   | (172,344)             | (164,237)            |
| Property and equipment, net  | 109,927               | 103,051              |
| Other assets   | 2,420                 | 2,535                |
| Total assets   | \$ 273,580            | \$ 240,328           |
| <b>Current Liabilities</b>   |                       |                      |
| Current maturities of long-term debt   | \$ 382                | \$ 372               |
| Accounts payable   | 22,905                | 30,037               |
| Accrued expenses   | 8,545                 | 11,171               |
| Total current liabilities  | 31,832                | 41,580               |
| <b>Long-term debt, less current maturities</b>   |                       |                      |
| Long-term debt, less current maturities  | 21,133                | 21,407               |
| Credit agreement - revolver  | 23,605                | 2,775                |
| Deferred credits   | 1,687                 | 2,151                |
| Accrued retirement, health and life insurance benefits   | 2,913                 | 3,133                |
| Other noncurrent liabilities   | 1,112                 | 540                  |
| Deferred income taxes  | 936                   | 12                   |
| Total liabilities  | 83,218                | 71,598               |
| <b>Contingencies (Note 7)</b>  |                       |                      |
| <b>Stockholders' Equity</b>  |                       |                      |
| <b>Capital stock</b>   |                       |                      |
| Preferred, 5% non-cumulative; \$10 par value; authorized 1,000 shares; issued and outstanding 437 shares   | 4                     | 4                    |
| <b>Common stock</b>  |                       |                      |
| No par value; authorized 40,000,000 shares; issued 18,115,965 shares at September 30, 2018 and December 31, 2017, and 16,851,916 and 16,797,420 shares outstanding at September 30, 2018 and December 31, 2017, respectively | 6,715                 | 6,715                |
| Additional paid-in capital   | 14,888                | 13,912               |
| Retained earnings  | 188,469               | 167,129              |
| Accumulated other comprehensive loss   | (269)                 | (311)                |
| Treasury stock, at cost  |                       |                      |
| Shares of 1,264,049 at September 30, 2018 and 1,318,545 at December 31, 2017   | (19,445)              | (18,719)             |



Edgar Filing: MGP INGREDIENTS INC - Form 10-Q

|  |            |            |
|--|------------|------------|
| Total stockholders' equity                 | 190,362    | 168,730    |
| Total liabilities and stockholders' equity | \$ 273,580 | \$ 240,328 |

See accompanying notes to unaudited condensed consolidated financial statements

5

---

MGP INGREDIENTS, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)  
 (Dollars in thousands)

|   | Year to Date Ended    |                       |
|---|-----------------------|-----------------------|
|   | September 30,<br>2018 | September 30,<br>2017 |
| Cash Flows from Operating Activities  |                       |                       |
| Net income  | \$25,462              | \$ 29,184             |
| Adjustments to reconcile net income to net cash provided by operating activities: |                       |                       |
| Depreciation and amortization   | 8,529                 | 8,441                 |
| Distributions received from equity method investee                                | —                     | 7,131                 |
| Deferred income taxes   | 924                   | 356                   |
| Share-based compensation  | 2,464                 | 2,130                 |
| Gain on sale of equity method investment  | —                     | (11,381 )             |
| Equity method investment loss   | —                     | 348                   |
| Changes in operating assets and liabilities:                                      |                       |                       |
| Receivables, net  | (15,644 )             | (11,366 )             |
| Inventory   | (14,197 )             | (10,794 )             |
| Prepaid expenses  | 297                   | (824 )                |
| Accounts payable  | (3,453 )              | 4,193                 |
| Accounts payable to affiliate, net  | —                     | (3,349 )              |
| Accrued expenses  | (2,623 )              | 790                   |
| Income taxes payable/refundable   | (31 )                 | 2,472                 |
| Deferred credit   | (464 )                | (617 )                |
| Accrued retirement health and life insurance benefits                             | 395                   | (267 )                |
| Net cash provided by operating activities   | 1,659                 | 16,447                |
| Cash Flows from Investing Activities  |                       |                       |
| Additions to plant, property and equipment  | (18,870 )             | (13,630 )             |
| Return of equity method investment  | —                     | 22,832                |
| Proceeds from property insurance recoveries                                       | —                     | 14                    |
| Net cash provided by (used in) investing activities                               | (18,870 )             | 9,216                 |
| Cash Flows from Financing Activities  |                       |                       |
| Purchase of treasury stock for tax withholding on equity-based compensation       | (2,215 )              | (1,377 )              |
| Payment of dividends and dividend equivalents                                     | (4,125 )              | (16,692 )             |
| Proceeds on long-term debt  | —                     | 20,000                |
| Principal payments on long-term debt  | (279 )                | (268 )                |
| Proceeds from credit agreement - revolver   | 22,766                | 20,580                |
| Payments on credit agreement - revolver   | (2,020 )              | (41,985 )             |
| Loan fees incurred with borrowings  | —                     | (377 )                |
| Net cash provided by (used in) financing activities                               | 14,127                | (20,119 )             |
| Increase (decrease) in cash and cash equivalents                                  | (3,084 )              | 5,544                 |
| Cash and cash equivalents, beginning of period                                    | 3,084                 | 1,569                 |
| Cash and cash equivalents, end of period  | \$—                   | \$ 7,113              |

See accompanying notes to unaudited condensed consolidated financial statements



MGP INGREDIENTS, INC.  
 CONDENSED CONSOLIDATED STATEMENT OF  
 CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

(Dollars in thousands)

|   | Capital<br>Stock<br>Preferred | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock | Total      |
|---|-------------------------------|-----------------|----------------------------------|----------------------|---|-------------------|------------|
| Balance, December 31, 2017  | \$ 4                          | \$ 6,715        | \$ 13,912                        | \$ 167,129           | \$ (311 )                                     | \$(18,719)        | \$ 168,730 |
| Comprehensive income:   |                               |                 |                                  |                      |   |                   |            |
| Net income  | —                             | —               | —                                | 25,462               | —   | —                 | 25,462     |
| Other comprehensive income  | —                             | —               | —                                | —                    | 42  | —                 | 42         |
| Dividends and dividend equivalents, net<br>of estimated forfeitures               | —                             | —               | —                                | (4,122 )             | —   | —                 | (4,122 )   |
| Share-based compensation  | —                             | —               | 2,049                            | —                    | —   | —                 | 2,049      |
| Stock shares awarded, forfeited, or<br>vested                                     | —                             | —               | (1,073 )                         | —                    | —   | 1,489             | 416        |
| Purchase of treasury stock for tax<br>withholding on equity-based<br>compensation | —                             | —               | —                                | —                    | —   | (2,215 )          | (2,215 )   |
| Balance, September 30, 2018   | \$ 4                          | \$ 6,715        | \$ 14,888                        | \$ 188,469           | \$ (269 )                                     | \$(19,445)        | \$ 190,362 |

See accompanying notes to unaudited condensed consolidated financial statements

7

---

MGP INGREDIENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, unless otherwise noted)

Note 1. Accounting Policies and Basis of Presentation

The Company. MGP Ingredients, Inc. ("Company") is a Kansas corporation headquartered in Atchison, Kansas and is a leading producer and supplier of premium distilled spirits and specialty wheat protein and starch food ingredients. Distilled spirits include premium bourbon and rye whiskeys and grain neutral spirits, including vodka and gin. MGP is also a top producer of high quality industrial alcohol for use in both food and non-food applications. The Company's protein and starch food ingredients provide a host of functional, nutritional, and sensory benefits for a wide range of food products to serve the packaged goods industry. The Company's distillery products are derived from corn and other grains (including rye, barley, wheat, barley malt, and milo), and its ingredient products are derived from wheat flour. The majority of the Company's sales are made directly or through distributors to manufacturers and processors of finished packaged goods or to bakeries.

Basis of Presentation and Principles of Consolidation. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. These unaudited condensed consolidated financial statements as of and for the quarter ended September 30, 2018 should be read in conjunction with the consolidated financial statements and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission ("SEC"). The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal and recurring adjustments) necessary to fairly present the results for interim periods in accordance with United States ("U.S.") generally accepted accounting principles ("GAAP"). Pursuant to the rules and regulations of the SEC, certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted.

Use of Estimates. The financial reporting policies of the Company conform to GAAP. The preparation of unaudited condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The application of certain of these policies places demands on management's judgment, with financial reporting results relying on estimation about the effects of matters that are inherently uncertain. For all of these policies, management cautions that future events rarely develop as forecast, and estimates routinely require adjustment and may require material adjustment.

Inventory. Inventory includes finished goods, raw materials in the form of agricultural commodities used in the production process and certain maintenance and repair items. Bourbon and whiskeys are normally aged in barrels for several years, following industry practice; all barreled bourbon and whiskey is classified as a current asset. The Company includes warehousing, insurance, and other carrying charges applicable to barreled whiskey in inventory costs.

Inventories are stated at lower of cost or net realizable value on the first-in, first-out, or FIFO, method. Inventory valuations are impacted by constantly changing prices paid for key materials, primarily corn. Inventory consists of the following:

Edgar Filing: MGP INGREDIENTS INC - Form 10-Q

|   | September 30, | December 31, |
|---|---------------|--------------|
|   | 2018          | 2017         |
| Finished goods                            | \$ 19,924     | \$ 13,284    |
| Barreled distillate (bourbon and whiskey) | 71,531        | 65,726       |
| Raw materials                             | 5,109         | 3,954        |
| Work in process                           | 1,551         | 1,935        |
| Maintenance materials                     | 7,555         | 7,256        |
| Other                                     | 1,676         | 994          |
| Total                                     | \$ 107,346    | \$ 93,149    |

8

---

Revenue Recognition. As a result of the adoption of Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers and related amendments ("Topic 606") on January 1, 2018, the Company has changed its accounting policy for revenue recognition (see Note 2). Revenue is recognized when control of the promised goods or services, through performance obligations by the Company, is transferred to the customer in an amount that reflects the consideration it expects to be entitled to in exchange for the performance obligations. The term between invoicing and when payment is due is not significant and the period between when the entity transfers the promised good or service to the customer and when the customer pays for that good or service is one year or less.

