

HAWKINS INC  
Form 10-Q  
February 03, 2014

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

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

For the quarterly period ended December 29, 2013  
Commission file number 0-7647

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

MINNESOTA  
(State or other jurisdiction of  
incorporation or organization)  
2381 ROSEGATE, ROSEVILLE, MINNESOTA 55113  
(Address of principal executive offices, including zip code)  
(612) 331-6910  
(Registrant's telephone number, including area code)

41-0771293  
(I.R.S. Employer  
Identification No.)

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

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

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

Large Accelerated Filer  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

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

CLASS	Shares Outstanding at January 31, 2014
Common Stock, par value \$.05 per share	10,620,560



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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## HAWKINS, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In thousands, except share data)

	December 29, 2013	March 31, 2013
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$27,860	\$28,715
Investments available-for-sale	13,951	15,625
Trade receivables — less allowance for doubtful accounts: \$412 as of December 29, 2013 and \$469 as of March 31, 2013	34,318	35,920
Inventories	30,724	28,208
Prepaid expenses and other current assets	3,398	2,613
Total current assets	110,251	111,081
<b>PROPERTY, PLANT, AND EQUIPMENT:</b>		
Less accumulated depreciation and amortization	(68,115	) (62,081
Net property, plant, and equipment	91,349	90,974
<b>OTHER ASSETS:</b>		
Goodwill	7,392	6,495
Intangible assets — less accumulated amortization: \$2,886 as of December 29, 2013 and \$2,398 as of March 31, 2013	8,692	7,678
Long-term investments	12,941	5,597
Other	322	323
Total other assets	29,347	20,093
Total assets	\$230,947	\$222,148
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable — trade	\$17,500	\$18,516
Dividends payable	—	3,592
Accrued payroll and employee benefits	5,600	5,391
Deferred income taxes	2,175	2,554
Income tax payable	1,849	1,446
Other current liabilities	4,278	3,626
Total current liabilities	31,402	35,125
<b>PENSION WITHDRAWAL LIABILITY</b>	6,961	7,136
<b>OTHER LONG-TERM LIABILITIES</b>	1,786	1,653
<b>DEFERRED INCOME TAXES</b>	9,870	8,062
Total liabilities	50,019	51,976
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock; authorized: 30,000,000 shares of \$0.05 par value; 10,547,822 and 10,495,427 shares issued and outstanding as of December 29, 2013 and March 31, 2013, respectively	528	525
Additional paid-in capital	49,651	48,779
Retained earnings	130,954	120,974
Accumulated other comprehensive loss	(205	) (106
Total shareholders' equity	180,928	170,172

Total liabilities and shareholders' equity	\$230,947	\$222,148
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See accompanying notes to condensed consolidated financial statements.

## HAWKINS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

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

	Three Months Ended		Nine Months Ended	
	December 29, 2013	December 30, 2012	December 29, 2013	December 30, 2012
Sales	\$81,697	\$85,527	\$263,040	\$262,786
Cost of sales	(68,147 )	(70,191 )	(215,689 )	(212,947 )
Pension withdrawal	—	(7,210 )	—	(7,210 )
Gross profit	13,550	8,126	47,351	42,629
Selling, general and administrative expenses	(8,167 )	(7,617 )	(25,430 )	(23,299 )
Operating income	5,383	509	21,921	19,330
Interest (expense) income	9	35	(18 )	99
Income from continuing operations before income taxes	5,392	544	21,903	19,429
Income tax provision	(1,912 )	804	(8,104 )	(6,486 )
Income from continuing operations	3,480	1,348	13,799	12,943
Income from discontinued operations, net of tax	—	—	—	18
Net income	\$3,480	\$1,348	\$13,799	\$12,961
Weighted average number of shares outstanding - basic	10,547,882	10,474,214	10,538,595	10,454,669
Weighted average number of shares outstanding - diluted	10,595,935	10,535,549	10,590,880	10,528,150
Basic earnings per share				
Earnings per share from continuing operations	\$0.33	\$0.13	\$1.31	\$1.24
Earnings per share from discontinued operations	—	—	—	—
Basic earnings per share	\$0.33	\$0.13	\$1.31	\$1.24
Diluted earnings per share				
Earnings per share from continuing operations	\$0.33	\$0.13	\$1.30	\$1.23
Earnings per share from discontinued operations	—	—	—	—
Diluted earnings per share	\$0.33	\$0.13	\$1.30	\$1.23
Cash dividends declared per common share	\$—	\$—	\$0.36	\$0.34

See accompanying notes to condensed consolidated financial statements.

## HAWKINS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In thousands)

	Three Months Ended		Nine Months Ended	
	December 29, 2013	December 30, 2012	December 29, 2013	December 30, 2012
Net income	\$3,480	\$1,348	\$13,799	\$12,961
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on available-for-sale investments	(17	) 1	(61	) 7
Unrealized gain (loss) on post-retirement liability	(38	) —	(38	) 78
Total other comprehensive income (loss)	(55	) 1	(99	) 85
Total comprehensive income	\$3,425	\$1,349	\$13,700	\$13,046

See accompanying notes to condensed consolidated financial statements.

