

KMG CHEMICALS INC  
Form 10-Q  
June 09, 2014  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-Q**

(One)

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

**For the quarterly period ended April 30, 2014**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission file number: 001-35577**

**KMG CHEMICALS, INC.**

**(Exact name of registrant as specified in its charter)**

**Texas**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**75-2640529**  
**(I.R.S. Employer**  
**Identification No.)**

**9555 West Sam Houston Parkway South,**

**Suite 600 Houston, Texas**  
**(Address of principal executive offices)**

**77099**  
**(Zip Code)**

**(713) 600-3800**

**(Registrant's telephone number, including area code)**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of June 9, 2014, there were 11,641,733 shares of the registrant's common stock outstanding.

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**Table of Contents****ITEM 1. FINANCIAL STATEMENTS****KMG CHEMICALS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except for share and per share amounts)**

	<b>April 30, 2014</b>	<b>July 31, 2013</b>
	<b>(Unaudited)</b>	
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 19,402	\$ 13,949
Accounts receivable		
Trade, net of allowances of \$211 at April 30, 2014 and \$224 at July 31, 2013	40,651	41,935
Other	3,832	4,210
Inventories, net	46,636	53,387
Current deferred tax assets	631	1,400
Prepaid expenses and other	3,406	3,955
Total current assets	114,558	118,836
Property, plant and equipment, net	95,175	96,688
Deferred tax assets	991	1,069
Goodwill	11,110	10,929
Intangible assets, net	28,803	29,261
Restricted cash	1,000	1,000
Other assets, net	4,419	4,232
Total assets	\$ 256,056	\$ 262,015
<b>Liabilities and stockholders equity</b>		
Current liabilities		
Accounts payable	\$ 32,052	\$ 35,492
Accrued liabilities	16,540	10,351
Current maturities of long-term debt	20,000	
Total current liabilities	68,592	45,843
Long-term debt, net of current maturities	52,000	85,000
Deferred tax liabilities	10,683	11,462
Other long-term liabilities	2,666	2,470
Total liabilities	133,941	144,775
Commitments and contingencies		

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Stockholders' equity		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued		
Common stock, \$0.01 par value, 40,000,000 shares authorized, 11,635,636 shares issued and outstanding at April 30, 2014 and 11,522,321 shares issued and outstanding at July 31, 2013	116	115
Additional paid-in capital	28,492	26,689
Accumulated other comprehensive income (loss)	1,776	(2,504)
Retained earnings	91,731	92,940
<b>Total stockholders' equity</b>	<b>122,115</b>	<b>117,240</b>
Total liabilities and stockholders' equity	\$ 256,056	\$ 262,015

See accompanying notes to condensed consolidated financial statements.

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**KMG CHEMICALS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)**

**(UNAUDITED)**

**(In thousands, except for per share amounts)**

	<b>Three Months Ended April 30,</b>		<b>Nine Months Ended April 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net sales	\$ 84,437	\$ 59,929	\$ 262,250	\$ 182,224
Cost of sales	59,672	43,596	186,728	130,082
Gross profit	24,765	16,333	75,522	52,142
Distribution expenses	11,975	6,399	36,979	19,374
Selling, general and administrative expenses	8,815	5,579	29,085	18,113
Restructuring charges	1,061		5,092	
Operating income	2,914	4,355	4,366	14,655
Other income (expense)				
Interest expense, net	(926)	(388)	(2,250)	(1,194)
Other, net	(105)	(49)	(540)	(175)
Total other expense, net	(1,031)	(437)	(2,790)	(1,369)
Income from continuing operations before income taxes	1,883	3,918	1,576	13,286
Provision for income taxes	(657)	(1,026)	(1,742)	(4,531)
Income (loss) from continuing operations	1,226	2,892	(166)	8,755
Discontinued operations				
Loss from discontinued operations, before income taxes		(33)		(187)
Income tax benefit		6		57
Loss from discontinued operations		(27)		(130)
Net income (loss)	\$ 1,226	\$ 2,865	\$ (166)	\$ 8,625
Earnings per share				
Basic				
Income (loss) from continuing operations	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.76
Loss from discontinued operations				(0.01)

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Net income (loss)	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.75
<b>Diluted</b>				
Income (loss) from continuing operations	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.76
Loss from discontinued operations				(0.01)
Net income (loss)	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.75
<b>Weighted average shares outstanding</b>				
Basic	11,634	11,513	11,606	11,476
Diluted	11,673	11,580	11,606	11,574
See accompanying notes to condensed consolidated financial statements.				

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**KMG CHEMICALS, INC. AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(UNAUDITED)**

**(In thousands)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Net income (loss)	\$ 1,226	\$ 2,865	\$ (166)	\$ 8,625
Other comprehensive income				
Foreign currency translation income (loss)	1,776	(772)	4,280	1,195
Total other comprehensive income (loss)	1,776	(772)	4,280	1,195
Total comprehensive income	\$ 3,002	\$ 2,093	\$ 4,114	\$ 9,820

See accompanying notes to condensed consolidated financial statements.

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**KMG CHEMICALS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(UNAUDITED)**

**(In thousands)**

	<b>Nine Months Ended</b>	
	<b>April 30,</b>	
	<b>2014</b>	<b>2013</b>
Cash flows from operating activities		
Net income (loss)	\$ (166)	\$ 8,625
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	10,422	5,407
Non-cash restructuring charges	1,720	
Amortization of loan costs included in interest expense	45	34
Stock-based compensation expense	1,777	455
Bad debt expense	89	78
Allowance for excess and obsolete inventory	33	(340)
(Gain)/loss on disposal of property	(14)	59
Loss on sale of animal health business		57
Deferred income taxes	751	783
Tax benefit from stock-based awards	(328)	(569)
Changes in operating assets and liabilities		
Accounts receivable trade	1,906	2,229
Accounts receivable other	538	(3,339)
Inventories	7,277	(3,268)
Other current and noncurrent assets	389	(1,819)
Accounts payable	(3,916)	1,309
Accrued liabilities and other	5,383	(158)
Net cash provided by operating activities	25,906	9,543
Cash flows from investing activities		
Additions to property, plant and equipment	(7,133)	(3,785)
Disposals of property, plant and equipment	39	
Net cash used in investing activities	(7,094)	(3,785)
Cash flows from financing activities		
Net payments under revolving credit agreement	(13,000)	(2,000)
Proceeds from exercise of stock options		70
Tax benefit from stock-based awards	328	569
Payment of dividends	(1,043)	(1,032)

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Net cash used in financing activities	(13,715)	(2,393)
Effect of exchange rate changes on cash	356	100
Net increase in cash and cash equivalents	5,453	3,465
Cash and cash equivalents at beginning of period	13,949	1,633
Cash and cash equivalents at end of period	\$ 19,402	\$ 5,098
Supplemental disclosures of cash flow information		
Cash paid for interest	\$ 1,909	\$ 1,163
Cash paid for income taxes	\$ 527	\$ 5,254
Supplemental disclosure of non-cash investing activities		
Purchase of property, plant and equipment through accounts payable	\$ 637	\$
See accompanying notes to condensed consolidated financial statements.		