Excise taxes that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer are excluded from revenue. Revenue is recognized for the sale of products at the point in time finished products are delivered to the customer in accordance with shipping terms. This is a faithful depiction of the satisfaction of the performance obligation because, at that point control passes to the customer, the customer has legal title and the risk and rewards of ownership have transferred, and the customer has present obligation to pay.

The Company's distillery products segment routinely enters into bill and hold arrangements, whereby the Company produces and sells unaged distillate to customers, and the product is subsequently barreled at the customer's request and warehoused at a Company location for an extended period of time in accordance with directions received from the Company's customers. Even though the unaged distillate remains in the Company's possession, a sale is recognized at the point in time when the customer obtains control of the product. Control is transferred to the customer in bill and hold transactions when: customer acceptance specifications have been met, legal title has transferred, the customer has a present obligation to pay for the product, the risk and rewards of ownership have transferred to the customer, and all the following additional bill and hold criteria have been met: the customer has requested the product be warehoused, the product has been identified as separately belonging to the customer, the product is currently ready for physical transfer to the customer, and the Company does not have the ability to use the product or direct it to another customer.

Warehouse service revenue is recognized over the time that warehouse services are rendered and as they are rendered. This is a faithful depiction of the satisfaction of the performance obligation because control of the aging products has already passed to the customer and there are no additional performance activities required by the Company, except as requested by the customer. The performance of the service activities, as requested, is invoiced as satisfied and revenue is concurrently recognized.

Income Taxes. The Company accounts for income taxes using an asset and liability method which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis.

Earnings Per Share ("EPS"). Basic and diluted EPS are computed using the two-class method, which is an earnings allocation formula that determines net income per share for each class of Common Stock and participating security according to dividends declared and participation rights in undistributed earnings. Per share amounts are computed by dividing net income attributable to common shareholders by the weighted average shares outstanding during the period.

Fair Value of Financial Instruments. The Company determines the fair values of its financial instruments based on a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy is broken down into three levels based upon the observability of inputs. Fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if



any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value in its entirety requires judgment and considers factors specific to the asset or liability.

The Company's short term financial instruments include cash and cash equivalents, accounts receivable and accounts payable. The carrying value of the short term financial instruments approximates the fair value due to their short term nature. These financial instruments have no stated maturities or the financial instruments have short term maturities that approximate market.

The fair value of the Company's debt is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was \$45,045 and \$24,838 at September 30, 2018 and December 31, 2017, respectively. The financial statement carrying value of total debt was \$45,120 (including unamortized loan fees) and \$24,554 (including unamortized loan fees) at September 30, 2018 and December 31, 2017, respectively. These fair values are considered Level 2 under the fair value hierarchy.

**Recently Issued Accounting Pronouncements.** In July 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-09, Codification Improvements, which clarifies and corrects unintended application of guidance, and makes improvements to several Codification Topics. Most of the amendments are effective immediately. Some of the amendments are effective for Public business entities for annual and interim periods in fiscal years beginning after December 15, 2018, and for all other entities, for annual periods in fiscal years beginning after December 15, 2019, and interim periods in fiscal years beginning after December 15, 2020. Other amendments, which affect recently issued ASUs that are not yet effective, are effective with the original ASU. The Company is evaluating the effect that ASU 2018-09 will have on its consolidated financial statements and related disclosures.

In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases, which clarifies and corrects errors in ASC 842. The effective date and transition requirements in ASU 2018-10 are the same as the effective date and transition requirements of ASU 2016-02. The Company is evaluating the effect that ASU 2018-10 will have on its consolidated financial statements and related disclosures in conjunction with ASU 2016-02.

In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements, which creates a new, optional transition method for implementing ASU 2016-02 and a lessor practical expedient for separating lease and non-lease components. This ASU is effective for entities that have not early adopted ASU 2016-02, with the effective date of ASU 2016-02. It is effective for entities that have early adopted ASU 2016-02, upon issuance. However, it can only be adopted by entities either at (1) the beginning of the company's first reporting period after issuance or (2) the entity's mandatory ASC 842 effective date. The Company is evaluating the effect that ASU 2018-11 will have on its consolidated financial statements and related disclosures in conjunction with ASU 2016-02.

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. This ASU is effective for all entities for annual and interim periods in fiscal years beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period, (1) for public business entities for reporting periods for which financial statements have not yet been issued and (2) for all other entities for reporting periods for which financial statements have not yet been made available for issuance. The Company is evaluating the effect that ASU 2018-02 will have on its consolidated financial statements and related disclosures.

In January 2018, the FASB issued ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842, which clarifies that land easements are in the scope of ASU 2016-02, Leases, and provides transition relief. The effective date and transition requirements of ASU 2018-01 are the same as the effective date and transition requirements of ASU 2016-02 (see below). The Company expects to elect this practical expedient and not evaluate under Topic 842 existing or expired land easements.

In February 2016, the FASB issued ASU 2016-02, Leases, which aims to make leasing activities more transparent and comparable and requires substantially all leases be recognized by lessees on their balance sheet as a liability for lease payments and a right-of-use asset for its right to use the underlying asset during the lease term. This ASU is effective for public business entities for interim and annual reporting periods beginning after December 15, 2018. Although early adoption is permitted, the Company is not planning to early adopt the new standard, which replaces existing lease accounting guidance. The Company can elect to adopt ASC 2016-02 using a modified retrospective transition

method requiring application for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Alternatively, the Company can and has chosen to use its effective date as the date of initial application. The Company expects to elect all of the new standard's available transition practical expedients. This ASU will have no impact on the covenants of the Company's Credit Agreements, as changes in leasing standards are excluded from covenant calculations for the Credit Agreements. While the Company has not yet reached a conclusion on the overall impacts of adopting ASU 2016-02, management has identified its rail car lease obligations as being the primary operating lease pool impacted. As of December 31, 2017, the Company had operating leases for 223 rail cars.

Recently Adopted Accounting Standard Updates. In March 2017, the FASB issued ASU 2017-07, Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires companies to present the service cost component of net benefit cost in the same line items in which they report compensation cost. Companies will present all other components of net benefit cost outside operating income, if this subtotal is presented. This ASU was effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. The Company adopted ASU 2017-07 on January 1, 2018, with an immaterial impact on its financial results and presentation for the quarter and year to date ended September 30, 2018.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires companies to include cash and cash equivalents that have restrictions on withdrawal or use in total cash and cash equivalents on the statement of cash flows. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. The Company adopted ASU 2016-18 on January 1, 2018, and has determined that there was no impact to the presentation of the unaudited condensed consolidated statements of cash flows because the Company had no restricted cash for the quarter and year to date ended September 30, 2018 and 2017.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses eight classification issues related to the statement of cash flows: Debt prepayment or debt extinguishment costs; Settlement of zero coupon bonds; Contingent consideration payments made after a business combination; Proceeds from the settlement of insurance claims; Proceeds from the settlement of corporate owned life insurance policies, including bank owned life insurance policies; Distributions received from equity method investees; Beneficial interests in securitization transactions; and Separately identifiable cash flows and application of the predominance principle. This ASU was effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. The Company adopted ASU 2016-15 on January 1, 2018, and has determined that there was no impact to the presentation of the unaudited condensed consolidated statements of cash flows for the quarter and year to date ended September 30, 2018 and 2017.

## Note 2. Revenue

### Adoption of Topic 606, Revenue from Contracts with Customers

On January 1, 2018, the Company adopted Topic 606, using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Financial results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under Accounting Standards Codification 605, Revenue Recognition ("ASC 605"). The Company has completed its evaluation of the impact of Topic 606 and concluded that there is no impact to the financial statements as a result of its adoption. The Company recorded no adjustment to opening retained earnings as of January 1, 2018 related to the transition from ASC 605 to Topic 606 and there are no differences to disclose to reconcile financial statement activity as reported under Topic 606 to ASC 605 for the quarter and year to date ended September 30, 2018.

## Disaggregation of Revenue.

The following table presents the Company's revenues disaggregated by segment and major products and services.

|   | NET SALES     |                     | NET SALES          |                     |
|---|---------------|---------------------|--------------------|---------------------|
|   | Quarter Ended |                     | Year to Date Ended |                     |
|   | September 30, |                     | September 30,      |                     |
|   | 2018          | 2017 <sup>(a)</sup> | 2018               | 2017 <sup>(a)</sup> |
| <b>Distillery Products</b>              |               |                     |                    |                     |
| Premium beverage alcohol                | \$46,864      | \$43,941            | \$133,135          | \$131,868           |
| Industrial alcohol                      | 20,661        | 19,310              | 59,300             | 57,775              |
| Food grade alcohol                      | 67,525        | 63,251              | 192,435            | 189,643             |
| Fuel grade alcohol                      | 1,576         | 1,458               | 5,006              | 4,867               |
| Distillers feed and related co-products | 5,898         | 4,860               | 18,785             | 14,514              |
| Warehouse services                      | 3,337         | 2,766               | 9,139              | 7,960               |
| Total distillery products               | \$78,336      | \$72,335            | \$225,365          | \$216,984           |
| <b>Ingredient Solutions</b>             |               |                     |                    |                     |
| Specialty wheat starches                | \$7,030       | \$7,008             | \$21,170           | \$20,826            |
| Specialty wheat proteins                | 5,486         | 4,939               | 16,230             | 14,541              |
| Commodity wheat starch                  | 2,793         | 1,948               | 6,926              | 6,302               |
| Commodity wheat protein                 | 1,386         | 103                 | 1,548              | 602                 |
| Total ingredient solutions              | \$16,695      | \$13,998            | \$45,874           | \$42,271            |
| Total net sales                         | \$95,031      | \$86,333            | \$271,239          | \$259,255           |

<sup>(a)</sup> Prior period amounts were not adjusted upon adoption of Topic 606.