## HAWKINS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)

	Nine Months Ended	
	December 29, 2013	December 30, 2012
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$13,799	\$12,961
Reconciliation to cash flows:		
Depreciation and amortization	9,678	7,224
Deferred income taxes	1,216	80
Stock compensation expense	946	1,235
Pension withdrawal liability	—	7,210
Loss from property disposals	35	140
Changes in operating accounts providing (using) cash, net of effects of acquisition:		
Trade receivables	1,708	2,803
Inventories	(2,188	) (1,281
Accounts payable	(301	) 1,711
Accrued liabilities	402	(1,987
Income taxes	403	1,070
Other	(786	) (1,162
Net cash provided by operating activities	24,912	30,004
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Additions to property, plant, and equipment	(10,489	) (20,083
Purchases of investments	(17,956	) (16,795
Sale and maturities of investments	12,185	8,530
Acquisitions	(2,416	) (100
Proceeds from property disposals	114	160
Net cash used in investing activities	(18,562	) (28,288
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Cash dividends paid	(7,410	) (6,936
New shares issued	459	500
Shares surrendered for payroll taxes	(485	) —
Proceeds from the exercise of stock options	186	515
Excess tax benefit from share-based compensation	45	222
Net cash used in financing activities	(7,205	) (5,699
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(855</b>	<b>) (3,983</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>28,715</b>	<b>28,566</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$27,860</b>	<b>\$24,583</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>		
Cash paid for income taxes	\$6,426	\$5,124
Noncash investing activities - Capital expenditures in accounts payable	\$529	\$516
See accompanying notes to condensed consolidated financial statements.		



## HAWKINS, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## Note 1 – Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions for Form 10-Q and, accordingly, do not include all information and footnotes required by generally accepted accounting principles for complete financial statements. These statements should be read in conjunction with the consolidated financial statements and footnotes included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013, previously filed with the Securities and Exchange Commission (“SEC”). In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly our financial position and the results of our operations and cash flows for the periods presented. All adjustments made to the interim condensed consolidated financial statements were of a normal recurring nature. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounting policies we follow are set forth in “Item 8. Financial Statements and Supplementary Data, Note 1 – Nature of Business and Significant Accounting Policies” to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013 filed with the SEC on May 30, 2013. There has been no significant change in our accounting policies since the end of fiscal 2013.

The results of operations for the nine months ended December 29, 2013 are not necessarily indicative of the results that may be expected for the full year.

References to fiscal 2013 refer to the fiscal year ended March 31, 2013 and references to fiscal 2014 refer to the fiscal year ending March 30, 2014.

## Note 2 – Earnings per Share

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

	Three Months Ended		Nine Months Ended	
	December 29, 2013	December 30, 2012	December 29, 2013	December 30, 2012
Weighted-average common shares outstanding—basic	10,547,882	10,474,214	10,538,595	10,454,669
Dilutive impact of stock options, performance units, and restricted stock	48,053	61,335	52,285	73,481
Weighted-average common shares outstanding—diluted	10,595,935	10,535,549	10,590,880	10,528,150

For the three and nine months ended December 29, 2013 and December 30, 2012, there were no shares or stock options excluded from the calculation of weighted-average common shares for diluted EPS.

## Note 3 – Business Combinations

Acquisition of Advance Chemical Solutions, Inc.: On October 1, 2013, we acquired substantially all of the assets of Advance Chemical Solutions, Inc. (“ACS”), under the terms of an asset purchase agreement with ACS and its shareholders. We paid \$2.4 million in cash, and may be obligated to pay an aggregate of \$0.5 million in additional consideration to ACS over the next three years. The amount of such additional payments will be based on the achievement of certain financial performance targets for each of the next three years. Costs associated with this transaction were immaterial.

The acquisition has been accounted for under the acquisition method of accounting, under which the total estimated purchase price is allocated to the net tangible and intangible assets of ACS acquired in connection with the acquisition, based on their estimated fair values.

In connection with this acquisition, we estimated the fair value of the future consideration payable and recorded \$0.4 million for such consideration on our balance sheet. We have determined that this liability is a Level 3 fair value measurement within the FASB's fair value hierarchy, and such liability is adjusted to fair value at each reporting date, with the adjustment reflected

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in selling, general and administrative expenses. The fair value adjustments recorded during the three months ended December 29, 2013 were immaterial.

We estimated the fair value of the assets acquired and liabilities assumed to be \$2.8 million using a discounted cash flow analysis (income approach). Fair values of acquired assets and liabilities include: \$0.4 million of net working capital and fixed assets; \$1.5 million to intangible assets; and \$0.9 million to goodwill. The goodwill recognized as a result of the ACS acquisition is primarily attributable to expected synergies. Such goodwill is deductible for tax purposes.

ACS had revenues of approximately \$4 million for the 12 months ended September 30, 2013. The results of its operations since the acquisition date, and the goodwill associated with this acquisition, are included in our Water Treatment segment.

#### Note 4 – Cash and Cash Equivalents and Investments

The following table presents information about our financial assets that are measured at fair value on a recurring basis, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value.