**Table of Contents****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. Basis of Presentation**

The consolidated balance sheet as of July 31, 2013, which has been derived from audited consolidated financial statements, and the unaudited condensed consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting. As permitted under those requirements, certain footnotes or other financial information that are normally required by generally accepted accounting principles in the United States of America ( GAAP ) have been condensed or omitted. The Company believes that the disclosures made are adequate to make the information not misleading and in the opinion of management reflect all adjustments, including those of a normal recurring nature, that are necessary for a fair presentation of financial position and results of operations for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of results of operations to be expected for the full year. The unaudited condensed consolidated financial statements included herein should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended July 31, 2013.

These condensed consolidated financial statements are prepared using certain estimates by management and include the accounts of KMG Chemicals, Inc. and its subsidiaries (collectively, the Company ). All significant intercompany balances and transactions have been eliminated in consolidation.

**2. Acquisitions**

On May 31, 2013, the Company completed the acquisition of the ultra pure chemicals ( UPC ) business subsidiaries of OM Group, with facilities located in the United States, the United Kingdom, France and Singapore. The purchase price was \$62.6 million. The subsidiaries sell high purity and ultra purity, wet process chemicals to the semiconductor industry.

The following table summarizes the acquired assets and assumed liabilities and the acquisition accounting for the fair value of the assets and liabilities recognized in the consolidated balance sheets at the acquisition date (in thousands):

Cash	\$ 689
Accounts receivable	14,698
Inventory	11,047
Other current assets	1,963
Property, plant and equipment	28,939
Intangible assets:	
Value of product qualifications	12,800
Non-compete agreement	1,900
Transition services	154
Total intangible assets	14,854
Total assets acquired	\$ 72,190

Current liabilities	\$ 11,401
Other long-term liabilities	5,326
Total liabilities assumed	16,727
Net assets acquired	\$ 55,463

The Company recognized goodwill associated with the acquisition which represented the value of the assembled workforce and expected synergies from combining operations. As of April 30, 2014, the goodwill was adjusted for the post-closing working capital adjustment of \$138,000. The goodwill recognized in the Company's consolidated balance sheets is as follows (in thousands):

Carrying value at July 31, 2013	\$ 7,150
Post-closing working capital adjustment	(138)
Foreign currency translation adjustment	320
Carrying value at April 30, 2014	\$ 7,332

**Table of Contents****3. Earnings Per Share**

Basic earnings per share have been computed by dividing net income by the weighted average shares outstanding. Diluted earnings per share have been computed by dividing net income by the weighted average shares outstanding plus potentially dilutive common shares. The following table presents information necessary to calculate basic and diluted earnings per share for periods indicated:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(Amounts in thousands, except per share data)</b>			
Income (loss) from continuing operations	\$ 1,226	\$ 2,892	\$ (166)	\$ 8,755
Loss from discontinued operations		(27)		(130)
Net income (loss)	\$ 1,226	\$ 2,865	\$ (166)	\$ 8,625
Weighted average shares outstanding-basic	11,634	11,513	11,606	11,476
Dilutive effect of options and stock awards	39	67		98
Weighted average shares outstanding-diluted	11,673	11,580	11,606	11,574
<b>Basic earnings per share</b>				
Basic earnings per share from continuing operations	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.76
Basic earnings per share on loss from discontinued operations				(0.01)
Basic earnings per share	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.75
<b>Diluted earnings per share</b>				
Diluted earnings per share from continuing operations	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.76
Diluted earnings per share on loss from discontinued operations				(0.01)
Diluted earnings per share	\$ 0.11	\$ 0.25	\$ (0.01)	\$ 0.75

Outstanding stock-based awards are not included in the computation of diluted earnings per share under the treasury stock method if including them would be anti-dilutive. There were no such potentially dilutive securities that were not included for the three months ended April 30, 2014. There were an average of approximately 21,000 shares of potentially dilutive securities not included in the computation of diluted earnings per share for the nine months ended April 30, 2014, and there were an average of 21,200 shares and 8,300 shares of potentially dilutive shares not included in the computation of diluted earnings per share for the three and nine months ended April 30, 2013. Potentially dilutive shares are not included in the computation of diluted weighted average shares outstanding due to a loss from continuing operations for the nine months ended April 30, 2014.

**4. Inventories**

Inventories are summarized in the following table (in thousands):

	<b>April 30, 2014</b>	<b>July 31, 2013</b>
Raw materials	\$ 8,489	\$ 8,003
Work in process	1,948	1,382
Supplies	1,722	1,730
Finished products	34,705	42,452
Less: reserve for inventory obsolescence	(228)	(180)
Inventories, net	\$ 46,636	\$ 53,387

**Table of Contents****5. Property, Plant and Equipment**

Property, plant and equipment and related accumulated depreciation and amortization are summarized as follows (in thousands):

	<b>April 30, 2014</b>	<b>July 31, 2013</b>
Land	\$ 16,229	\$ 15,620
Buildings and improvements	42,986	41,273
Equipment	75,352	66,807
Leasehold improvements	143	143
	134,710	123,843
Less: accumulated depreciation and amortization	(47,891)	(36,933)
	86,819	86,910
Construction-in-progress	8,356	9,778
Property, plant and equipment, net	\$ 95,175	\$ 96,688

**6. Stock-Based Compensation**

The Company has stock-based incentive plans which are described in more detail in Note 11 to the consolidated financial statements in the Company's Annual Report on Form 10-K for fiscal year 2013. The Company recognized stock-based compensation costs of approximately \$343,000 and \$158,000 for the three months and \$1.8 million and \$455,000 for the nine months ended April 30, 2014 and 2013, respectively. The Company also recognized the related tax benefits of \$120,000 and \$53,000, respectively, for the three months and \$663,000 and \$163,000 for the nine months ended April 30, 2014 and 2013, respectively. Stock-based compensation costs are recorded under selling, general and administrative expenses in the condensed consolidated statements of income (loss).

As of April 30, 2014, the unrecognized compensation costs related to stock-based awards was approximately \$1.9 million, which is expected to be recognized over a weighted-average period of 2.2 years.

A summary of stock option and stock activity is presented below.

***Stock Options***

A summary of activity for the nine months ended April 30, 2014 is presented below. No options were granted in the first nine months of fiscal years 2014 or 2013:

	<b>Shares</b>	<b>Weighted- Average Exercise Price</b>
Outstanding on August 1, 2013	58,000	\$ 4.03

Granted		
Exercised	(58,000)	4.03
Forfeited/expired		
Outstanding on April 30, 2014		

No stock options were outstanding at April 30, 2014.

There were 58,000 stock options exercised in the nine months ended April 30, 2014, with an intrinsic value of \$952,000. There were 27,000 and 107,000 options exercised in the three and nine months ended April 30, 2013, respectively, with an intrinsic value of \$423,000 and \$1.6 million, respectively.