The following table presents the Company's revenues disaggregated by segment and timing of revenue recognition.

|   | NET SALES     |                     | NET SALES          |                     |
|---|---------------|---------------------|--------------------|---------------------|
|   | Quarter Ended |                     | Year to Date Ended |                     |
|   | September 30, |                     | September 30,      |                     |
|   | 2018          | 2017 <sup>(a)</sup> | 2018               | 2017 <sup>(a)</sup> |
| <b>Distillery Products</b>              |               |                     |                    |                     |
| Products transferred at a point in time | \$74,999      | \$69,569            | \$216,226          | \$209,024           |
| Services transferred over time          | 3,337         | 2,766               | 9,139              | 7,960               |
| Total distillery products               | \$78,336      | \$72,335            | \$225,365          | \$216,984           |
| <b>Ingredient Solutions</b>             |               |                     |                    |                     |
| Products transferred at a point in time | \$16,695      | \$13,998            | \$45,874           | \$42,271            |
| Total net sales                         | \$95,031      | \$86,333            | \$271,239          | \$259,255           |

<sup>(a)</sup> Prior period amounts were not adjusted upon adoption of Topic 606.

The Company generates revenues from the distillery products segment by the sale of products and by providing warehouse services related to the storage and aging of customer products. The Company generates revenues from the ingredient solutions segment by the sale of products.



Contracts with customers in both segments include a single performance obligation (either the sale of products or the provision of warehouse services). Certain customers may receive volume rebates or discounts, which are accounted for as variable consideration. The Company estimates these amounts based on the expected amount to be provided to customers and reduces revenues recognized. The Company believes there will be no significant changes to the estimates of variable consideration.

### Note 3. Equity Method Investments

As of September 30, 2018, the Company had no investments accounted for using the equity method of accounting. Until July 3, 2017, the Company had a 30 percent interest in Illinois Corn Processing ("ICP"), which manufactured alcohol for fuel, industrial and beverage applications. The Company completed the sale of its equity ownership interest in ICP to Pacific Ethanol Central, LLC, on July 3, 2017, consistent with an Agreement and Plan of Merger entered into on June 26, 2017.

Summary Financial Information (unaudited). Condensed financial information related to the Company's non-consolidated equity method investment in ICP for the quarter and year to date ended September 30, 2017 is shown below.

|   | Quarter<br>Ended<br>September<br>30,<br>2017 | Year to<br>Date<br>Ended<br>September<br>30,<br>2017 |
|---|--|--|
| ICP's Operating results:                  |  |  |
| Net sales <sup>(a)</sup>                  | \$   | —\$ 78,062   |
| Cost of sales and expenses <sup>(b)</sup> | —  | 79,224   |
| Net loss                                  | \$   | —\$ (1,162 )   |

(a) Includes related party sales to MGPI for the quarter and year to date ended September 30, 2017 of \$0 and \$17,672, respectively.

(b) Includes depreciation and amortization for the quarter and year to date ended September 30, 2017 of \$0 and \$1,720, respectively.

The Company's equity method investment losses for the quarter and year to date ended September 30, 2017, based on unaudited financial statements, were \$0 and \$348, respectively. The Company also had a gain on sale of equity method investment for the quarter and year to date ended September 30, 2017 of \$11,381, resulting from the July 3, 2017 sale of ICP.

### Note 4. Corporate Borrowings

#### Indebtedness Outstanding:

| Description <sup>(a)</sup>                                      | September 30,<br>2018 | December 31,<br>2017 |
|---|-----------------------|----------------------|
| Credit Agreement - Revolver, 3.593% (variable rate) due 2022    | \$ 24,044             | \$ 3,298             |
| Secured Promissory Note, 3.71% (variable rate) due 2022         | 1,688                 | 1,966                |
| Prudential Note Purchase Agreement, 3.53% (fixed rate) due 2027 | 20,000                | 20,000               |
| Unamortized loan fees <sup>(b)</sup>                            | (612 )                | (710 )               |
| Total indebtedness outstanding                                  | \$ 45,120             | \$ 24,554            |
| Less current maturities of long-term debt                       | (382 )                | (372 )               |

|                |           |           |
|----------------|-----------|-----------|
| Long-term debt | \$ 44,738 | \$ 24,182 |
|----------------|-----------|-----------|

(a) Interest rates are as of September 30, 2018.

(b) Loan fees are being amortized over the life of the Credit Agreement and Note Purchase Agreement.

Credit and Note Purchase Agreements. On August 23, 2017, the Company entered into a credit agreement (the "Credit Agreement") with Wells Fargo Bank, National Association. The Credit Agreement provides for a \$150,000 revolving credit facility. The Company may increase the facility from time to time by an aggregate principal amount of up to \$25,000 provided certain conditions are satisfied and at the discretion of the lender. The Credit Agreement matures on August 23, 2022. The Credit Agreement includes certain requirements and covenants, which the Company was in compliance with at September 30, 2018. As of September 30, 2018, the Company's total outstanding borrowings under the Credit Agreement were \$24,044 leaving \$125,956 available.



On August 23, 2017, the Company also entered into a Note Purchase and Private Shelf Agreement (the “Note Purchase Agreement”) with PGIM, Inc., an affiliate of Prudential Financial, Inc., and certain affiliates of PGIM, Inc. The Note Purchase Agreement provides for the issuance of up to \$75,000 of Senior Secured Notes, and the Company issued \$20,000 of Senior Secured Notes with a maturity date of August 23, 2027. The Note Purchase Agreement includes certain requirements and covenants, which the Company was in compliance with at September 30, 2018.

#### Note 5. Income Taxes

On December 22, 2017, the U.S. government enacted tax reform legislation commonly known as the Tax Cuts and Jobs Act (the “Tax Act”), resulting in significant modifications to U.S. tax law. In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. As of September 30, 2018, the Company has not made a measurement period adjustment and the accounting for the Tax Act remains incomplete.

The Company's tax provision for interim periods is determined using an estimated annual effective tax rate, adjusted for discrete items arising in that quarter. In each quarter, the estimated annual effective tax rate is updated and a year-to-date adjustment is made to the provision. The Company's quarterly effective tax rate is subject to significant volatility due to the effect of discrete items arising in a given quarter. Income tax expense for the quarter and year to date ended September 30, 2018 was \$2,673 and \$7,244, respectively, for an effective tax rate for the quarter of 22.9 percent and for the year to date of 22.1 percent. For the quarter, the effective tax rate differed from the 21 percent federal statutory rate (as lowered by the Tax Act) on pretax income, primarily due to state taxes, including a reduction of state taxes for state income tax credits in Indiana and Kansas. Year to date, the effective tax rate differed from the 21 percent federal statutory rate (as lowered by the Tax Act) on pretax income, primarily due to state taxes, including a reduction of state taxes for state income tax credits in Indiana and Kansas, a change in estimate related to the sale of the Company's interest in ICP, and an increase in the Company's valuation allowance related to capital loss carryforwards and state net operating losses. These amounts were partially offset by the impact of income tax benefits related to share-based compensation as accounted for in ASU 2016-09, Compensation - Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting.

Income tax expense for the quarter and year to date ended September 30, 2017 was \$7,491 and \$13,292, respectively, for an effective tax rate for the quarter of 34.6 percent and for the year to date of 31.3 percent. The increase in tax expense, compared to prior quarters in 2017, largely relates to the Company's sale of its interest in ICP, and the corresponding tax gain recognized in the annual effective tax rate calculation. The effective tax rate differed from the 35 percent federal statutory rate on pretax income, primarily due to the impact of income tax benefits related to share-based compensation as accounted for in ASU 2016-09, Compensation - Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting, the domestic production activities deduction, state tax planning including state income tax credits in Indiana and Kansas, and changes to the Company's valuation allowance, partially offset by state taxes.

## Note 6. EPS

The computations of basic and diluted EPS for the quarters and year to date ended September 30, 2018 and 2017 are as follows:

|   | Quarter Ended      |                    | Year to Date Ended |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 30, 2018 | September 30, 2017 | September 30, 2018 | September 30, 2017 |
| Operations:   |                    |                    |                    |                    |
| Net income <sup>(a)</sup>                                       | \$9,008            | \$ 14,137          | \$25,462           | \$ 29,184          |
| Income attributable to participating securities <sup>(b)</sup>  | 174                | 414                | 491                | 806                |
| Net income attributable to common shareholders                  | \$8,834            | \$ 13,723          | \$24,971           | \$ 28,378          |
| Share information:  |                    |                    |                    |                    |
| Basic and diluted weighted average common shares <sup>(c)</sup> | 16,872,000         | 16,751,346         | 16,861,700         | 16,735,378         |
| Basic and diluted EPS   | \$0.52             | \$ 0.82            | \$1.48             | \$ 1.70            |

(a) Net income attributable to all shareholders.

(b) Participating securities included 331,375 and 485,491 unvested restricted stock units ("RSUs"), at September 30, 2018 and 2017, respectively.