	December 29, 2013	Level 1	Level 2	Level 3
(In thousands)				
Assets:				
Cash	\$27,860	\$27,860	\$—	\$—
Certificates of deposit	23,209	—	23,209	—
Municipal bonds	3,684	—	3,684	—

	March 31, 2013	Level 1	Level 2	Level 3
(In thousands)				
Assets:				
Cash	\$28,715	\$28,715	\$—	\$—
Certificates of deposit	21,222	—	21,222	—

Our financial assets that are measured at fair value on a recurring basis are certificates of deposit (“CD’s”) and municipal bonds, with original maturities ranging from three months to three years that fall within valuation technique Level 2. The CD’s and municipal bonds are classified as investments in current assets and noncurrent assets on the condensed consolidated balance sheets. As of December 29, 2013, the combined CD’s and municipal bonds had a fair value of \$14.0 million in current assets and \$12.9 million in noncurrent assets.

The carrying value of cash and cash equivalents accounts approximates fair value, as original maturities are three months or less.

#### Note 5 – Inventories

Inventories at December 29, 2013 and March 31, 2013 consisted of the following:

	December 29, 2013	March 31, 2013
(In thousands)		
Inventory (FIFO basis)	\$37,640	\$35,281
LIFO reserve	(6,916)	(7,073)
Net inventory	\$30,724	\$28,208

The first in, first out (“FIFO”) value of inventories accounted for under the last in, first out (“LIFO”) method was \$32.8 million at December 29, 2013 and \$30.3 million at March 31, 2013. The remainder of the inventory was valued and accounted for under the FIFO method.

The LIFO reserve changed nominally during the three months ended December 29, 2013, and increased \$0.1 million during the three months ended December 30, 2012. During the nine months ended December 29, 2013 the LIFO reserve decreased \$0.2 million, and for the nine months ended December 30, 2012 the LIFO reserve increased \$0.2

million. The valuation of LIFO inventory for interim periods is based on our estimates of year-end inventory levels and costs.

## Note 6 – Goodwill and Intangible Assets

Goodwill. The carrying amount of goodwill as of December 29, 2013 and March 31, 2013 was \$7.4 million and \$6.5 million, respectively. The increase in goodwill is related to goodwill recorded in conjunction with the acquisition of ACS as discussed in Note 3.

Intangible assets. Intangible assets consist primarily of customer lists, trademarks, trade secrets and non-compete agreements classified as finite life and trade names classified as indefinite life, related to business acquisitions. A summary of our intangible assets as of December 29, 2013 and March 31, 2013 were as follows:

(In thousands)	December 29, 2013			March 31, 2013		
	Gross Amount	Accumulated Amortization	Net	Gross Amount	Accumulated Amortization	Net
Finite-life intangible assets						
Customer relationships	\$6,913	\$(1,205)	) \$5,708	\$5,508	\$(981)	) \$4,527
Trademark	1,335	(379)	) 956	1,240	(274)	) 966
Trade secrets	962	(736)	) 226	962	(640)	) 322
Carrier relationships	800	(237)	) 563	800	(177)	) 623
Other finite-life intangible assets	341	(329)	) 12	339	(326)	) 13
Total finite-life intangible assets	10,351	(2,886)	) 7,465	8,849	(2,398)	) 6,451
Indefinite-life intangible assets	1,227	—	) 1,227	1,227	—	) 1,227
Total intangible assets	\$11,578	\$(2,886)	) \$8,692	\$10,076	\$(2,398)	) \$7,678

## Note 7 – Income Taxes

In the preparation of our condensed consolidated financial statements, management calculates income taxes based upon the estimated effective rate applicable to operating results for the full fiscal year. This includes estimating the current tax liability as well as assessing differences resulting from different treatment of items for tax and book accounting purposes. These differences result in deferred tax assets and liabilities, which are recorded on the condensed consolidated balance sheet. These assets and liabilities are analyzed regularly and management assesses the likelihood that deferred tax assets will be recovered from future taxable income. We record any interest and penalties related to income taxes as income tax expense in the condensed consolidated statements of income.

We recognize the effect of income tax positions only if those positions are more likely than not of being sustained.

Changes in recognition or measurement are reflected in the period in which the change in judgment occurs.

We file income tax returns in the U.S. federal jurisdiction and numerous state and local jurisdictions. The tax years beginning with our fiscal year ended March 29, 2009 remain open to examination by the Internal Revenue Service, and with few exceptions, state and local income tax jurisdictions.

## Note 8 – Accumulated Other Comprehensive Loss

Components of accumulated other comprehensive loss on our balance sheet, net of tax, were as follows:

(In thousands)	December 29, 2013	March 31, 2013
Unrealized gain (loss) on:		
Available-for-sale investments	\$(50)	) \$11
Post-retirement plan liability	(155)	) (117)
Accumulated other comprehensive loss	\$(205)	) \$(106)

## Note 9 – Share-Based Compensation

Stock Option Awards. Although no stock options have been granted since the fiscal year ended March 28, 2010, our Board of Directors (the "Board") previously approved a long-term incentive equity compensation arrangement for our executive officers that provided for the grant of non-qualified stock options that vested at the end of a three-year period. As of December 29, 2013, we had 9,333 stock options outstanding and exercisable at a weighted average exercise price of \$19.90. No compensation expense was recorded related to stock options for the three and nine months ended December 29, 2013. Compensation expense related to stock options for the three and nine month periods ended December 30, 2012 was nominal.