**Table of Contents****Performance Shares**

On August 1, 2013, there were 154,758 non-vested performance shares outstanding which reflected the maximum number of shares under the awards. No performance share awards vested during the nine months ended April 30, 2014. There were a maximum of 190,694 performance share awards granted during the nine months ended April 30, 2014. As of April 30, 2014, the non-vested performance-based stock awards consisted of Series 1 and Series 2 awards granted to certain executives and employees in fiscal years 2014, 2013 and 2012, as summarized below.

<b>Date of Grant</b>	<b>Series Award</b>	<b>Maximum Award (Shares)<sup>(1)</sup></b>	<b>Grant Date Fair Value</b>	<b>Measurement Period Ending</b>	<b>Expected Percentage Vesting</b>	<b>Shares Expected to Vest</b>
<b>Fiscal Year 2014 Awards (2)</b>						
2/25/2014	Series 1	190,694	\$ 14.88	07/31/2016	40%	76,278
		190,694				76,278
<b>Fiscal Year 2013 Awards</b>						
12/04/2012	Series 1	58,600	\$ 18.75	07/31/2015	0%	
		58,600				
<b>Fiscal Year 2012 Awards</b>						
2/27/2012	Series 1	300	\$ 18.08	07/31/2014	10%	30
2/27/2012	Series 2	200	\$ 18.08	07/31/2014	0%	
		500				30
10/28/2011	Series 1	13,800	\$ 15.30	07/31/2014	10%	1,380
10/28/2011	Series 2	9,200	\$ 15.30	07/31/2014	0%	
		23,000				1,380
10/11/2011	Series 1	16,658	\$ 14.16	07/31/2014	10%	1,666
10/11/2011	Series 2	11,105	\$ 14.16	07/31/2014	0%	
		27,763				1,666
<b>Total</b>		<b>300,557</b>				<b>79,354</b>

(1) The table does not include awards of 23,242 and 12,992 in Series 1 awards (at maximum) in fiscal years 2013 and 2012, respectively, and 8,661 (at maximum) in Series 2 awards in fiscal year 2012, all of which were forfeited during the nine months ended April 30, 2014.

(2) The percentage vesting for the 2014 performance shares award is based on the target award, which is 66.67% of the maximum award. The expected percentage of vesting is currently estimated at 60% of the target award for

the fiscal year 2014 Award.

Series 1: For the fiscal year 2014 awards, vesting is subject to performance requirements composed of certain objectives including average annual return on invested capital and annual compound growth rate in the Company's earnings per share. The percentage of vesting for the Fiscal Year 2014 award is based on the target award, which is at 66.67% of the maximum award. For the fiscal year 2013 awards, vesting is subject to performance requirements composed of certain objectives including average annual return on invested capital and annual compound growth rate in the Company's diluted earnings per share. For the fiscal year 2012 award, vesting for the Series 1 awards is subject to a performance requirement composed of certain earnings per share or revenue growth objectives and average annual return on invested capital measured across a three year period. These objectives are measured quarterly using the Company's budget, actual results and long-term projections. For each of the Series 1 awards, the expected percentage of vesting is evaluated through April 30, 2014, and reflects the percentage of shares projected to vest for the respective awards at the end of their measurement periods.

Series 2: Vesting for the Series 2 awards is subject to performance requirements pertaining to the growth rate in the Company's basic earnings per share over a three year period. The achievement of performance requirements is measured quarterly using the Company's budget, actual results and long-term projections. For fiscal year 2012 awards, the expected percentage of vesting is evaluated through April 30, 2014, and reflects the percentage of shares projected to vest for the respective awards at the end of their measurement periods.

The weighted-average grant-date fair value of performance awards outstanding was \$16.47 and \$17.66 at April 30, 2014 and August 1, 2013, respectively.

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The table does not include certain performance-based awards granted to Christopher T. Fraser on February 25, 2014. Such grants to Mr. Fraser included (i) a performance-based Series 3 award for 10,000 shares of common stock (at maximum) having the same performance requirement as those of the 2014 Series 3 awards, and (ii) a performance-based Series 3 award for 4,000 shares of common stock (at maximum) having certain personal objectives as a performance requirement, and in each case such awards vest and are measured over a one year period beginning August 1, 2013 and ending July 31, 2014. As of April 30, 2014, the Series 3 award granted to Mr. Fraser is not expected to vest and the Series 3 award based on personal objectives is expected to vest at 100%.

The weighted-average grant-date fair value of the performance-based awards granted for fiscal year 2014 was \$14.88. The expected percentage of vesting and the percentage of shares projected to vest for the respective awards at the end of their measurement periods are evaluated quarterly.

**Time Based Shares**

A summary of activity for time-based stock awards for the nine months ended April 30, 2014 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Non-vested on August 1, 2013		
Granted <sup>(1)</sup>	72,868	\$ 18.84
Vested <sup>(2)</sup>	(21,268)	18.29
Non-vested on April 30, 2014	51,600	19.06

- (1) Includes 21,600 shares granted to certain executives and employees on February 25, 2014 which generally vest over one, two or three year service periods from the grant date or commencement of their employment. Additionally, the Company granted a time-based award for 30,000 shares to Christopher T. Fraser, when he became the Company's full-time President and CEO on September 24, 2013. These time-based shares vest in equal installments of 6,000 shares each over one, two, three, four and five years, respectively, from the date of grant. Compensation expense will be recorded over the vesting period using the straight-line method. The September 24, 2013 grant date fair value was approximately \$662,000 using the Company's closing stock price of \$22.07 on the grant date.
- (2) Reflects 5,760 shares, 6,380 shares, 4,000 shares and 5,128 shares granted to non-employee directors on April 30, 2014, January 31, 2014, October 31, 2013 and August 27, 2013 respectively, for service for the three months ended April 30, 2014, the three months ended January 31, 2014, the two months ended October 31, 2013 and the three months ended August 31, 2013, respectively. The shares vest on the date of grant and the Company recognizes compensation expense related to the awards over the respective service periods in accordance with GAAP.

Mr. Fraser was granted 50,000 shares upon becoming President and CEO. The shares vested on the date of grant on September 24, 2013, and the Company recognized compensation expense of the grant date fair value of \$1.1 million based on the closing stock price on that date.

The Company's board of directors granted 4,900 shares and 1,000 shares of common stock to certain employees on February 25, 2014 and April 8, 2014, respectively. These shares were vested on the date of grant and related compensation expense of the grant-date fair value of approximately \$90,000, based on the closing stock price at respective grant dates, was recognized during the three months ended April 30, 2014.

The total fair value of shares vested during the nine months ended April 30, 2014 and 2013 was approximately \$1.6 million and \$363,000, respectively.