(c) Under the two-class method, basic and diluted weighted average common shares at September 30, 2018 and 2017, exclude unvested, participating securities.

## Note 7. Contingencies

There are various legal and regulatory proceedings involving the Company and its subsidiaries. The Company accrues estimated costs for a contingency when management believes that a loss is probable and can be reasonably estimated.

A chemical release occurred at the Company's Atchison facility on October 21, 2016, which resulted in emissions venting into the air ("the Atchison Chemical Release"). The Company reported the event to the Environmental Protection Agency ("EPA"), the Occupational, Safety, and Health Administration ("OSHA"), and to Kansas and local authorities on that date, and is cooperating fully to investigate and ensure that all appropriate response actions are taken. The Company has also engaged outside experts to assist the investigation and response. The Company believes it is probable that a fine or penalty may be imposed by regulatory authorities, but it is currently unable to reasonably estimate the amount thereof since some investigations are not complete and could take several months up to a few years to complete. Private plaintiffs have initiated, and additional private plaintiffs may initiate, legal proceedings for damages resulting from the emission, but the Company is currently unable to reasonably estimate the amount of any such damages that might result. The Company's insurance is expected to provide coverage of any damages to private plaintiffs, subject to a deductible of \$250, but certain regulatory fines or penalties may not be covered and there can be no assurance to the amount or timing of possible insurance recoveries if ultimately claimed by the Company. There was no significant damage to the Company's Atchison plant as a result of this incident. No other MGP facilities, including the distillery in Lawrenceburg, Indiana, were affected by this incident.

OSHA completed its investigation of the Atchison Chemical Release and, on April 19, 2017, issued its penalty to the Company in the amount of \$138. Management settled this assessment with OSHA in full for \$75, which was paid on May 16, 2017. A portion, or all, of the penalty amount may be covered by insurance.

The EPA informed the Company on August 1, 2017, that it intends to seek civil penalties of approximately \$250 in connection with its investigation of the Atchison Chemical Release, while offering the Company the opportunity to settle the matter prior to the EPA proceeding with a formal enforcement action. The Company is seeking a negotiated settlement with the EPA, but negotiations have paused pending resolution of the EPA's criminal investigation. Since the Company expects a negotiated resolution of the EPA civil case and EPA-proposed civil penalties are not material to the quarter and year to date ended September 30, 2018, the Company has not included an accrual in its results. A portion, or all, of the settled penalty amount may be covered by insurance.

## Note 8. Employee and Non-Employee Benefit Plans

Equity-Based Compensation Plans. The Company's equity-based compensation plans provide for the awarding of stock options, stock appreciation rights, shares of restricted stock ("Restricted Stock"), and RSUs for senior executives and salaried employees, as well as non-employee directors. The Company has two active equity-based compensation plans: the Employee Equity Incentive Plan of 2014 (the "2014 Plan") and the Non-Employee Director Equity Incentive Plan (the "Directors' Plan"). The 2014 Plan replaced the inactive Stock Incentive Plan of 2004.

As of September 30, 2018, 321,151 RSUs had been granted of the 1,500,000 shares approved under the 2014 Plan, and 68,934 shares had been granted of the 300,000 shares approved under the Directors' Plan. As of September 30, 2018, 334,225 unvested RSUs were outstanding under the Company's long-term incentive plans.

## Note 9. Operating Segments

At September 30, 2018 and 2017, the Company had two segments: distillery products and ingredient solutions. The distillery products segment consists of food grade alcohol and distillery co-products, such as distillers feed (commonly called dried distillers grain in the industry) and fuel grade alcohol. The distillery products segment also includes warehouse services, including barrel put away, storage, retrieval, and blending services. Ingredient solutions consists of specialty starches and proteins and commodity starches and proteins.

Operating profit for each segment is based on net sales less identifiable operating expenses. Non-direct SG&A, interest expense, earnings from the Company's equity method investments until sold on July 3, 2017, other special charges, and other general miscellaneous expenses are excluded from segment operations and are classified as Corporate. Receivables, inventories, and equipment have been identified with the segments to which they relate. All other assets are considered as Corporate.

|                                   | Quarter Ended |               | Year to Date Ended |               |
|-----------------------------------|---------------|---------------|--------------------|---------------|
|                                   | September 30, | September 30, | September 30,      | September 30, |
|                                   | 2018          | 2017          | 2018               | 2017          |
| Net Sales to Customers            |               |               |                    |               |
| Distillery products               | \$78,336      | \$ 72,335     | \$225,365          | \$ 216,984    |
| Ingredient solutions              | 16,695        | 13,998        | 45,874             | 42,271        |
| Total                             | 95,031        | 86,333        | 271,239            | 259,255       |
| Gross Profit                      |               |               |                    |               |
| Distillery products               | 16,269        | 16,501        | 48,819             | 49,069        |
| Ingredient solutions              | 3,330         | 2,124         | 9,172              | 7,422         |
| Total                             | 19,599        | 18,625        | 57,991             | 56,491        |
| Depreciation and Amortization     |               |               |                    |               |
| Distillery products               | 2,067         | 2,128         | 6,565              | 6,300         |
| Ingredient solutions              | 369           | 419           | 1,182              | 1,242         |
| Corporate                         | 267           | 340           | 782                | 899           |
| Total                             | 2,703         | 2,887         | 8,529              | 8,441         |
| Income (loss) before Income Taxes |               |               |                    |               |
| Distillery products               | 14,344        | 14,836        | 43,298             | 44,485        |
| Ingredient solutions              | 2,671         | 1,518         | 7,236              | 5,592         |
| Corporate                         | (5,334 )      | 5,274         | (17,828 )          | (7,601 )      |
| Total                             | \$11,681      | \$ 21,628     | \$32,706           | \$ 42,476     |

The following table allocates assets to each segment as of:

|                      | September 30,<br>2018 | December 31, 2017 |
|----------------------|-----------------------|-------------------|
| Identifiable Assets  |                       |                   |
| Distillery products  | \$ 219,587            | \$191,321         |
| Ingredient solutions | 38,139                | 28,950            |
| Corporate            | 15,854                | 20,057            |
| Total                | \$ 273,580            | \$240,328         |

Note 10. Subsequent Events

On October 30, 2018, the Board of Directors declared a quarterly dividend payable to stockholders of record as of November 15, 2018, of the Company's Common Stock, and a dividend equivalent payable to holders of certain RSUs as of November 15, 2018, of \$.08 per share and per unit, payable on November 30, 2018.

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

(Dollar amounts in thousands, unless otherwise noted)

### CAUTIONARY NOTE CONCERNING FACTORS THAT MAY AFFECT FUTURE RESULTS

This Report on Form 10-Q contains forward looking statements as well as historical information. All statements, other than statements of historical facts, regarding the prospects of our industry and our prospects, plans, financial position, and strategic plan may constitute forward looking statements. In addition, forward looking statements are usually identified by or are associated with such words as "intend," "plan," "believe," "estimate," "expect," "anticipate," "hopeful," "should," "may," "will," "could," "encouraged," "opportunities," "potential," and/or the negatives or variations of these terms or similar terminology. Forward looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from those expressed or implied in the forward looking statements. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward looking statements is included in the section titled "Risk Factors" (Item 1A) of our Annual Report on Form 10-K for the year ended December 31, 2017. Forward looking statements are made as of the date of this report, and we undertake no obligation to update or revise publicly any forward looking statements, whether because of new information, future events or otherwise.

### OVERVIEW

MGP is a leading producer and supplier of premium distilled spirits and specialty wheat protein and starch food ingredients. Distilled spirits include premium bourbon and rye whiskeys and grain neutral spirits ("GNS"), including vodka and gin. We are also a top producer of high quality industrial alcohol for use in both food and non-food applications. Our protein and starch food ingredients provide a host of functional, nutritional and sensory benefits for a wide range of food products to serve the packaged goods industry. We have two reportable segments: our distillery products segment and our ingredient solutions segment.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes included in this Form 10-Q, as well as our audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations - General, set forth in our Annual Report on Form 10-K for the year ended December 31, 2017.

## RESULTS OF OPERATIONS

## Consolidated results

The table below details the consolidated results for quarters ended September 30, 2018 and 2017:

|  | September 30, |          | 2018 v. |                     |
|--|---------------|----------|---------|---------------------|
|  | 2018          | 2017     | 2017    |                     |
| Net sales  | \$95,031      | \$86,333 | 10.1    | %                   |
| Cost of sales  | 75,432        | 67,708   | 11.4    |                     |
| Gross profit   | 19,599        | 18,625   | 5.2     |                     |
| Gross margin %   | 20.6          | % 21.6   | (1.0)   | ) pp <sup>(a)</sup> |
| Selling, general, and administrative ("SG&A") expenses | 7,584         | 8,154    | (7.0)   | )                   |
| Operating income                                       | 12,015        | 10,471   | 14.7    |                     |
| Operating margin %                                     | 12.6          | % 12.1   | 0.5     | ) pp                |
| Gain on sale of equity method investment               | —             | 11,381   | —       |                     |
| Interest expense, net                                  | (334)         | (224)    | 49.1    | )                   |
| Income before income taxes                             | 11,681        | 21,628   | (46.0)  |                     |
| Income tax expense                                     | 2,673         | 7,491    | (64.3)  |                     |
| Effective tax expense rate %                           | 22.9          | % 34.6   | (11.7)  | ) pp                |
| Net income   | \$9,008       | \$14,137 | (36.3)  | %                   |
| Net income margin %                                    | 9.5           | % 16.4   | (6.9)   | ) pp                |

(a) Percentage points ("pp").

