Scott's Liquid Gold - Inc.
Form 10-Q
November 13, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

OR

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

For the transition period from to

Commission File Number: 001-13458

SCOTT'S LIQUID GOLD-INC.

(Exact name of registrant as specified in its charter)

Colorado (State or other jurisdiction of incorporation or organization)	84-0920811 (I.R.S. Employer Identification

	No.)
4880 Havana Street, Suite 400, Denver, CO	80239
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (303) 373-4860

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 12, 2018, the registrant had 12,408,177 shares of its common stock, $0.10 par value per share, outstanding.

CAUTIONARY NOTE ON FORWARD-LOOKING INFORMATION

This Quarterly Report on Form 10-Q (this “Report”) contains “forward-looking statements” within the meaning of U.S. federal securities laws. All statements, other than statements of historical fact, included in this Report that address activities, events, or developments with respect to our financial condition, results of operations, or economic performance that we expect, believe, or anticipate will or may occur in the future, or that address plans and objectives of management for future operations, are forward-looking statements. You can typically identify forward-looking statements by the use of words, such as “may,” “could,” “should,” “assume,” “project,” “believe,” “anticipate,” “expect,” “esti “potential,” “plan,” and other similar words. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements and our performance inherently involve risk and uncertainty that could cause actual results to differ materially from the forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to:

- changing consumer preferences and the continued acceptance of each of our significant products in the marketplace;
- the degree of success of any new product or product line introduction by us;
- competitive factors, including any decrease in distribution of (i.e., retail stores carrying) our significant products;
- continuation of our distributorship agreements for 7^{th} Heaven (previously known as Montagne Jeunesse) skin care products and Batiste Dry Shampoos;
- the need for effective advertising of our products and limited resources available for such advertising;
- new competitive products and/or technological changes;
- dependence upon third party vendors and upon sales to major customers;
- the availability of necessary raw materials and potential increases in the prices of these raw materials;
- changes in the regulation of our products, including applicable environmental and U.S. Food and Drug Administration (“FDA”) regulations;
- the degree of success of the integration of product lines or businesses we may acquire;
- future losses which could affect our liquidity;
- the loss of any executive officer;
- dependence on the efforts of our exclusive distributor in the People’s Republic of China (“China”) to market and sell certain of our products there; and
- other matters discussed in this Report, including the risks described in the Risk Factors section of this Report.

We caution you that forward-looking statements are not guarantees of future performance and that actual results or performance may be materially different from those expressed or implied in the forward-looking statements. The forward-looking statements in this Report speak as of the filing date of this Report. Although we may from time to time voluntarily update our prior forward-looking statements, we undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this Report.

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PART I

ITEM 1. FINANCIAL STATEMENTS.
SCOTT'S LIQUID GOLD-INC. & SUBSIDIARIES

Condensed Consolidated Statements of Income (Unaudited)

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net sales	$9,686	$10,341	$27,921	$30,657
Cost of sales	4,808	5,420	14,644	16,649
Gross Profit	4,878	4,921	13,277	14,008
Operating expenses:				
Advertising	324	110	1,206	531
Selling	2,063	1,583	5,536	4,879
General and administrative	1,079	1,063	3,604	3,166
Total operating expenses	3,466	2,756	10,346	8,576
Income from operations	1,412	2,165	2,931	5,432
Interest expense	(5)	(26)	(77)	(102)
Income before income taxes	1,407	2,139	2,854	5,330
Income tax expense	(340)	(664)	(699)	(1,899)
Net income	$1,067	$1,475	$2,155	$3,431
Net income per common share				
Basic	$0.09	$0.12	$0.18	$0.29
Diluted	$0.09	$0.12	$0.17	$0.28
Weighted average shares outstanding				
Basic	12,162	11,886	12,039	11,841
Diluted	12,540	12,360	12,581	12,218

See accompanying notes to these Condensed Consolidated Financial Statements (Unaudited).