**Table of Contents****7. Intangible Assets**

Intangible assets are summarized as follows (in thousands):

	<b>Number of Years Weighted Average Amortization Period</b>	<b>Original Cost</b>	<b>April 30, 2014</b>		
			<b>Accumulated Amortization</b>	<b>Foreign Currency Adjustment</b>	<b>Carrying Amount</b>
<b>Intangible assets subject to amortization: (range of useful life):</b>					
Electronic chemicals-related contracts (5-8 years)	6.5	\$ 2,297	\$ (577)	\$ 79	\$ 1,799
Electronic chemicals-related trademarks and patents (10-15 years)	12.0	117	(64)		53
Electronic chemicals-value of product qualifications (5-15 years)	14.1	14,100	(2,080)	827	12,847
<b>Total intangible assets subject to amortization</b>	<b>13.0</b>	<b>\$ 16,514</b>	<b>\$ (2,721)</b>	<b>\$ 906</b>	<b>14,699</b>
<b>Intangible assets not subject to amortization:</b>					
Creosote product registrations					5,339
Penta product registrations					8,765
<b>Total intangible assets not subject to amortization</b>					<b>14,104</b>
<b>Total intangible assets, net</b>					<b>\$ 28,803</b>

	<b>Number of Years Weighted Average Amortization Period</b>	<b>Original Cost</b>	<b>July 31, 2013</b>		
			<b>Accumulated Amortization</b>	<b>Carrying Amount</b>	
<b>Intangible assets subject to amortization: (range of useful life):</b>					
Electronic chemicals-related contracts (5-8 years)	6.5	\$ 2,297	\$ (253)	\$ 2,044	
Electronic chemicals-related trademarks and patents (10-15 years)	12.0	117	(57)	60	
Electronic chemicals-value of product qualifications (5-15 years)	14.1	14,100	(1,047)	13,053	
<b>Total intangible assets subject to amortization</b>	<b>13.0</b>	<b>\$ 16,514</b>	<b>\$ (1,357)</b>	<b>15,157</b>	

**Intangible assets not subject to amortization:**

Creosote product registrations	5,339
Penta product registrations	8,765

<b>Total intangible assets not subject to amortization</b>	<b>14,104</b>
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Total intangible assets, net	\$ 29,261
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Intangible assets subject to amortization are amortized over their estimated useful lives. Amortization expense was approximately \$403,000 and \$74,000 for the three month periods ended April 30, 2014 and 2013, respectively, and \$1.4 million and \$224,000 for the nine month periods ended April 30, 2014 and 2013, respectively.

**8. Dividends**

Dividends of approximately \$349,000 (\$0.03 per share) and \$345,000 (\$0.03 per share) were declared and paid in the third quarter of fiscal years 2014 and 2013, respectively. Dividends of approximately \$1.0 million (\$0.09 per share) and \$1.0 million (\$0.09 per share) were declared and paid in the first nine months of fiscal years 2014 and 2013, respectively. A dividend of \$0.03 per share was approved by the Company's board of directors on May 20, 2014 to be paid on June 20, 2014 to shareholders of record on June 6, 2014.

**Table of Contents****9. Segment Information**

The Company has two reportable segments – electronic chemicals and wood treating chemicals.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(Amounts in thousands)</b>			
<b>Sales</b>				
Electronic chemicals	\$ 61,542	\$ 36,333	\$ 187,422	\$ 111,487
Wood treating chemicals	22,851	23,525	74,710	70,408
<b>Total sales for reportable segments</b>	<b>\$ 84,393</b>	<b>\$ 59,858</b>	<b>\$ 262,132</b>	<b>\$ 181,895</b>
<b>Depreciation and amortization</b>				
Electronic chemicals	\$ 3,202	\$ 1,665	\$ 9,794	\$ 4,754
Wood treating chemicals	104	102	300	314
Other	104	136	328	339
<b>Total consolidated depreciation and amortization</b>	<b>\$ 3,410</b>	<b>\$ 1,903</b>	<b>\$ 10,422</b>	<b>\$ 5,407</b>
<b>Segment income from operations <sup>(1)</sup></b>				
Electronic chemicals	\$ 3,175	\$ 2,978	\$ 9,508	\$ 10,479
Wood treating chemicals	2,092	2,546	5,708	8,132
<b>Total segment income from operations</b>	<b>\$ 5,267</b>	<b>\$ 5,524</b>	<b>\$ 15,216</b>	<b>\$ 18,611</b>

(1) Segment income from operations includes allocated corporate overhead expenses.

Corporate overhead expenses allocated to segment income from operations for the three and nine months ended April 30, 2014 and 2013 were as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(Amounts in thousands)</b>			
Electronic chemicals	\$ 2,054	\$ 1,185	\$ 6,492	\$ 3,816
Wood treating chemicals	1,110	1,037	3,240	3,269
<b>Total corporate overhead expense allocation</b>	<b>\$ 3,164</b>	<b>\$ 2,222</b>	<b>\$ 9,732</b>	<b>\$ 7,085</b>

A reconciliation of total segment information to consolidated amounts is as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>April 30,</b>		<b>April 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(Amounts in thousands)</b>			
<b>Sales</b>				
Total sales for reportable segments	\$ 84,393	\$ 59,858	\$ 262,132	\$ 181,895
Other	44	71	118	329
Net sales	\$ 84,437	\$ 59,929	\$ 262,250	\$ 182,224
<b>Segment income from operations</b>				
Total segment income from operations	\$ 5,267	\$ 5,524	\$ 15,216	\$ 18,611
Other corporate expense <sup>(1)</sup>	(1,292)	(1,169)	(5,758)	(3,956)
Restructuring charges	(1,061)		(5,092)	
Operating income	2,914	4,355	4,366	14,655
Interest expense, net	(926)	(388)	(2,250)	(1,194)
Other expense, net	(105)	(49)	(540)	(175)
Income from continuing operations before income taxes	\$ 1,883	\$ 3,918	\$ 1,576	\$ 13,286

- (1) Other corporate expense primarily represents employee stock-based compensation expenses and those public entity expenses such as board compensation, audit expense, fees related to the listing of our stock, and expenses incurred to pursue acquisition opportunities.

**Table of Contents****10. Long-Term Debt**

The Company's debt consisted of the following (in thousands):

	<b>April 30, 2014</b>	<b>July 31, 2013</b>
	<b>(Amounts in thousands)</b>	
<b>Senior secured debt:</b>		
Note purchase agreement, maturing on December 31, 2014, interest rate of 7.43%	\$ 20,000	\$ 20,000
Revolving loan facility, maturing on April 30, 2018, variable interest rates based on LIBOR plus 2.00% at April 30, 2014 and July 31, 2013	52,000	65,000
Total debt	72,000	85,000
Current maturities of long-term debt	20,000	
Long-term debt, net of current maturities	\$ 52,000	\$ 85,000

To finance the acquisition of the electronic chemicals business in December 2007, the Company entered into an amended and restated credit agreement and a note purchase agreement. The amended and restated credit agreement is now with Wells Fargo Bank, National Association, and with Bank of America, N.A. The note purchase agreement is now with The Prudential Insurance Company of America and Pruco Life Insurance Company.

Initially, the amended and restated credit agreement included a revolving loan facility and a term loan facility. The term loan was paid off in fiscal year 2012, and that aspect of the facility has been removed. The Company amended these facilities several times, most recently in April and in May 2013 to increase the amount that may be borrowed under the revolving loan up to \$110.0 million, to include an accordion feature that allows for an additional revolving loan increase of up to \$25.0 million from current or additional lenders willing to participate, to extend the maturity date of the revolving loan facility to April 30, 2018, and to include a mandatory reduction in revolving loan commitment of \$10.0 million each year from September 30, 2014 to September 30, 2017 totaling \$40.0 million. The matrix for the calculation of interest payable on the revolving loan facility and the method for the calculation of the fixed charge coverage ratio were also revised.