Net sales - Net sales for quarter ended September 30, 2018 were \$95,031, an increase of 10.1 percent compared to the year-ago quarter, which was the result of increased net sales in both segments. Within the distillery segment, net sales were up 8.3 percent, primarily due to increases in the net sales of food grade alcohol, distillers feed and related co-products and warehouse services. Within the ingredient solutions segment, net sales were up 19.3 percent. Net sales were higher across all product categories, with the largest increases in commodity wheat proteins and starches and specialty wheat proteins (see Segment Results).

Gross profit - Gross profit for quarter ended September 30, 2018 was \$19,599, an increase of 5.2 percent compared to the year-ago quarter. The increase was driven by an increase in gross profit in the ingredients solutions segment, partially offset by a decrease in gross profit in the distillery products segment. In the ingredient solutions segment, gross profit increased by \$1,206, or 56.8 percent. In the distillery products segment, gross profit declined by \$232, or 1.4 percent (see Segment Results).

SG&A expenses - SG&A expenses for quarter ended September 30, 2018 were \$7,584, a decrease of 7.0 percent compared to the year-ago quarter. The decrease in SG&A was primarily due to lower personnel costs and a decrease in professional fees, partially offset by an investment in our brands platform.

Operating income - Operating income for quarter ended September 30, 2018 increased to \$12,015 from \$10,471 for quarter ended September 30, 2017, primarily due to an increase in gross profit in our ingredient solutions segment and a decrease in SG&A expenses described above, partially offset by a decrease in gross profit in our distillery products segment.

| Operating income, quarter versus quarter                               | Operating<br>Income | Change |                   |
|--|---------------------|--------|-------------------|
| Operating income for quarter ended September 30, 2017                  | \$10,471            |        |                   |
| Increase in gross profit - ingredient solutions segment <sup>(a)</sup> | 1,206               | 11.5   | pp <sup>(b)</sup> |
| Decrease in gross profit - distillery products segment <sup>(a)</sup>  | (232 )              | (2.2 ) | pp                |
| Decrease in SG&A expenses  | 570                 | 5.4    | pp                |
| Operating income for quarter ended September 30, 2018                  | \$12,015            | 14.7   | %                 |

(a) See segment discussion.

(b) Percentage points ("pp").

Gain on equity method investment - We had no equity method investment earnings for quarters ended September 30, 2018 and 2017 due to the sale of our ICP equity method investment on July 3, 2017, which resulted in a gain on sale of equity method investment for the quarter ended September 30, 2017 of \$11,381 (see Note 3).

Income tax expense - Income tax expense for quarter ended September 30, 2018 was \$2,673, for an effective tax rate of 22.9 percent. Income tax expense for the quarter ended September 30, 2017 was \$7,491, for an effective tax rate of 34.6 percent. The significant decrease in income tax expense, quarter versus quarter, was due to the tax impact of the previously-mentioned sale of ICP and the implementation of the Tax Cuts and Jobs Act (the "Tax Act"). The primary reason for the 11.7 percentage point decline in our effective tax rate, quarter versus quarter, is the decrease resulting from implementation of the Tax Act.

Earnings per share ("EPS") - EPS was \$0.52 for quarter ended September 30, 2018 compared to \$0.82 for quarter ended September 30, 2017. EPS decreased, quarter versus quarter, primarily due to the absence of a gain on sale of equity method investment in the current year quarter, partially offset by the decrease in our effective tax rate previously described and an increase in operating income.

| Change in basic and diluted EPS, quarter versus quarter             | Basic<br>and<br>Diluted<br>EPS | Change  |                   |
|---|--------------------------------|---------|-------------------|
| Basic and diluted EPS for quarter ended September 30, 2017          | \$0.82                         |         |                   |
| Increase in operations <sup>(a)</sup>                               | 0.06                           | 7.3     | pp <sup>(b)</sup> |
| Decrease in gain on sale of equity method investment <sup>(a)</sup> | (0.44 )                        | (53.7)  | pp                |
| Tax: Change in effective tax rate                                   | 0.07                           | 8.6     | pp                |
| Decrease in income attributable to participating securities         | 0.01                           | 1.2     | pp                |
| Basic and diluted EPS for quarter ended September 30, 2018          | \$0.52                         | (36.6)% |                   |

(a) Items are net of tax based on the effective tax rate for the base year (2017).

(b) Percentage points ("pp").





## Consolidated results

The table below details the consolidated results for year to date ended September 30, 2018 and 2017:

|  | September 30, |           | 2018 v. |                     |
|--|---------------|-----------|---------|---------------------|
|  | 2018          | 2017      | 2017    |                     |
| Net sales                                | \$271,239     | \$259,255 | 4.6     | %                   |
| Cost of sales                            | 213,248       | 202,764   | 5.2     |                     |
| Gross profit                             | 57,991        | 56,491    | 2.7     |                     |
| Gross margin %                           | 21.4          | % 21.8    | % (0.4) | ) pp <sup>(a)</sup> |
| SG&A expenses                            | 24,455        | 24,114    | 1.4     |                     |
| Operating income                         | 33,536        | 32,377    | 3.6     |                     |
| Operating margin %                       | 12.4          | % 12.5    | % (0.1) | ) pp                |
| Gain on sale of equity method investment | —             | 11,381    | —       |                     |
| Equity method investment loss            | —             | (348)     | (100.0) | )                   |
| Interest expense, net                    | (830)         | (934)     | (11.1)  | )                   |
| Income before income taxes               | 32,706        | 42,476    | (23.0)  | )                   |
| Income tax expense                       | 7,244         | 13,292    | (45.5)  | )                   |
| Effective tax expense rate %             | 22.1          | % 31.3    | % (9.2) | ) pp                |
| Net income                               | \$25,462      | \$29,184  | (12.8)  | )%                  |
| Net income margin %                      | 9.4           | % 11.3    | % (1.9) | ) pp                |

<sup>(a)</sup> Percentage points ("pp").

Net sales - Net sales for year to date September 30, 2018 were \$271,239, an increase of 4.6 percent compared to the year-ago period, which was the result of increased net sales in both segments. Within the distillery segment, net sales were up 3.9 percent. Increases in the net sales of distillers feed and related co-products, food grade alcohol, and warehouse services increased over the prior-year period. Net sales of industrial alcohol and premium beverage alcohol products within food grade alcohol both increased. Within the ingredient solutions segment, net sales were up 8.5 percent. This increase was driven by higher net sales across all product categories, with the largest increases in specialty wheat proteins and commodity wheat proteins and starches (see Segment Results).

Gross profit - Gross profit for year to date September 30, 2018 was \$57,991, an increase of 2.7 percent compared to the year-ago period. The increase was driven by an increase in gross profit in the ingredient solutions segment, partially offset by a decrease in gross profit in the distillery products segment. In the ingredient solutions segment, gross profit increased by \$1,750, or 23.6 percent. In the distillery products segment, gross profit declined by \$250, or 0.5 percent (see Segment Results).

SG&A expenses - SG&A expenses for year to date September 30, 2018 were \$24,455, an increase of 1.4 percent compared to the year-ago period. The increase in SG&A was primarily due to investments in our brands platform (personnel costs and advertising and promotion), partially offset by a reduction in professional fees and lower personnel costs.

Operating income - Operating income for year to date September 30, 2018 increased to \$33,536 from \$32,377 for the period ended September 30, 2017, due to a gross profit increase in our ingredient solutions segment, partially offset by an increase in SG&A expenses described above and a gross profit decrease in our distillery products segment.

| Operating income, year to date versus year to date                     | Operating<br>Income | Change |                   |
|--|---------------------|--------|-------------------|
| Operating income for year to date ended September 30, 2017             | \$32,377            |        |                   |
| Increase in gross profit - ingredient solutions segment <sup>(a)</sup> | 1,750               | 5.4    | pp <sup>(b)</sup> |
| Decrease in gross profit - distillery products segment <sup>(a)</sup>  | (250 )              | (0.8 ) | pp                |
| Increase in SG&A expenses  | (341 )              | (1.0 ) | pp                |
| Operating income for year to date ended September 30, 2018             | \$33,536            | 3.6    | %                 |

<sup>(a)</sup> See segment discussion.

<sup>(b)</sup> Percentage points ("pp").

Equity method investment / Gain on sale of equity method investment - We had no equity method investment earnings for year to date September 30, 2018, compared to an equity method investment loss of \$348 for the period ended September 30, 2017. The change in equity method investment earnings was due to the sale of our ICP equity method investment on July 3, 2017, which resulted in a gain on sale of equity method investment for the year to date of \$11,381 (see Note 3).

Income tax expense - Income tax expense for year to date September 30, 2018 was \$7,244, for an effective tax rate of 22.1 percent. Income tax expense for year to date September 30, 2017 was \$13,292, for an effective tax rate of 31.3 percent. The significant decrease in income tax expense, year to date versus year to date, was due to the tax impact of the previously-mentioned sale of ICP and the implementation of the Tax Act. The primary reasons for the 9.2 percentage point decline in our effective tax rate, period versus period, are the decrease resulting from implementation of the Tax Act, partially offset by a change in estimate related to the income tax impact of the ICP sale.