Performance-Based Restricted Stock Units. The Board approved a performance-based equity compensation arrangement for our executive officers during the first quarters of each of fiscal 2014 and 2013. These performance-based arrangements provide for the grant of performance-based restricted stock units that represent a possible future issuance of restricted shares of our common stock based on a pre-tax income target for the applicable fiscal year. The actual number of restricted shares to be issued to each executive officer is determined when our final financial information becomes available after the applicable fiscal year and will be between zero shares and 39,833 shares in the aggregate for fiscal 2014. The restricted shares issued will fully vest two years after the last day of the fiscal year on which the performance is based. We are recording the compensation expense for the outstanding performance share units and the converted restricted stock over the life of the awards.

The following table represents the restricted stock activity for the nine months ended December 29, 2013:

	Shares	Weighted-Average Grant Date Fair Value
Outstanding at beginning of period	63,244	\$34.26
Granted	28,648	40.25
Vested	(36,182)	) 35.20
Forfeited or expired	(3,606)	) 33.01
Outstanding at end of period	52,104	\$36.99

We recorded compensation expense of \$0.2 million and \$0.6 million related to performance share units and restricted stock for the three and nine months ended December 29, 2013, respectively. We recorded compensation expense of \$0.3 million and \$0.8 million related to performance share units and restricted stock for the three and nine months ended December 30, 2012, respectively. Substantially all of the compensation expense was recorded in selling, general and administrative expenses in the condensed consolidated statements of income.

Restricted Stock Awards. As part of their retainer, each non-employee director receives an annual grant of restricted stock for their Board services. The restricted stock awards are expensed over the requisite vesting period, which is one year from the date of issuance, based on the market value on the date of grant. As of December 29, 2013, there were 6,055 shares of restricted stock with a weighted averaged grant date fair value of \$40.42 outstanding under this program. Compensation expense for each of the the three and nine months ended December 29, 2013 and December 30, 2012 related to restricted stock awards to the Board was \$0.1 million and \$0.2 million, respectively.

#### Note 10 – Employee Pension Plans

Multiemployer pension plan. In fiscal 2013, we concluded negotiations with two collective bargaining units to discontinue our participation in the Central States, Southeast and Southwest Areas Pension Fund (“CSS” or “the plan”), a collectively bargained multiemployer pension plan. As a result, we recorded a pre-tax charge of \$7.2 million (approximately \$4.5 million after tax, or \$0.43 per share, fully diluted) in the third quarter of fiscal 2013. This charge represents the discounted value of our withdrawal payment obligation and was recorded as a charge to cost of sales in our Industrial segment.

Payment of our share of the unfunded vested benefit liability will be made over 20 years and is subject to a cap. At the end of the 20-year period we will have no further liability, even if our share of the unfunded vested benefit liability has not yet been paid in full. The aggregate cash payments to be made will total approximately \$9.3 million, or \$467,000 per year. Our payments began in the third quarter of fiscal 2014.

Effective March 1, 2013, we established defined-contribution retirement benefits to our union employees that are similar to those benefits currently offered to our non-union employees.

#### Note 11 – Litigation, Commitments and Contingencies

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

In the first quarter of fiscal 2013, we entered into a settlement agreement with a chemical supplier to us, pursuant to which we mutually resolved the previously disclosed litigation and all disputes among us. The settlement provided for a cash payment by us to the supplier and provided that both parties enter into new contracts for the supply by the supplier of certain chemicals to us. Our obligations under the settlement agreement resulted in a \$3.2 million charge to pre-tax income recorded in cost of sales



in our Industrial segment (approximately \$2.0 million after tax, or \$0.19 per share, fully diluted) in the first quarter of fiscal 2013.

#### Note 12 – Segment Information

We have two reportable segments: Industrial and Water Treatment. The accounting policies of the segments are the same as those described in the summary of significant accounting policies as disclosed in our fiscal 2013 Annual Report on Form 10-K. Product costs and expenses for each segment are based on actual costs incurred along with cost allocation of shared and centralized functions. We evaluate performance based on profit or loss from operations before income taxes not including nonrecurring gains and losses. Reportable segments are defined by product and type of customer. Segments are responsible for the sales, marketing and development of their products and services. The segments do not have separate accounting, administration, customer service or purchasing functions. There are no intersegment sales and no operating segments have been aggregated. Given our nature, it is not practical to disclose revenues from external customers for each product or each group of similar products. No single customer's revenues amounted to 10% or more of our total revenue. Sales are primarily within the United States and all assets are located within the United States.

(In thousands)	Industrial	Water Treatment	Total
Three months ended December 29, 2013:			
Sales	\$58,510	\$23,187	\$81,697
Gross profit	7,351	6,199	13,550
Selling, general, and administrative expenses	4,799	3,368	8,167
Operating income	2,552	2,831	5,383
Three months ended December 30, 2012:			
Sales	\$63,109	\$22,418	\$85,527
Gross profit	2,627	5,499	8,126
Selling, general, and administrative expenses	4,731	2,886	7,617
Operating income	(2,104	) 2,613	509
Nine months ended December 29, 2013:			
Sales	\$182,224	\$80,816	\$263,040
Gross profit	23,855	23,496	47,351
Selling, general, and administrative expenses	15,114	10,316	25,430
Operating income	8,741	13,180	21,921
Nine months ended December 30, 2012:			
Sales	\$182,474	\$80,312	\$262,786
Gross profit	19,992	22,637	42,629
Selling, general, and administrative expenses	14,261	9,038	23,299
Operating income	5,731	13,599	19,330

Gross profit for our Industrial segment was negatively impacted by the \$7.2 million (pre-tax) charge in the third quarter of fiscal 2013 related to our withdrawal from a multiemployer pension plan as discussed in Note 10, and was negatively impacted by the \$3.2 million (pre-tax) charge in the first quarter of fiscal 2013 related to the legal settlement discussed in Note 11. The cumulative impact of these pre-tax charges to the industrial gross profit for the nine months ended December 30, 2012 was \$10.4 million.