The revolving loan bears interest at a varying rate of LIBOR plus a margin based on our funded debt to earnings before interest, taxes, depreciation and amortization ( EBITDA ).

<b>Ratio of Funded Debt to EBITDA</b>	<b>Margin</b>
Equal to or greater than 2.5 to 1.0	2.25%
Equal to or greater than 2.0 to 1.0, but less than 2.5 to 1.0	2.00%
Equal to or greater than 1.5 to 1.0, but less than 2.0 to 1.0	1.75%
Less than 1.5 to 1.0	1.50%

Advances outstanding under the revolving loan bear interest at 2.15% and 1.69% as of April 30, 2014 and July 31, 2013, respectively. The amount outstanding on the revolving loan at April 30, 2014 was \$52.0 million, and an

additional \$3.5 million is reserved for outstanding letters of credit. The amount that may be borrowed under the revolving facility is limited by a covenant for funded debt to pro-forma earnings before interest, taxes and depreciation, and at April 30, 2014 that limitation restricts the Company's borrowing capacity to \$19.9 million.

The note purchase agreement is for \$20.0 million. Advances under the note purchase agreement mature on December 31, 2014, and bear interest at 7.43% per annum. Principal is payable at maturity. At April 30, 2014, \$20.0 million was outstanding under the note purchase agreement.

Loans under the amended and restated credit agreement and the note purchase agreement are secured by the Company's assets, including inventory, accounts receivable, equipment, intangible assets, and real property. The credit facility and the note purchase agreement have restrictive covenants, including that the Company must maintain a fixed charge coverage ratio of 1.5 to 1.0 or greater, a ratio of funded debt to earnings before interest, taxes and depreciation (as adjusted for extraordinary items, with lender consent) of 3.0 to 1.0 or below, and a current ratio of at least 1.5 to 1.0.

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**Table of Contents****11. Income Taxes**

Income tax expense for the interim periods was computed using the effective tax rate based on the application of an estimated annual effective income tax rate applied to year-to-date income before income tax expense. In determining the estimated annual effective income tax rate, we analyze various factors, including forecasts of projected annual earnings and the ability to use tax credits and net operating loss carry forwards. The overall effective income tax rate for the three and nine month periods ended April 30, 2014 is 34.9% and 110.5%, respectively, primarily due to the valuation allowances recorded during the second quarter of fiscal year 2014 against the Company's current and prior period operating losses for its Italian subsidiary, as a result of the restructuring of those operations. Excluding the Italian results, the estimated annual effective tax rate on ordinary income is 31.3% and 32.0% for the three and nine month periods ended April 30, 2014, respectively. For the three and nine month periods ended April 30, 2013, the overall effective rate was 26.2% and 34.1%. In general, differences between the effective tax rates and the rate of 35.0%, excluding for the effect of restructuring charges and operational results in Italy, are primarily due to foreign and state income taxes, and the distribution of income between the U.S. and foreign operations. In addition, the Company recognized \$190,000 of discrete items benefits in the three months ended April 30, 2014.

**12. Litigation and Other Contingencies**

The Company is subject to contingencies, including litigation relating to environmental laws and regulations, commercial disputes and other matters. Certain of these contingencies are discussed below. The ultimate resolution of these contingencies is subject to significant uncertainty, and should the Company fail to prevail in any of them or should several of them be resolved against the Company in the same reporting period, these matters could, individually or in the aggregate, be material to the consolidated financial statements. The ultimate outcome of these matters, however, cannot be determined at this time, nor can the amount of any potential loss be reasonably estimated, and as a result except where indicated no amounts have been recorded in the Company's consolidated financial statements.

The Company records legal costs associated with loss contingencies as expenses in the period in which they are incurred.

A lawsuit was filed against the Company's wholly-owned subsidiary, KMG de Mexico, relating to the title to the land on which its facility in Matamoros is located. The plaintiffs claim that their title to the land is superior to the person from whom our subsidiary bought the land. The plaintiffs are seeking to have our subsidiary's purchase overturned, and to recover the land and certain improvements or their value. The lawsuit was initially filed in 1998 in Matamoros, Mexico under *Adolfo Cazares Rosas, et al vs. KMG de Mexico and Guillermo Villarreal*. In January 2008, the case was sent by the appeals court back to the lower court to obtain additional factual information, and on April 20, 2009 the plaintiffs were required to re-file the case in the First Civil Court in Matamoros, Tamaulipas, Mexico as *Adolfo Cazares, Luis Escudero and Juan Cue vs. KMG de Mexico and Guillermo Villarreal*. In June 2011 the lower court ruled against KMG de Mexico, and held that the plaintiffs had superior title to the land, but that verdict was overturned on appeal in May 2012, and the case will be returned to the trial court for further action. The Company intends to continue to vigorously defend KMG de Mexico.

The Company's subsidiary in Italy has filed suit in the Provincial Tax Court in Milan, Italy to contest assessments by the taxing authority in Italy pertaining to the three year period ended July 31, 2011. In the aggregate, the amount of the assessments, including interest and penalties, is 1.8 million. If all the adjustments are sustained, the additional liability for the years 2009 through 2011 would total approximately \$2.4 million, including interest and penalties through April 30, 2014 (at an exchange rate of 1.36 \$/€). The Company recorded a liability for an uncertain tax position for items in the amount of \$437,000. The Company intends to vigorously pursue its position before the court, but the

ultimate outcome of this litigation is subject to uncertainty.

The Company's subsidiary in Italy has filed suit in the Provincial Court in Milan, Italy to contest the assessment of additional registration tax against the Company's subsidiary in Italy based on an increased valuation of assets purchased from Air Products and Chemicals, Inc. in December 2007. The amount of the assessment, including interest and penalties through April 30, 2014, is 784,000 (or approximately \$1.1 million, at an exchange rate of 1.36 \$/ ). The ultimate outcome of this assessment is subject to uncertainty.

The Company is subject to federal, state, local and foreign laws and regulations and potential liabilities relating to the protection of the environment and human health and safety including, among other things, the cleanup of contaminated sites, the treatment, storage and disposal of wastes, the emission of substances into the air or waterways, and various health and safety matters. The Company expects to incur substantial costs for ongoing compliance with such laws and regulations. The Company may also face governmental or third-party claims, or otherwise incur costs, relating to cleanup of, or for injuries resulting from, contamination at sites associated with past and present operations. The Company accrues for environmental liabilities when a determination can be made that they are probable and reasonably estimable.

**Table of Contents****13. Restructuring Events**

In October 2013, the Company announced that as part of global restructuring of its electronic chemicals operations, the Fremont, California manufacturing site acquired in the acquisition from OM Group will be closed, and production shifted primarily to the Company's Hollister, California and Pueblo, Colorado facilities. In November 2013, the Company announced that it will close a facility in Milan, Italy, and shift production to facilities in France and the United Kingdom. The Company will continue to operate the warehouse facility in Milan. The Company estimates that restructuring charges, exclusive of accelerated depreciation, will range between \$7.0 million and \$9.0 million cumulatively over fiscal years 2014 and 2015, and that accelerated depreciation with respect to the closed facilities will be approximately \$4.0 million over those two fiscal years.