EPS - EPS was \$1.48 for year to date September 30, 2018 compared to \$1.70 for the period ended September 30, 2017. EPS decreased, year to date versus year to date, primarily due to the absence of a gain on sale of equity method investment in the current period, partially offset by the decrease in our effective tax rate previously described and an increase in operating income.

| Change in basic and diluted EPS, year to date versus year to date   | Basic<br>and<br>Diluted<br>EPS | Change  |                   |
|---|--------------------------------|---------|-------------------|
| Basic and diluted EPS for year to date ended September 30, 2017     | \$ 1.70                        |         |                   |
| Increase in operations <sup>(a)</sup>                               | 0.05                           | 2.9     | pp <sup>(b)</sup> |
| Decrease in equity method investment loss <sup>(a)</sup>            | 0.01                           | 0.6     | pp                |
| Decrease in gain on sale of equity method investment <sup>(a)</sup> | (0.44 )                        | (25.9)  | pp                |
| Tax: Change in effective tax rate                                   | 0.14                           | 8.2     | pp                |
| Decrease in income attributable to participating securities         | 0.02                           | 1.3     | pp                |
| Basic and diluted EPS for year to date ended September 30, 2018     | \$ 1.48                        | (12.9)% |                   |

<sup>(a)</sup> Items are net of tax based on the effective tax rate for the base year (2017), excluding the effect of the tax benefit on vested share-based compensation on the 2017 rate.

<sup>(b)</sup> Percentage points ("pp").



## SEGMENT RESULTS

## Distillery Products

The following table shows selected financial information for our distillery products segment for quarters ended September 30, 2018 and 2017.

|   | PRODUCT GROUP NET SALES |          |                |        |            | Quarter versus       |  |
|---|-------------------------|----------|----------------|--------|------------|----------------------|--|
|   | Quarter Ended           |          | Quarter versus |        | Quarter    | Quarter              |  |
|   | September 30,           |          | Quarter Net    |        | Volume     | Increase /           |  |
|   | 2018                    | 2017     | Sales Change   |        | Increase / | (Decrease)           |  |
|   |                         |          | \$             | %      | (Decrease) | (Decrease)           |  |
|   |                         |          | Change         | Change | % Change   | % Change             |  |
| Premium beverage alcohol                | \$46,864                | \$43,941 | \$2,923        | 6.7    | %          |                      |  |
| Industrial alcohol                      | 20,661                  | 19,310   | 1,351          | 7.0    |            |                      |  |
| Food grade alcohol <sup>(a)</sup>       | 67,525                  | 63,251   | 4,274          | 6.8    |            |                      |  |
| Fuel grade alcohol <sup>(a)</sup>       | 1,576                   | 1,458    | 118            | 8.1    |            |                      |  |
| Distillers feed and related co-products | 5,898                   | 4,860    | 1,038          | 21.4   |            |                      |  |
| Warehouse services                      | 3,337                   | 2,766    | 571            | 20.6   |            |                      |  |
| Total distillery products               | \$78,336                | \$72,335 | \$6,001        | 8.3    | %          | 7.3 % <sup>(a)</sup> |  |

## Other Financial Information

|                | Quarter Ended |          | Quarter versus   |                   |
|----------------|---------------|----------|------------------|-------------------|
|                | September 30, |          | Quarter Increase |                   |
|                | 2018          | 2017     | \$               | %                 |
|                |               |          | Change           | Change            |
| Gross profit   | \$16,269      | \$16,501 | \$(232)          | (1.4)%            |
| Gross margin % | 20.8 %        | 22.8 %   | (2.0)            | pp <sup>(b)</sup> |

<sup>(a)</sup> Volume change for alcohol products.

<sup>(b)</sup> Percentage points ("pp").

Total net sales of distillery products increased \$6,001, or 8.3 percent. Net sales of food grade alcohol, distillers feed and related co-products, and warehouse services increased. Net sales of premium beverage alcohol and industrial alcohol products increased 6.7 percent and 7.0 percent, respectively, compared to the prior-year quarter. The growth in premium beverage alcohol was driven both by volume and a higher average selling price. Industrial alcohol net sales growth was driven by volume as the average selling price was down due to more difficult market conditions. The increase in net sales of distillers feed and related co-products was due to a higher average selling price reflecting improved market conditions during the quarter.

Gross profit decreased slightly quarter versus quarter by \$232, or 1.4 percent. Gross margin for the quarter ended September 30, 2018 decreased to 20.8 percent from 22.8 percent for the prior-year quarter. The decline in gross profit was primarily due to higher production costs at the Lawrenceburg facility, lower gross margins and profits on industrial alcohol, partially offset by higher gross profits on premium beverage alcohol (excluding the higher production costs) and distillers feed and related co-products.



## Distillery Products

The following table shows selected financial information for our distillery products segment for year to date ended September 30, 2018 and 2017.

|   | PRODUCT GROUP NET SALES |           |                |                 |              | Year-to-Date |  |
|---|-------------------------|-----------|----------------|-----------------|--------------|--------------|--|
|   | Year to Date Ended      |           | Year to Date   |                 | Year-to-Date |              |  |
|   | September 30,           |           | versus Year to |                 | to Date      |              |  |
|   |                         |           |                | Change Increase | Volume       | Increase /   |  |
|   | 2018                    | 2017      | \$             | %               | (Decrease)   | (Decrease)   |  |
|   |                         |           | Change         | Change          | % Change     | % Change     |  |
| Premium beverage alcohol                | \$133,135               | \$131,868 | \$1,267        | 1.0             | %            |              |  |
| Industrial alcohol                      | 59,300                  | 57,775    | 1,525          | 2.6             |              |              |  |
| Food grade alcohol <sup>(a)</sup>       | 192,435                 | 189,643   | 2,792          | 1.5             |              |              |  |
| Fuel grade alcohol <sup>(a)</sup>       | 5,006                   | 4,867     | 139            | 2.9             |              |              |  |
| Distillers feed and related co-products | 18,785                  | 14,514    | 4,271          | 29.4            |              |              |  |
| Warehouse services                      | 9,139                   | 7,960     | 1,179          | 14.8            |              |              |  |
| Total distillery products               | \$225,365               | \$216,984 | \$8,381        | 3.9             | %            | 2.7 % (a)    |  |

## Other Financial Information

|                | Year to Date Ended |          | Year to Date   |        | Year to Date |                   |
|----------------|--------------------|----------|----------------|--------|--------------|-------------------|
|                | September 30,      |          | versus Year to |        | to Date      |                   |
|                |                    |          |                |        | Increase /   | (Decrease)        |
|                | 2018               | 2017     | \$             | %      | (Decrease)   | (Decrease)        |
|                |                    |          | Change         | Change | % Change     | % Change          |
| Gross profit   | \$48,819           | \$49,069 | \$(250 )       | (0.5 ) | %            |                   |
| Gross margin % | 21.7               | % 22.6   |                |        | (0.9 )       | pp <sup>(b)</sup> |

<sup>(a)</sup> Volume change for alcohol products.

<sup>(b)</sup> Percentage points ("pp").

Total net sales of distillery products increased \$8,381, or 3.9 percent. Net sales of distillers feed and related co-products, food grade alcohol, and warehouse services increased over the prior-year period. Net sales of industrial alcohol and premium beverage alcohol products within food grade alcohol increased 2.6 percent and 1.0 percent, respectively, compared to the prior-year period. The increase in net sales of distillers feed and related co-products was due to a higher average selling price reflecting improved market conditions during the period.

Gross profit decreased slightly year to date versus year to date by \$250, or 0.5 percent. Gross margin for year to date September 30, 2018 decreased to 21.7 percent from 22.6 percent for the prior-year period. The decline in gross profit was primarily due to lower gross margins and profits on industrial alcohol and higher production costs at the Lawrenceburg facility, partially offset by higher gross margins and profits on distillers feed and related co-products and premium beverage alcohol (excluding higher production costs).





## Ingredient Solutions

The following table shows selected financial information for our ingredient solutions segment for quarters ended September 30, 2018 and 2017.

## PRODUCT GROUP NET SALES

|                            | Quarter Ended<br>September 30, |          | Quarter versus<br>Quarter Net Sales<br>Change Increase /<br>(Decrease) |         | Quarter<br>versus<br>Quarter<br>Volume<br>Increase /<br>(Decrease) |   |
|----------------------------|--------------------------------|----------|--|---------|--|---|
|                            | 2018                           | 2017     | \$   | %       | % Change   |   |
| Specialty wheat starches   | \$7,030                        | \$7,008  | \$22   | 0.3     |  |   |
| Specialty wheat proteins   | 5,486                          | 4,939    | 547  | 11.1    |  |   |
| Commodity wheat starches   | 2,793                          | 1,948    | 845  | 43.4    |  |   |
| Commodity wheat proteins   | 1,386                          | 103      | 1,283  | 1,245.6 |  |   |
| Total ingredient solutions | \$16,695                       | \$13,998 | \$2,697  | 19.3    | 16.0   | % |

## Other Financial Information

|                | Quarter Ended<br>September 30, |         | Quarter versus<br>Quarter Increase /<br>(Decrease) |      |                   |
|----------------|--------------------------------|---------|--|------|-------------------|
|                | 2018                           | 2017    | \$   | %    |                   |
| Gross profit   | 3,330                          | \$2,124 | \$1,206  | 56.8 | %                 |
| Gross margin % | 20.0                           | % 15.2  | %  | 4.8  | pp <sup>(a)</sup> |

(a) Percentage points ("pp").

Total ingredient solutions net sales for quarter ended September 30, 2018 increased by \$2,697, or 19.3 percent, compared to the prior-year quarter. This increase was driven by higher net sales across all product categories, with the largest increases in commodity wheat proteins and starches and specialty wheat proteins, quarter versus quarter. Gross profit increased quarter versus quarter by \$1,206, or 56.8 percent. Gross margin for the quarter ended September 30, 2018 increased to 20.0 percent from 15.2 percent for the prior-year quarter. The increase in gross profit was primarily due to higher gross profits on specialty wheat proteins and starches and commodity wheat proteins, partially offset by lower gross profits on commodity wheat starches. Overall gross profit growth was aided by improved plant efficiencies relative to the prior-year quarter.