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

The following is a discussion and analysis of our financial condition and results of operations for the three and nine months ended December 29, 2013 as compared to December 30, 2012. This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements included in this Form 10-Q and Item 8 of our Annual Report on Form 10-K for the fiscal year ended March 31, 2013 ("fiscal 2013"). References to fiscal 2014 refer to the fiscal year ending March 30, 2014.

### Overview

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

We have continued to invest in infrastructure to support increased business. During fiscal 2013, we completed construction of a new Industrial manufacturing facility in Rosemount, Minnesota. The site provides capacity for future business growth and lessens our dependence on our flood-prone sites on the Mississippi River. While we have transferred some blending and manufacturing activity to the Rosemount site, we do not intend to close any sites we currently operate as a result of this transfer of activity. In the first nine months of fiscal 2014, we incurred incremental costs compared to the same period of fiscal 2013 related to this new facility of approximately \$1.5 million, which have been recorded in cost of sales in our Industrial segment. We expect to incur incremental costs for the entire fiscal year of approximately \$1.6 million to operate this facility.

In April 2013, we moved into a new corporate headquarters located in Roseville, Minnesota. The move was necessary because we had outgrown our former corporate headquarters that had been our home for over 60 years. As a result of this move, we incurred incremental costs during the first nine months of fiscal 2014 of approximately \$0.8 million, recorded in selling, general and administrative expenses and allocated among both our Water Treatment and Industrial segments. We expect to incur incremental costs for the entire fiscal year of approximately \$1.1 million in fiscal 2014 to lease and operate this facility.

In the first quarter of fiscal 2013, we entered into a settlement agreement with a chemical supplier to us, pursuant to which we mutually resolved the previously disclosed litigation and all disputes among us. The settlement agreement provided for a cash payment by us to the supplier and provided that both parties enter into new contracts for the supply by the supplier of certain chemicals to us. Our obligations under the settlement agreement resulted in a \$3.2 million charge to pre-tax income recorded in cost of sales in our Industrial segment (approximately \$2.0 million after tax, or \$0.19 per share, fully diluted) in the first quarter of fiscal 2013.

In the third quarter of fiscal 2013, we recorded a pre-tax charge of \$7.2 million in our Industrial segment (approximately \$4.5 million after tax, or \$0.43 per share, fully diluted). This charge represented the discounted value of our estimated withdrawal payment obligation from the Central States, Southeast and Southwest Areas Pension Fund ("CSS" or "the plan"), a collectively bargained multiemployer pension plan. Our payments began in the third quarter of fiscal 2014.

In the second quarter of fiscal 2014, we vacated the leased facility used to serve our bulk pharmaceutical customers and transferred production of certain products to our other Industrial production facilities while discontinuing production of the remaining product lines. As a result, we recorded a pre-tax charge of approximately \$0.8 million in cost of sales in our Industrial segment (approximately \$0.5 million after tax) primarily related to accelerated depreciation on leasehold improvements and manufacturing equipment related to this facility in the first half of fiscal 2014.

In the third quarter of fiscal 2014, we acquired substantially all the assets of Advance Chemical Solutions, Inc. (“ACS”), under the terms of an asset purchase agreement with ACS and its shareholders. We paid \$2.4 million in cash, and may be obligated to pay an aggregate of \$0.5 million in additional consideration to ACS over the next three years depending upon the achievement of certain financial performance targets. ACS had revenues of approximately \$4 million for the 12 months ended September 30, 2013. The results of its operations since the acquisition date are included in our Water Treatment segment.

We use the last in, first out (“LIFO”) method for valuing substantially all our inventory, which causes the most recent product costs to be recognized in our income statement. The valuation of LIFO inventory for interim periods is based on our estimates of fiscal year-end inventory levels and costs. The LIFO inventory valuation method and the resulting cost of sales are consistent with our business practices of pricing to current chemical raw material prices. Our LIFO reserve for the three months ended December 29, 2013 changed nominally. For the nine months ended December 29, 2013 we recorded a \$0.2 million decrease in

our LIFO reserve which increased our gross profit in the period by that amount. We recorded a \$0.1 million increase in our LIFO reserve for the three months ended December 30, 2012 and a \$0.2 million increase in our LIFO reserve for the nine months ended December 30, 2012, both of which decreased our gross profit for the respective periods by those amounts