At April 30, 2014, the accrued liability associated with restructuring and other related charges consisted of the following:

			<b>Non-Cash Decommissioning and Environmental Accelerated</b>		
	<b>Employee Costs</b>	<b>and Environmental</b>	<b>Depreciation</b>	<b>Other</b>	<b>Total</b>
Charges	\$ 2,629	\$ 710	\$ 1,719	\$ 34	\$ 5,092
Payments	(273)				(273)
Adjustment	30	5	22	(6)	51
Accrued liability at April 30, 2014	2,386	715	1,741	28	4,870

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

We manufacture, formulate and distribute specialty chemicals globally. We operate businesses engaged in electronic chemicals and industrial wood treating chemicals. Our electronic chemicals are sold to the semiconductor industry, where they are used primarily to clean and etch silicon wafers in the production of semiconductors. Our wood treating chemicals, pentachlorophenol ( penta ) and creosote are used by our industrial customers primarily to extend the useful life of utility poles and railroad cross-ties.

**Acquisition**

We completed our acquisition of the ultra pure chemicals ( UPC ) business subsidiaries of OM Group, Inc., in the fourth quarter of fiscal year 2013. The purchase price was \$62.6 million. The UPC subsidiaries sell high purity, wet process chemicals to the semiconductor industry.

**Restructuring**

In October 2013, we announced that, as part of global restructuring of our electronic chemicals operations, we would close our Fremont, California manufacturing site acquired in the UPC acquisition, and shift production primarily to our Hollister, California and Pueblo, Colorado facilities. As planned, we ceased production at the Fremont facility, and expect to complete site decommissioning by the end of the fiscal year. In November 2013, we announced that we would close a facility in Milan, Italy, and shift production to our facilities in France and the United Kingdom. We will

continue to operate our warehouse facility in Milan. We have begun decommissioning certain manufacturing equipment in Milan, and have started to transition products from there to other sites in Europe. Overall, the consolidation of our global operations remains on schedule. Total costs related to restructuring accrued for the three and nine months ended April 30, 2014 was approximately \$1.1 million and \$5.1 million, respectively. See Note 13 to the financial statements included in this report. We estimate that restructuring charges, exclusive of accelerated depreciation, will range between \$7.0 million and \$9.0 million cumulatively over fiscal years 2014 and 2015, and that accelerated depreciation with respect to the closed facilities will be approximately \$4.0 million over those two fiscal years.

**Table of Contents****Results of Operations****Three and Nine Month Periods Ended April 30, 2014 compared with the Three and Nine Month Periods Ended April 30, 2013***Segment Net Sales*

Segment data is presented for our two reportable segments for the three and nine month periods ended April 30, 2014 and 2013. The segment data should be read in conjunction with our condensed consolidated financial statements and related notes thereto included elsewhere in this report.

	<b>Three Months Ended April 30,</b>		<b>Nine Months Ended April 31,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(Amounts in thousands)</b>			
<b>Sales</b>				
Electronic chemicals	\$ 61,542	\$ 36,333	\$ 187,422	\$ 111,487
Wood treating chemicals	22,851	23,525	74,710	70,408
Total sales for reportable segments	\$ 84,393	\$ 59,858	\$ 262,132	\$ 181,895

*Net Sales*

Net sales for reportable segments increased \$24.5 million, or 41.0%, to \$84.4 million in the third quarter of fiscal year 2014 from \$59.9 million for the same period of the prior year. For the nine months ended April 30, 2014, net sales for reportable segments increased \$80.2 million, or 44.1%, to \$262.1 million from \$181.9 million in the prior year period. The increase in net sales was because of the UPC acquisition in our electronic chemicals segment.

In the third quarter of fiscal year 2014, the electronic chemicals segment had net sales of \$61.5 million, an increase of \$25.2 million, or 69.4%, as compared to \$36.3 million for the prior year period. For the nine month periods, net sales in the electronic chemicals segment increased \$75.9 million, or 68.1%, to \$187.4 million from \$111.5 million. Net sales in both the third quarter and the first nine months of fiscal year 2014 increased over the prior year periods, because of the UPC acquisition. That acquisition has allowed us to expand our global presence, and expand our ability to serve a broader spectrum of our semiconductor customers' requirements.

Net sales of wood treating chemicals decreased \$674,000, or 2.9%, to \$22.9 million in the third quarter of fiscal year 2014 as compared to \$23.5 million for the prior year period. For the nine month comparison, net sales in the wood treating segment increased \$4.3 million, or 6.1%, to \$74.7 million from \$70.4 million, because of a greater volume of creosote shipments to customers that service the crosstie market. Although our creosote volume increased, demand for creosote is impacted by customers continuing to pre-treat railroad ties with borate to increase the service life of the crosstie. This practice has the effect of reducing the amount of creosote used to treat the tie, and Class I railroads intend to continue purchasing a portion of their ties with the borate treatment. Penta product sales declined approximately \$1.1 million in the third quarter of fiscal year 2014, and declined \$2.1 million for the first nine months of fiscal year 2014. Penta sales were down primarily on lower pricing for hydrochloric acid that is a byproduct of penta production. Penta sales in the Southeast remained weak due to limited timber availability and the absence of

severe weather conditions.

*Gross Profit*

Gross profit increased by \$8.4 million, or 51.6%, to \$24.8 million in the third quarter of fiscal year 2014 from \$16.3 million in the same quarter of the prior year. For the nine month period, gross profit increased \$23.4 million or 44.8%, to \$75.5 million from \$52.1 million in the prior year period. The increase in aggregate gross profit for the quarter and the nine months period was due to sales attributable to the UPC acquisition. Gross profit as a percentage of sales improved to 29.3% in the third quarter of fiscal year 2014 from 27.3% in the third quarter of fiscal year 2013, while gross profit as a percentage of sales was flat for the nine month periods ended April 30, 2014 and 2013. The increase in consolidated gross profit in the quarterly and nine month comparisons came from increased gross profit in our electronic chemicals segment, despite declines of about 13.0% in gross profits for each of the comparable periods in our wood treating chemicals business.

Other companies may include certain costs that we record in cost of sales as distribution expenses or selling, general and administrative expenses, and may include certain of the costs that we record in distribution expenses or selling, general and administrative expenses as a component of cost of sales, resulting in a lack of comparability between our gross profit and that reported by other companies.

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**Table of Contents***Distribution Expenses*

Distribution expenses were up by \$5.6 million in the third quarter of fiscal year 2014 to \$12.0 million from \$6.4 million in the prior year period, an 87.1% increase. Distribution expenses were approximately 14.2% and 10.7% of net sales for the third quarter of fiscal years 2014 and 2013, respectively. Distribution expenses for the nine month periods ending April 30, 2014 and 2013 were \$37.0 million and \$19.4 million, respectively, an increase of \$17.6 million, or 90.9%, in fiscal year 2014 over the prior year period. Distribution expense as percent of revenue of the nine month periods ending April 30, 2014 and 2013 were 14.1% and 10.6% of net sales, respectively. Distribution expense is heavily concentrated in our electronic chemicals business, and the increases in the quarterly and nine month comparisons for that expense in fiscal year 2014 reflect greater volume shipments from UPC-related sales and from expenses for chemical management operations in Singapore. Distribution expense in our Singapore operations were 34.0% of sales in the three months ended April 30, 2014, due to personnel costs in chemical management operations.