## Ingredient Solutions

The following table shows selected financial information for our ingredient solutions segment for year to date ended September 30, 2018 and 2017.

|                            | Year to Date Ended September 30, |          | Year to Date versus Year to Date Net Sales Change Increase / (Decrease) |        | Year to Date versus Year to Date Volume Increase / (Decrease) |       |
|----------------------------|----------------------------------|----------|---|--------|---|-------|
|                            | 2018                             | 2017     | \$  | %      |   |       |
|                            |                                  |          | Change  | Change | % Change  |       |
| Specialty wheat starches   | \$21,170                         | \$20,826 | \$344   | 1.7    | %   |       |
| Specialty wheat proteins   | 16,230                           | 14,541   | 1,689   | 11.6   |   |       |
| Commodity wheat starches   | 6,926                            | 6,302    | 624   | 9.9    |   |       |
| Commodity wheat proteins   | 1,548                            | 602      | 946   | 157.1  |   |       |
| Total ingredient solutions | \$45,874                         | \$42,271 | \$3,603   | 8.5    | %   | 1.0 % |

## Other Financial Information

|                | Year to Date Ended September 30, |         | Year to Date versus Year to Date Increase / (Decrease) |        |                   |  |
|----------------|----------------------------------|---------|--|--------|-------------------|--|
|                | 2018                             | 2017    | \$   | %      |                   |  |
|                |                                  |         | Change   | Change |                   |  |
| Gross profit   | \$9,172                          | \$7,422 | \$1,750  | 23.6   | %                 |  |
| Gross margin % | 20.0                             | % 17.6  | %  | 2.4    | pp <sup>(a)</sup> |  |

(a) Percentage points ("pp").

Total ingredient solutions net sales for year to date ended September 30, 2018 increased by \$3,603, or 8.5 percent, compared to the prior-year period. This increase was driven by higher net sales across all product categories, with the largest increases in specialty wheat proteins and commodity wheat proteins and starches, period versus period. Gross profit increased period versus period by \$1,750, or 23.6 percent. Gross margin for year to date ended September 30, 2018 increased to 20.0 percent from 17.6 percent for the prior-year period. The increase in gross profit was primarily due to higher gross profits on specialty wheat proteins and starches, partially offset by lower gross profits on commodity wheat products. Overall gross profit growth was aided by improved plant efficiencies relative to the prior-year period.



## CASH FLOW, FINANCIAL CONDITION AND LIQUIDITY

We believe our financial condition continues to be of high quality, as evidenced by our ability to generate adequate cash from operations while having ready access to capital at competitive rates.

Operating cash flow and debt through our Credit Agreement and Note Purchase Agreement (Note 4) provide the primary sources of cash to fund operating needs and capital expenditures. These same sources of cash are used to fund shareholder dividends and other discretionary uses. Going forward, we expect to use cash to implement our invest to grow strategy, particularly in the distillery products segment. Our overall liquidity reflects our strong business results and an effective cash management strategy that takes into account liquidity management, economic factors, and tax considerations. We expect our sources of cash, including our Credit Agreement and Note Purchase Agreement, to be adequate to provide for budgeted capital expenditures and anticipated operating requirements for the foreseeable future.

## Cash Flow Summary

|   | Year to Date Ended       |                          |  |
|---|--------------------------|--------------------------|--|
|   | September<br>30,<br>2018 | September<br>30,<br>2017 | Changes,<br>Year to<br>Date<br>versus<br>Year to<br>Date |
| Cash provided by operating activities:  |                          |                          |  |
| Net income, after giving effect to adjustments to reconcile net income to net cash provided by operating activities | \$37,379                 | \$36,209                 | \$1,170  |
| Receivables, net  | (15,644 )                | (11,366 )                | (4,278 )   |
| Inventory   | (14,197 )                | (10,794 )                | (3,403 )   |
| Prepaid expenses  | 297                      | (824 )                   | 1,121  |
| Accrued expenses  | (2,623 )                 | 790                      | (3,413 )   |
| Income taxes payable/refundable   | (31 )                    | 2,472                    | (2,503 )   |
| Accounts payable and accounts payable to affiliate, net   | (3,453 )                 | 844                      | (4,297 )   |
| Other, net  | (69 )                    | (884 )                   | 815  |
| Total   | \$1,659                  | \$16,447                 | \$(14,788)   |
| Cash provided by (used in) investing activities:  |                          |                          |  |
| Additions to property, plant, and equipment   | (18,870 )                | (13,630 )                | (5,240 )   |
| Return of equity method investment  | —                        | 22,832                   | (22,832 )  |
| Other   | —                        | 14                       | (14 )  |
| Total   | \$(18,870)               | \$9,216                  | \$(28,086)   |
| Cash provided by (used in) financing activities:  |                          |                          |  |
| Payment of dividends and dividend equivalents   | (4,125 )                 | (16,692 )                | 12,567   |
| Proceeds (payments) on debt:  |                          |                          |  |
| Proceeds on long-term debt  | —                        | 20,000                   | (20,000 )  |
| Principal payments on long-term debt  | (279 )                   | (268 )                   | (11 )  |
| Proceeds from credit agreement - revolver   | 22,766                   | 20,580                   | 2,186  |
| Payments on credit agreement - revolver   | (2,020 )                 | (41,985 )                | 39,965   |
| Proceeds (payments) on debt, net  | 20,467                   | (1,673 )                 | 22,140   |
| Other   | (2,215 )                 | (1,754 )                 | (461 )   |
| Total   | \$14,127                 | \$(20,119)               | \$34,246   |

Edgar Filing: MGP INGREDIENTS INC - Form 10-Q

|  |             |          |             |
|--|-------------|----------|-------------|
| Increase (decrease) in cash and cash equivalents | \$ (3,084 ) | \$ 5,544 | \$ (8,628 ) |
|--|-------------|----------|-------------|

Changes, year to date versus year to date. Cash decreased \$3,084 in year to date ended September 30, 2018 compared to an increase of \$5,544 in year to date ended September 30, 2017 for a net decrease in cash of \$8,628, period versus period.

Cash provided by operating activities for year to date ended September 30, 2018 was \$1,659, compared to cash provided by operating activities of \$16,447 for year to date ended September 30, 2017, resulting in lower cash from operations year to date versus year to date, of \$14,788. Decreased cash flows were primarily due to a decline in the change in accounts payable and accounts payable to affiliate, net, of \$4,297, related to the timing of operating expense cash disbursements, an increase in the change in receivables, net, of \$4,278, reflecting increased sales in the quarter and year to date ended September 30, 2018 compared to the quarter and year to date ended September 30, 2017, a decrease in the change in accrued expenses of \$3,413, reflecting payment of incentive compensation, an increase in the change in inventory of \$3,403, primarily due to increases in the change in inventory categories including finished goods and raw materials, and a decrease in the change in income taxes payable of \$2,503. Cash flow decreases were partially offset by cash flow increases, primarily related to an increase in the change in net income, after giving effect to adjustments to reconcile net income to net cash provided by operating activities of \$1,170 and an increase in the change in prepaid expenses of \$1,121.

Cash used in investing activities for year to date ended September 30, 2018 was \$18,870, compared to cash provided by investing activities of \$9,216 for year to date ended September 30, 2017, resulting in increased cash used in investing activities, year to date versus year to date, of \$28,086. The change in cash outflows reflected the absence of a return of equity method investment for year to date ended September 30, 2018 of \$22,832, as well as an increase in additions to property, plant, and equipment of \$5,240 (see Capital Spending).

Cash provided by financing activities for year to date ended September 30, 2018 was \$14,127, compared to cash used in financing activities of \$20,119 for year to date ended September 30, 2017, reflecting a net increase, year to date versus year to date, in cash provided by financing activities of \$34,246. Net changes in cash flows from financing activities reflected a decrease in payments on credit agreement - revolver of \$39,965 and an increase in proceeds from the credit agreement - revolver of \$2,186, that were partially offset by a decrease in proceeds on long-term debt of \$20,000. Net changes in cash flows from financing activities also included a decrease in the payment of dividends and dividend equivalents of \$12,567 (see Dividends and Dividend Equivalents).

**Capital Spending.** We manage capital spending to support our business growth plans. Investments in plant, property and equipment were \$18,870 and \$13,630, respectively, for year to date ended September 30, 2018 and 2017. Adjusted for the change in capital expenditures in accounts payable for year to date ended September 30, 2018 and 2017 of \$(3,679) and \$(3,826), respectively, total capital expenditures were \$15,191 and \$9,804, respectively. We expect approximately \$29,000 in capital expenditures in 2018 for facility improvement and expansion (including warehouse expansion), facility sustenance projects, and environmental health and safety projects.

As part of our strategic plan to support the growth of the American Whiskey category, we previously announced a \$33,800 warehouse expansion project. Based on the continued strong growth in the American Whiskey category and demand for our products, and as announced last quarter, we have expanded the scope of the project and added an incremental investment this year of approximately \$18,000, bringing our total warehouse expansion project investment to approximately \$51,800. As of September 30, 2018, we had incurred approximately \$33,000 of the total investment. The estimated project completion date is by the end of calendar year 2020.

**Treasury Purchases.** 75,363 RSUs vested and converted to common shares during year to date ended September 30, 2018, of which we withheld and purchased for treasury 25,746 shares valued at \$2,215 to cover payment of associated withholding taxes.