### Results of Operations

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

	Three months ended		Nine months ended		
	December 29, 2013	December 30, 2012	December 29, 2013	December 30, 2012	
Sales	100.0	% 100.0	% 100.0	% 100.0	%
Cost of sales	(83.4	)% (82.1	)% (82.0	)% (81.0	)%
Pension withdrawal	—	% (8.4	)% —	% (2.7	)%
Gross profit	16.6	% 9.5	% 18.0	% 16.3	%
Selling, general and administrative expenses	(10.0	)% (8.9	)% (9.7	)% (8.9	)%
Operating income	6.6	% 0.6	% 8.3	% 7.4	%
Interest (expense) income	—	% —	% —	% —	%
Income from continuing operations before income taxes	6.6	% 0.6	% 8.3	% 7.4	%
Income tax provision	(2.3	)% 1.0	% (3.1	)% (2.5	)%
Income from continuing operations	4.3	% 1.6	% 5.2	% 4.9	%
Income from discontinued operations, net of tax	—	% —	% —	% —	%
Net income	4.3	% 1.6	% 5.2	% 4.9	%

#### Three Months Ended December 29, 2013 Compared to the Three Months Ended December 30, 2012

##### Sales

Sales decreased \$3.8 million, or 4.5%, to \$81.7 million for the three months ended December 29, 2013, as compared to \$85.5 million for the same period of the prior year. Sales of bulk chemicals accounted for approximately 25% of sales dollars during the third quarter of both fiscal 2014 and fiscal 2013.

**Industrial Segment.** Industrial segment sales decreased \$4.6 million, or 7.3%, to \$58.5 million for the three months ended December 29, 2013, as compared to \$63.1 million for the same period of the prior year. Our overall volumes decreased from the same period a year ago. While volumes of our bulk commodity products were higher, these bulk products carry lower per-unit selling prices. In addition, competitive pricing pressures negatively impacted our overall sales growth in this quarter.

**Water Treatment Segment.** Water Treatment segment sales for the third quarter of fiscal 2014 increased \$0.8 million, or 3.4% to \$23.2 million, as compared to \$22.4 million for the same period of the prior year. The higher sales were driven by our newly-acquired ACS operations, as well as increased sales of certain specialty chemical products and equipment, partially offset by competitive pricing pressure on bulk commodity products.

##### Gross Profit

Gross profit increased \$5.4 million to \$13.6 million, or 16.6% of sales, for the three months ended December 29, 2013, as compared to \$8.1 million, or 9.5% of sales, for the same period of the prior year. Gross profit in the Industrial segment increased \$4.7 million, while gross profit in the Water Treatment segment increased \$0.7 million as discussed below. Gross profit in our Industrial segment for the third quarter of fiscal 2013 was negatively impacted by the \$7.2 million charge resulting from the CSS pension withdrawal, which charge constituted 8.4% of sales for the quarter. The LIFO method of valuing inventory had a nominal impact on gross profit for the third quarter of fiscal 2014, while it decreased gross profit by \$0.1 million during the third quarter of fiscal 2013.

**Industrial Segment.** Gross profit for the Industrial segment increased \$4.7 million to \$7.4 million, or 12.6% of sales, for the three months ended December 29, 2013, as compared to \$2.6 million, or 4.2% of sales, for the same period of the prior year. The prior year's gross profit was negatively impacted by the \$7.2 million pension withdrawal charge

described above. The pension withdrawal charge constituted 11.4% of the segment's sales in the prior year. Gross profit reported for the current quarter was negatively impacted by \$0.5 million in incremental costs to operate our new manufacturing facility, competitive

pricing pressures, and an overall decrease in sales volume with a shift in product mix to lower-margin bulk commodity products. The LIFO method of valuing inventory increased gross profit in this segment by \$0.1 million for the current quarter, while it decreased gross profit in this segment by \$0.1 million for the same period of the prior year.

**Water Treatment Segment.** Gross profit for the Water Treatment segment was \$6.2 million, or 26.7% of sales, for the three months ended December 29, 2013, as compared to \$5.5 million, or 24.5% of sales, for the same period in the prior year. Increased sales of certain specialty chemical products and equipment, including our newly-acquired ACS operations, contributed to the year-over-year increase in gross profit, partially offset by profit declines in bulk commodity products due to pricing pressure. The LIFO method of valuing inventory nominally impacted gross profit for the current quarter and the same period of the prior year.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$8.2 million, or 10.0% of sales, for the three months ended December 29, 2013, as compared to \$7.6 million, or 8.9% of sales, for the same period of the prior year. The increase in expenses was primarily driven by \$0.3 million in incremental costs incurred related to our new headquarters facility, as well as costs from our newly-acquired ACS operations, partially offset by lower selling staff expenses in the Industrial segment.

#### Operating Income

Operating income was \$5.4 million for the three months ended December 29, 2013 and \$0.5 million for the same period of the prior year. Operating income for the Industrial segment increased \$4.7 million as a result of the \$7.2 million pension withdrawal charge recorded in the prior year, partially offset by the reduction in gross profit as discussed above. Operating income for the Water Treatment segment increased \$0.2 million, primarily as a result of higher gross profit partially offset by increased selling, general and administrative expenses as discussed above.

#### Provision for Income Taxes

Our effective income tax rate was 35.5% for the three months ended December 29, 2013. The income tax expense and resulting tax rate for the three months ended December 30, 2012 was reduced by a \$0.8 million non-recurring tax benefit related to the domestic manufacturing deduction and investment tax credits, resulting in an effective tax rate which was not meaningful for that quarter. The effective tax rate is impacted by projected levels of taxable income, permanent items, and state taxes.