*Selling, General and Administrative Expenses*

Selling, general, and administrative expenses increased \$3.2 million, or 58.0%, to \$8.8 million in the third quarter of fiscal year 2014 from \$5.6 million in the same quarter of fiscal year 2013. Those expenses were 10.4% and 9.3% of net sales in the third quarter of fiscal years 2014 and 2013, respectively. For the nine month period, those expenses increased \$11.0 million, or 60.6%, to \$29.1 million from \$18.1 million. Approximately 49.0% and 43.0% of the increase in selling, general and administrative expense in the three and nine months ending April 30, 2014, respectively, as compared with the prior year periods, was attributable to the acquired UPC business, and approximately 31.0% and 27.0% of the increase in the fiscal year 2014 periods over the prior year periods was due to higher professional services, employee-related costs and integration expenses for our UPC acquisition. For the nine months ended April 30, 2014, approximately 12.0% of the increase over the prior year period was due to CEO transition expense. For the first nine months of fiscal year 2014 selling, general and administrative expenses increased over the prior year period, by \$1.5 million in professional services, \$1.3 million of stock-based compensation expense related to our new CEO, and by \$2.0 million of other employee related costs. In the third quarter and first nine months of fiscal year 2013, we incurred \$80,000 and \$1.4 million, respectively, of acquisition-related expense for the UPC acquisition that we were then pursuing.

*Segment Income from Operations*

In the third quarter of fiscal year 2014, operating income in the electronic chemicals segment was \$3.2 million, an increase of \$197,000, or 6.1%, as compared to \$3.0 million for the prior year period. The improvement in the quarterly comparison was due to the effect of the UPC acquisition electronic chemicals business. This increase was partially offset by higher depreciation and amortization expenses of approximately \$1.6 million. For the nine month period, operating income in the electronic chemicals segment decreased \$971,000, or 9.3%, to \$9.5 million from \$10.5 million. The decrease in the nine month comparison was due primarily to increased depreciation and amortization of \$5.0 million, partially offset by operating profits from the acquired UPC business.

In our wood treating chemicals segment, operating income decreased approximately \$454,000, or 17.8%, to \$2.1 million in the third quarter of fiscal year 2014 as compared to \$2.6 million for the prior year period. For the nine month period, operating income in the wood treating segment decreased \$2.4 million or 29.8%, to \$5.7 million from \$8.1 million. Operating income in wood treating chemicals was down in the third quarter of fiscal year 2014 and for the nine months due to lower pricing of the hydrochloric acid that is a byproduct of penta production and lower penta sales in the Southeast. Although creosote volume improved in the quarter and in the nine month period over the prior year, we experienced lower pricing and higher logistics costs, including cleaning costs in the second quarter for a

barge that was returned to its owner.

Other corporate expenses are not allocated to segments in calculating a segment's income from operations. Other corporate expense primarily represents employee stock-based compensation expenses and those public entity expenses such as board compensation, audit expense, fees related to the listing of our stock, and expenses incurred to pursue potential acquisition opportunities. See Note 9 to the financial statements included in this report. For the three and nine months ended April 30, 2014, respectively, other corporate expense includes \$1.5 million and \$3.3 million for professional services, \$300,000 and \$1.5 million for stock based compensation. For the three and nine months ended April 30, 2013, respectively, other corporate expense includes \$750,000 and \$2.0 million for professional services and \$50,000 and \$100,000 for stock based compensation

*Interest Expense, net*

Interest expense was \$926,000 and \$388,000 in the third quarter of fiscal years 2014 and 2013, respectively, and was \$2.3 million and \$1.2 million for the first nine months of fiscal year 2014 and 2013, respectively. The increases in the periods were due to greater amounts outstanding on our revolving loan facility borrowed to consummate our UPC acquisition in May 2013.

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**Table of Contents***Income Taxes*

The overall effective income tax rate for the three and nine month period ended April 30, 2014 was 34.9% and 110.5%, respectively, primarily due to restructuring charges and operational results in Italy for which we will not be able to realize a tax benefit. With the consolidation of our European manufacturing facilities, it is more likely than not that our subsidiary in Italy will not generate a sufficient profit in the near future to recover the restructuring charges. The impact on our Italian subsidiary's tax provision was approximately \$1.4 million, and was recorded in the second quarter of fiscal year 2014. Excluding the Italian results, the estimated annual effective tax rate on ordinary income was 31.3% and 32.0% for the three and nine months ended April 30, 2014. The overall effective rate for continuing operations was 26.2% and 34.1% for the three and nine months ended April 30, 2013, respectively.

*Discontinued Operations*

Discontinued operations reflected a loss before income taxes of \$33,000 and \$187,000 for the third quarter and first nine months of fiscal year 2013, respectively. Those costs were related to the animal health business that was discontinued in March 2012, and to dismantling equipment relating to the agricultural chemicals business that was discontinued in fiscal year 2008.

**Liquidity and Capital Resources***Cash Flows*

For the nine months ended April 30, 2014, operating cash flows were favorably impacted by an increase in accrued liabilities of \$5.4 million and a decrease of \$7.4 million in inventories, primarily in our wood treating chemicals business. Accrued liabilities increased primarily due to recognition of restructuring charges and bonus accruals. Operating cash flows were negatively impacted by a decrease in accounts payable of \$3.5 million primarily in connection with our wood treating segment from the timing of payments for creosote purchases. Net borrowings decreased by \$13.0 million, because of payments on our revolving line of credit.

*Working Capital*

We have a revolving line of credit of \$110.0 million under an amended and restated credit agreement. At April 30, 2014, we had \$52.0 million outstanding under the revolving facility, and an additional \$3.5 million was reserved for outstanding letters of credit, with up to an additional \$54.5 million of additional borrowing capacity. However, the amount that may be borrowed under the revolving facility is limited by a covenant for funded debt to pro-forma earnings before interest, taxes and depreciation ( EBITDA ), and at April 30, 2014 that limitation restricted our borrowing capacity to \$19.9 million. We reduced the principal outstanding on our revolving loan by payments of \$7.0 million and \$13.0 million in the three and nine month periods ended April 30, 2014. Management believes that our current revolving credit facility, combined with cash flows from operations, will adequately provide for our working capital needs for current operations for the next twelve months, and to extend or replace \$20.0 million of indebtedness that matures on December 31, 2014. Management is in the process of accomplishing that extension or replacement, and is reviewing several viable alternatives.

*Long Term Debt*

To finance the acquisition of the electronic chemicals business in December 2007, we entered into an amended and restated credit agreement and a note purchase agreement. The amended and restated credit agreement is now with Wells Fargo Bank, National Association, and with Bank of America, N.A. The note purchase agreement is now with

The Prudential Insurance Company of America and Pruco Life Insurance Company.