86,000 RSUs vested and converted to common shares during year to date ended September 30, 2017, of which we withheld and purchased for treasury 29,816 shares valued at \$1,377 to cover payment of associated withholding taxes.

## Dividends and Dividend Equivalents

Dividend and dividend equivalent information for year to date ended September 30, 2018 and 2017 is detailed below:  
Dividend and Dividend Equivalent Information (per Share and Unit)

| Declaration date  | Record date     | Payment date       | Declared | Paid   | Dividend payment | Dividend equivalent payment <sup>(a)(b)</sup> | Total payment <sup>(b)</sup> |
|-------------------|-----------------|--------------------|----------|--------|------------------|---|------------------------------|
| 2018              |                 |                    |          |        |                  |   |                              |
| February 21, 2018 | March 9, 2018   | March 23, 2018     | \$ 0.08  | \$0.08 | \$ 1,348         | \$ 27   | \$ 1,375                     |
| April 30, 2018    | May 16, 2018    | June 1, 2018       | 0.08     | 0.08   | 1,348            | 27  | 1,375                        |
| July 31, 2018     | August 16, 2018 | August 31, 2018    | 0.08     | 0.08   | 1,348            | 27  | 1,375                        |
|                   |                 |                    | \$ 0.24  | \$0.24 | \$ 4,044         | \$ 81   | \$ 4,125                     |
| 2017              |                 |                    |          |        |                  |   |                              |
| February 15, 2017 | March 1, 2017   | March 24, 2017     | \$ 0.04  | \$0.04 | \$ 668           | \$ 20   | \$ 688                       |
| May 2, 2017       | May 15, 2017    | June 9, 2017       | 0.04     | 0.04   | 668              | 20  | 688                          |
| August 1, 2017    | August 18, 2017 | September 8, 2017  | 0.85     | 0.85   | 14,215           | 413   | 14,628                       |
| August 1, 2017    | August 18, 2017 | September 11, 2017 | 0.04     | 0.04   | 669              | 19  | 688                          |
|                   |                 |                    | \$ 0.97  | \$0.97 | \$ 16,220        | \$ 472  | \$ 16,692                    |

<sup>(a)</sup> Dividend equivalent payments on unvested participating securities (see Note 8).

<sup>(b)</sup> Includes estimated forfeitures.

On October 30, 2018, the Board of Directors declared a quarterly dividend payable to stockholders of record as of November 15, 2018, of the Company's Common Stock, and a dividend equivalent payable to holders of certain RSUs as of November 15, 2018, of \$.08 per share and per unit, payable on November 30, 2018.

**Long-Term and Short-Term Debt.** We maintain debt levels we consider appropriate after evaluating a number of factors, including cash flow expectations, cash requirements for ongoing operations, investment and financing plans (including brand development and share repurchase activities) and the overall cost of capital. Total debt was \$45,120 (net of unamortized loan fees of \$612) at September 30, 2018 and \$24,554 (net of unamortized loan fees of \$710) at December 31, 2017.

**Financial Condition and Liquidity.** Our principal uses of cash in the ordinary course of business are for input costs used in our production processes, salaries, capital expenditures, and investments supporting our strategic plan, such as the aging of barreled distillate. As part of our strategy, as demand grows for American whiskeys, in both the United States and global markets, we are building our inventories of aged premium whiskeys to fully participate in this growth (see "Barreled distillate (bourbon and whiskey)" in Note 1). Generally, during periods when commodities prices are rising, our operations require increased use of cash to support inventory levels.

Our principal sources of cash are product sales and borrowing on our Credit Agreement and Note Purchase Agreement. Under our Credit Agreement and Note Purchase Agreement, we must meet certain financial covenants and restrictions, and at September 30, 2018, we met those covenants and restrictions.

At September 30, 2018, our current assets exceeded our current liabilities by \$129,401, largely due to our inventories, at cost, of \$107,346. At September 30, 2018 our cash balance was \$0 and we have used our Credit Agreement and Note Purchase Agreement for liquidity purposes, with \$125,956 remaining for additional borrowings. We anticipate being able to support our short-term liquidity and operating needs largely through cash generated from operations. We regularly assesses our cash needs and the available sources to fund these needs. We utilize short-term and long-term debt to fund discretionary items, such as capital investments and dividend payments. In addition, we have strong operating results such that financial institutions should provide sufficient credit funding to meet short-term financing requirements, if needed.





### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to commodity price and interest rate market risks. We monitor and manage these exposures as part of our overall risk management program. Our risk management program focuses on the unpredictability of financial markets and seeks to reduce the potentially adverse effects that the volatility of these markets may have on our operating results.

**Commodity Costs.** Certain commodities we use in our production process, or input costs, expose us to market price risk due to volatility in the prices for those commodities. Through our grain supply contracts for our Atchison and Lawrenceburg facilities, our wheat flour supply contract for our Atchison facility, and our natural gas contracts for both facilities, we purchase grain, wheat flour, and natural gas, respectively, for delivery from one to 24 months into the future at negotiated prices. We have determined that the firm commitments to purchase grain, wheat flour, and natural gas under the terms of our supply contracts meet the normal purchases and sales exception as defined under Accounting Standards Codification ("ASC") 815, Derivatives and Hedging, because the quantities involved are for amounts to be consumed within the normal expected production process.

**Interest Rate Exposures.** Our Credit Agreement and Note Purchase Agreement (Note 4) expose us to market risks arising from adverse changes in interest rates. Established procedures and internal processes govern the management of this market risk.

Increases in market interest rates would cause interest expense to increase and earnings before income taxes to decrease. The change in interest expense and earnings before income taxes would be dependent upon the weighted average outstanding borrowings during the reporting period following an increase in market interest rates. Based on weighted average outstanding variable-rate borrowings at September 30, 2018, a 100 basis point increase over the non-default rates actually in effect at such date would increase our interest expense on an annualized basis by \$208. Based on weighted average outstanding fixed-rate borrowings at September 30, 2018, a 100 basis point increase in market rates would result in a decrease in the fair value of our outstanding fixed-rate debt of \$1,034, and a 100 basis point decrease in market rates would result in an increase in the fair value of our outstanding fixed-rate debt of \$1,103.

### ITEM 4. CONTROLS AND PROCEDURES

**Evaluation of Disclosure Controls and Procedures.** As of the quarter ended September 30, 2018, our Chief Executive Officer and Chief Financial Officer have each reviewed and evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have each concluded that our current disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

**Changes in Internal Controls.** There were no changes in our internal controls over financial reporting during the fiscal quarter ended September 30, 2018, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## PART II – OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

Reference is made to Part I, Item 3, Legal Proceedings of our Annual Report on Form 10-K for the year ended December 31, 2017 and Note 7 to this Report on Form 10-Q for information on certain proceedings to which we are subject.

We are a party to various other legal proceedings in the ordinary course of business, none of which is expected to have a material adverse effect on us.

## ITEM 1A. RISK FACTORS

Risk factors are described in "Item 1A. Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2017. There have been no material changes thereto during the quarter or year to date ended September 30, 2018.

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

There was no unregistered sale of equity securities during the quarter ended September 30, 2018.

## ISSUER PURCHASES OF EQUITY SECURITIES

|  | (1) Total<br>Number<br>of<br>Shares (or<br>Units)<br>Purchased | (2)<br>Average<br>Price<br>Paid<br>per<br>Share (or<br>Unit) | (3) Total<br>Number of<br>Shares (or<br>Units)<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | (4)<br>Maximum<br>Number (or<br>Approximate<br>Dollar<br>Value) of<br>Shares (or<br>Units)<br>that May Yet<br>Be<br>Purchased<br>Under<br>the Plans or<br>Programs |
|--|--|--|--|--|
| July 1, 2018 through July 31, 2018           | —  | —  | —  |  |
| August 1, 2018 through August 31, 2018       | —  | —  | —  |  |
| September 1, 2018 through September 30, 2018 | 1,821  | <sup>(a)</sup> \$ 77.84                                      | —  | 1,409,915  |
| Total  | 1,821  |  | —  |  |

<sup>(a)</sup> Vested RSUs awarded under the 2014 Plan purchased to cover employee withholding taxes.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

31

---

ITEM 6. EXHIBITS

| Exhibit Number | Description of Exhibit   |
|----------------|--|
| *31.1          | <u>CEO Certification pursuant to Rule 13a-14(a)</u>  |
| *31.2          | <u>CFO Certification pursuant to Rule 13a-14(a)</u>  |
| *32.1          | <u>CEO Certification furnished pursuant to Rule 13a-14(b) and 18 U.S.C. 1350</u>   |
| *32.2          | <u>CFO Certification furnished pursuant to Rule 13a-14(b) and 18 U.S.C. 1350</u>   |
| *101           | The following financial information from MGP Ingredients, Inc.'s Quarterly Report on Form 10-Q for the quarter and year-to-date periods ended September 30, 2018, formatted in XBRL (Extensible Business Reporting Language) includes: (i) Condensed Consolidated Balance Sheets as of September 30, 2018, and December 31, 2017, (ii) Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2018 and 2017, (iii) Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2018 and 2017, (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017, (v) Condensed Consolidated Statement of Changes in Stockholders' Equity, and (vi) the Notes to Condensed Consolidated Financial Statements. |

\*Filed  
herewith

SIGNATURES

Pursuant to the requirements on 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.

MGP INGREDIENTS, INC.

Date: November 1, 2018 By/s/ Augustus C. Griffin

Augustus C. Griffin, President and Chief Executive Officer

Date: November 1, 2018 By/s/ Thomas K. Pigott

Thomas K. Pigott, Vice President, Finance and Chief Financial Officer