#### Nine Months Ended December 29, 2013 Compared to the Nine Months Ended December 30, 2012:

##### Sales

Sales increased \$0.3 million to \$263.0 million for the nine months ended December 29, 2013, as compared to \$262.8 million for the same period of the prior year. Sales of bulk chemicals were approximately 24% of sales dollars during the nine months ended December 29, 2013, compared to 23% during the same period of the prior year.

**Industrial Segment.** Industrial segment sales decreased \$0.3 million to \$182.2 million for the nine months ended December 29, 2013, as compared to \$182.5 million for the same period of the prior year. Sales decreased despite an overall increase in volumes sold as the increased volumes were largely from bulk commodity products which generally carry lower per-unit selling prices and margins. In addition, competitive pricing pressures negatively impacted our overall sales growth in this nine month period.

**Water Treatment Segment.** Water Treatment segment sales increased \$0.5 million to \$80.8 million for the nine months ended December 29, 2013, as compared to \$80.3 million for the same period of the prior year. In the current period, we realized sales growth in our newer branches, including ACS, along with increased sales of certain specialty chemical products and equipment. These sales increases more than offset the negative impact of less favorable weather conditions during the majority of the spring and summer, along with reduced sales volume of bulk commodity products.

##### Gross Profit

Gross profit increased \$4.7 million to \$47.4 million, or 18.0% of sales, for the nine months ended December 29, 2013, as compared to \$42.6 million, or 16.3% of sales, for the same period of the prior year. Gross profit in the Industrial segment increased \$3.9 million, while gross profit in the Water Treatment segment increased \$0.9 million as discussed below. The prior year's gross profit was adversely impacted by the \$3.2 million charge resulting from the litigation

settlement in the first quarter of fiscal 2013 and the \$7.2 million pension withdrawal liability in the third quarter of fiscal 2013, both of which were recorded in our Industrial segment. Together these charges constituted 4.0% of total sales for the nine month period. The LIFO method

of valuing inventory increased gross profit by \$0.2 million for the nine months ended December 29, 2013 while it decreased gross profit by \$0.2 million for the same period of the prior year.

**Industrial Segment.** Gross profit for the Industrial segment increased \$3.9 million to \$23.9 million, or 13.1% of sales, for the nine months ended December 29, 2013, as compared to \$20.0 million, or 11.0% of sales, for the same period of the prior year. The prior year's gross profit was adversely impacted by the \$3.2 million charge resulting from the litigation settlement in the first quarter of fiscal 2013 and the \$7.2 million pension withdrawal liability in the third quarter of fiscal 2013. Together these charges constituted 5.7% of sales for this segment for the nine month period. Gross profit for the current fiscal year was negatively impacted by \$1.5 million in incremental costs to operate our new manufacturing facility as well as \$0.8 million in costs incurred to exit the leased facility used to serve our bulk pharmaceutical customers. Despite higher overall sales volumes, gross profit was also negatively impacted by an unfavorable product mix shift to lower-margin bulk commodity products and competitive pricing pressures. The LIFO method of valuing inventory increased gross profit in this segment by \$0.2 million for the nine months ended December 29, 2013, while it decreased gross profit in this segment by \$0.2 million for the same period of the prior year.

**Water Treatment Segment.** Gross profit for the Water Treatment segment was \$23.5 million, or 29.1% of sales, for the nine months ended December 29, 2013, as compared to \$22.6 million, or 28.2% of sales, for the same period of the prior year. While gross profit was negatively impacted in the first six months of fiscal 2014 by less favorable weather conditions, growth at our newer branches, along with sales increases of certain specialty chemical products and equipment, more than offset the negative impact that weather and the reduced sales of bulk commodity products had on our results. The LIFO method of valuing inventory nominally impacted gross profit for the nine months ended December 29, 2013 and the same period of the prior year.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$25.4 million, or 9.7% of sales, for the nine months ended December 29, 2013, as compared to \$23.3 million, or 8.9% of sales, for the same period of the prior year. The increase in expenses was driven by incremental costs of \$0.8 million incurred related to our new headquarters facility, as well as additional sales and infrastructure support staffing costs in the Water Treatment segment, including costs from our newly-acquired ACS operations.

#### Operating Income

Operating income was \$21.9 million for the nine months ended December 29, 2013 and \$19.3 million for the same period of the prior year. Operating income for the Industrial segment increased \$3.0 million primarily as a result of the \$3.2 million litigation settlement and the \$7.2 million pension withdrawal charges recorded in the prior year, partially offset by the reduction in gross profit, as discussed above. Operating income for the Water Treatment segment decreased \$0.4 million primarily as a result of the increased gross profit, offset by higher selling, general and administrative expenses, as discussed above.

#### Provision for Income Taxes

Our effective income tax rate was 37.0% for the nine months ended December 29, 2013 and 33.4% for the same period of the prior year. The effective tax rate is impacted by projected levels of taxable income, permanent items, and state taxes. The income tax expense recorded and the resulting tax rate for the nine months ended December 30, 2012 was reduced by a \$0.8 million non-recurring increase in the benefits recorded related to the domestic manufacturing deduction and investment tax credit.