Initially, the amended and restated credit agreement included a revolving loan facility and a term loan facility. The term loan was paid off in fiscal year 2012, and that aspect of the facility has been removed. We amended the facilities and the note purchase agreement several times, most recently in April and in May 2013 to increase the amount that may be borrowed under the revolving loan up to \$110.0 million, to include an accordion feature that allows for an additional revolving loan increase of up to \$25.0 million from current or additional lenders willing to participate, to extend the maturity date to April 30, 2018, and to include a mandatory reduction in revolving loan commitment of \$10.0 million each year from September 30, 2014 to September 30, 2017 totaling \$40.0 million. The matrix for the calculation of interest payable on the revolving loan facility and the method for the calculation of the fixed charge coverage ratio were also revised.

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The revolving loan matures April 30, 2018, and bears interest at a varying rate of LIBOR plus a margin based on our funded debt to EBITDA ratio, as described below.

<b>Ratio of Funded Debt to EBITDA</b>	<b>Margin</b>
Equal to or greater than 2.5 to 1.0	2.25%
Equal to or greater than 2.0 to 1.0, but less than 2.5 to 1.0	2.00%
Equal to or greater than 1.5 to 1.0, but less than 2.0 to 1.0	1.75%
Less than 1.5 to 1.0	1.50%

Advances under the revolving loan bear interest at 2.15% and 1.69% as of April 30, 2014 and July 31, 2013, respectively. At April 30, 2014, \$52.0 million was outstanding on the revolving loan, and an additional \$3.5 million was reserved for outstanding letters of credit.

The note purchase agreement is for \$20.0 million. Advances under the note purchase agreement mature on December 31, 2014, and bear interest at 7.43% per annum. Principal is payable at maturity. At April 30, 2014, \$20.0 million was outstanding under the note purchase agreement.

Loans under the amended and restated credit agreement and the note purchase agreement are secured by our assets, including stock in subsidiary inventory, accounts receivable, equipment, intangible assets and real property. The credit facility and the note have restrictive covenants, including that the Company must maintain a fixed charge coverage ratio of 1.5 to 1.0 or greater, and funded debt to EBITDA (as adjusted for extraordinary items, with lender consent) of no more than 3.0 to 1.0, and a current ratio of at least 1.5 to 1.0. On April 30, 2014, we were in compliance with all of our debt covenants.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements, such as financing or unconsolidated variable interest entities, other than operating leases.

**Disclosure Regarding Forward Looking Statements**

We are including the following discussion to inform our existing and potential security holders generally of some of the risks and uncertainties that can affect us and to take advantage of the safe harbor protection for forward-looking statements that applicable federal securities law affords. From time to time, our management or persons acting on our behalf make forward-looking statements to inform existing and potential security holders about our company. These forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as future capital expenditures, business strategy, competitive strengths, goals, growth of our business and operations, plans and references to future successes may be considered forward-looking statements. Also, when we use words such as anticipate, believe, estimate, intend, plan, project, forecast, may, should, budget, goal, expect, expressions, we are making forward-looking statements. Many risks and uncertainties may impact the matters addressed in these forward-looking statements. Our forward-looking statements speak only as of the date made and we will not update forward-looking statements unless the securities laws require us to do so.

Some of the key factors which could cause our future financial results and performance to vary from those expected include:

the loss or significant reduction in business from primary customers;

the loss of key suppliers;

the integration of our UPC acquisition taking longer or being more costly than currently believed, or the failure to achieve all the planned benefits of that integration;

penta being banned or restricted as a persistent organic pollutant under the Stockholm Convention Treaty;

the implementation of a new enterprise resource planning system taking longer or being more costly than currently believed;

our ability to implement productivity improvements, cost reduction initiatives or facilities expansions;

market developments affecting, and other changes in, the demand for our products and the entry of new competitors or the introduction of new competing products;

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availability or increases in the price of energy, our primary raw materials and active ingredients;

the timing of planned capital expenditures;

our ability to identify, develop or acquire, and market additional product lines and businesses necessary to implement our business strategy and our ability to finance such acquisitions and development;

the condition of the capital markets generally, which will be affected by interest rates, foreign currency fluctuations and general economic conditions;

cost and other effects of legal and administrative proceedings, settlements, investigations and claims, including environmental liabilities which may not be covered by indemnity or insurance;

the effects of weather, earthquakes, other natural disasters and terrorist attacks;

the ability to obtain registration and re-registration of our products under applicable law;

the political and economic climate in the foreign or domestic jurisdictions in which we conduct business; and

other United States or foreign regulatory or legislative developments which affect the demand for our products generally or increase the environmental compliance cost for our products or impose liabilities on the manufacturers and distributors of such products.

The information contained in this report, including the information set forth under the heading "Risk Factors", identifies additional factors that could cause our results or performance to differ materially from those we express in our forward-looking statements. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions and, therefore, the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements which are included in this report and the exhibits and other documents incorporated herein by reference, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

We are exposed to certain market risks in the ordinary course of our business, arising primarily from changes in interest rates and to a lesser extent foreign currency exchange rate fluctuations. Generally we do not utilize derivative financial instruments or hedging transactions to manage that risk. Our exposure to interest rate risk and foreign currency risk is discussed in our Annual Report on Form 10-K for the fiscal year ended July 31, 2013. There has been no material change in that information.

**ITEM 4. CONTROLS AND PROCEDURES**

The term disclosure controls and procedures is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There were no changes to our internal control over financial reporting during the quarterly period covered by this Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The information set forth in Note 12 to the condensed consolidated financial statements is incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors contained in our Annual Report on Form 10-K for the fiscal year ended July 31, 2013.

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**ITEM 5. OTHER INFORMATION**

The Nominating and Corporate Governance Committee will consider recommendations for directors made by shareholders for next annual meeting of shareholders, if such recommendations are received in writing, addressed to the chair of the committee, Mr. John C. Hunter III, in care of the Company, at 9555 W. Sam Houston Parkway S., Suite 600, Houston, Texas 77099 by July 15, 2014.

**ITEM 6. EXHIBITS**

The financial statements are filed as part of this report in Part 1, Item 1. The following documents are filed as exhibits. Documents marked with an asterisk (\*) are management contracts or compensatory plans, and portions of documents marked with a dagger ( † ) have been granted confidential treatment.

31.1	Certificates under Section 302 the Sarbanes-Oxley Act of 2002 of the Chief Executive Officer.
31.2	Certificates under Section 302 the Sarbanes-Oxley Act of 2002 of the Chief Financial Officer.
32.1	Certificates under Section 906 of the Sarbanes-Oxley Act of 2002 of the Chief Executive Officer.
32.2	Certificates under Section 906 of the Sarbanes-Oxley Act of 2002 of the Chief Financial Officer.
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KMG Chemicals, Inc.

By: /s/ Christopher T. Fraser  
Christopher T. Fraser  
President and Chief Executive Officer

Date: June 9, 2014

By: /s/ Malinda G. Passmore  
Malinda G. Passmore  
Chief Financial Officer

Date: June 9, 2014