#### Liquidity and Capital Resources

Cash provided by operating activities for the nine months ended December 29, 2013 was \$24.9 million compared to \$30.0 million for the same period of the prior year. The decrease in cash provided by operating activities was primarily due to a decrease in net income for the first nine months of fiscal 2014 when compared to the same period of the prior year after adjustment for the non-cash pension withdrawal charge, as well as an increase in cash used to fund working capital, primarily relating to the timing of inventory purchases and the payment of trade payables. Due to the nature of our operations, which includes purchases of large quantities of bulk chemicals, timing of purchases can result in significant changes in working capital investment and the resulting operating cash flow. Typically, our cash requirements increase during the period from April through November as caustic soda inventory levels increase as the



majority of barges are received during this period. Additionally, due to the seasonality of the water treatment business, our accounts receivable balance generally increases during the period of April through September.

Cash and investments available-for-sale of \$54.8 million at December 29, 2013 increased by \$4.9 million as compared with the \$49.9 million available as of March 31, 2013, primarily due to cash flows generated from operations, partially offset by capital expenditures and dividends paid.

We expect cash balances and our cash flows from operations will be sufficient to fund our cash requirements in fiscal 2014.

Capital expenditures were \$10.5 million for the nine months ended December 29, 2013, as compared to \$20.1 million in the same period of the prior fiscal year. Included in capital expenditures for the first nine months of fiscal 2014 was \$1.5 million related to our new headquarters facility and \$1.1 million for our new manufacturing facility, compared to capital expenditures of an aggregate \$12.8 million related to these same projects during the first nine months of fiscal 2013. Other capital spending was related to regulatory, safety, and facility improvements and new and replacement trucks for the Water Treatment segment.

#### Critical Accounting Policies

Our significant accounting policies are set forth in Note 1 to our consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013. The accounting policies used in preparing our interim fiscal 2014 condensed consolidated financial statements are the same as those described in our Annual Report.

### Forward-Looking Statements

The information presented in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements have been made pursuant to the provisions of the Private Securities Litigation Reform Act of 1995. These statements are not historical facts, but rather are based on our current expectations, estimates and projections, and our beliefs and assumptions. We intend words such as "anticipate," "expect," "intend," "plan," "believe," "see," "estimate," "will" and similar expressions to identify forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, some of which are beyond our control and are difficult to predict. These factors could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Additional information concerning potential factors that could affect future financial results is included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2013. We caution you not to place undue reliance on these forward-looking statements, which reflect our management's view only as of the date of this Quarterly Report on Form 10-Q. We are not obligated to update these statements or publicly release the result of any revisions to them to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.

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

At December 29, 2013, our investment portfolio included \$26.9 million of certificates of deposit and municipal bonds classified as fixed income securities and cash and cash equivalents of \$27.9 million. The fixed income securities, like all fixed income instruments, are subject to interest rate risks and will decline in value if market interest rates increase. However, while the value of the investment may fluctuate in any given period, we intend to hold our fixed income investments until recovery. Consequently, we would not expect to recognize an adverse impact on net income or cash flows during the holding period. We adjust the carrying value of our investments if impairment occurs that is other than temporary.

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

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of disclosure controls and procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, we conducted an evaluation, under supervision and with the participation of management, including the chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rules 13a-15 and 15d-15 of the Exchange Act. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are defined by Rules 13a-15(e) and 15d-15(e) of the Exchange Act as controls and other procedures that are designed to ensure that information required to be disclosed by us in reports filed with the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in reports filed under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, or person performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

#### Changes in Internal Control

There was no change in our internal control over financial reporting during the third quarter of fiscal 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

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

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

We did not sell or repurchase any shares of our common stock during the third quarter of fiscal 2014.

ITEM 6. EXHIBITS

Exhibit Index

Exhibit	Description	Method of Filing
3.1	Amended and Restated Articles of Incorporation. (1)	Incorporated by Reference
3.2	Amended and Restated By-Laws. (2)	Incorporated by Reference
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act.	Filed Electronically
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) of the Exchange Act.	Filed Electronically
32.1	Section 1350 Certification by Chief Executive Officer.	Filed Electronically
32.2	Section 1350 Certification by Chief Financial Officer.	Filed Electronically
101	Financial statements from the Quarterly Report on Form 10-Q of Hawkins, Inc. for the period ended December 29, 2013 filed with the SEC on February 3, 2014, formatted in Extensible Business Reporting Language (XBRL); (i) the Condensed Consolidated Balance Sheets at December 29, 2013 and March 31, 2013, (ii) the Condensed Consolidated Statements of Income for the Three and Nine Months Ended December 29, 2013 and December 30, 2012, (iii) the Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended December 29, 2013 and December 30, 2012, (iv) the Condensed Consolidated Statements of Cash Flows for the Nine Months Ended December 29, 2013 and December 30, 2012, and (v) Notes to Condensed Consolidated Financial Statements.	Filed Electronically

(1) Incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2010, filed on July 29, 2010.

(2) Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K dated October 28, 2009 and filed November 3, 2009.

SIGNATURES

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

HAWKINS, INC.

By: /s/ Kathleen P. Pepski  
Kathleen P. Pepski  
Vice President, Chief Financial Officer, and Treasurer  
(On behalf of the registrant and as principal financial officer)

Dated: February 3, 2014

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