SCOTT'S LIQUID GOLD-INC. & SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

(in thousands, except share and par value amounts)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 5,646	$ 4,114
Accounts receivable, net	3,346	3,104
Inventories, net	8,387	8,787
Income taxes receivable	177	-
Prepaid expenses	312	285
Total current assets	17,868	16,290
Property and equipment, net	988	909
Deferred tax asset	483	384
Goodwill	1,521	1,521
Intangible assets, net	5,683	6,148
Other assets	49	49
Total assets	$ 26,592	$ 25,301
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	$ 1,862	$ 1,656
Accrued expenses	763	936
Income taxes payable	-	366
Current maturities of long-term debt	-	800
Total current liabilities	2,625	3,758
Long-term debt, net of current maturities and debt issuance costs	-	362
Total liabilities	2,625	4,120
Shareholders' equity:		
Preferred stock, no par value, authorized 20,000,000 shares; no shares issued and outstanding	-	-
Common stock; $0.10 par value, authorized 50,000,000 shares; issued and outstanding 12,408,177 shares (2018) and 11,885,839 shares (2017)	1,241	1,189
Capital in excess of par	7,020	6,441
Retained earnings	15,706	13,551
Total shareholders' equity	23,967	21,181
Total liabilities and shareholders' equity	$ 26,592	$ 25,301

See accompanying notes to these Condensed Consolidated Financial Statements (Unaudited).

SCOTT'S LIQUID GOLD-INC. & SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Nine Months Ended September 30, 2018			2017		
Cash flows from operating activities:						
Net income	$	2,155		$	3,431	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization		626			591	
Stock-based compensation		184			184	
Deferred income taxes		(99	)		829	
Change in operating assets and liabilities:						
Accounts receivable		(242	)		304	
Inventories		400			(3,843	)
Prepaid expenses and other assets		(27	)		(75	)
Income taxes (receivable) payable		(543	)		204	
Accounts payable and accrued expenses		33			335	
Total adjustments to net income		332			(1,471	)
Net cash provided by operating activities		2,487			1,960	
Cash flows from investing activities:						
Purchase of property and equipment		(202	)		(353	)
Net cash used by investing activities		(202	)		(353	)
Cash flows from financing activities:						
Repayments under line-of-credit		-			(750	)

Repayments of long-term debt		(1,200	)		(600	)
Proceeds from exercise of stock options		447			35	
Net cash used by financing activities		(753	)		(1,315	)
Net increase in cash and cash equivalents		1,532			292	
Cash and cash equivalents, beginning of period		4,114			2,097	
Cash and cash equivalents, end of period	$	5,646		$	2,389	
Supplemental disclosures:						
Cash paid during the period for interest	$	39		$	102	
Cash paid during the period for income taxes	$	1,342		$	866	

See accompanying notes to these Condensed Consolidated Financial Statements (Unaudited).

SCOTT'S LIQUID GOLD-INC. & SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (Unaudited)

(in thousands, except per share data)

Note 1. Organization and Summary of Significant Accounting Policies

(a) Company Background

Scott's Liquid Gold-Inc. (a Colorado corporation) was incorporated on February 15, 1954. Scott's Liquid Gold-Inc. and its wholly-owned subsidiaries (collectively, the "Company," "we," "our," or "us") develop, manufacture, market and sell quality household and skin and hair care products. We are also a distributor in the United States of skin and hair care products manufactured by two other companies. Our business is comprised of two segments, household products and skin and hair care products.

(b) Principles of Consolidation

Our Condensed Consolidated Financial Statements include our accounts and those of our wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

(c) Basis of Presentation

The unaudited Condensed Consolidated Statements of Income, Condensed Consolidated Balance Sheets, and Condensed Consolidated Statements of Cash Flows included in this Report have been prepared by the Company. In our opinion, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at September 30, 2018 and results of operations and cash flows for all periods have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These Condensed Consolidated Financial Statements should be read in conjunction with our financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017. The results of operations for the period ended September 30, 2018 are not necessarily indicative of the operating results for the full year.

(d) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts in our financial statements of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include, but are not limited to, the realization of deferred tax assets, reserves for slow moving and obsolete inventory, customer returns and allowances, intangible asset useful lives and amortization method, and stock-based compensation. Actual results could differ from our estimates.

(e) Cash Equivalents

We consider all highly liquid investments with an original maturity of three months or less at the date of acquisition to be cash equivalents.

(f) Inventories Valuation and Reserves

Inventories consist of raw materials and finished goods and are stated at the lower of cost (first-in, first-out method) or net realizable value, which is defined as the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. We estimate an inventory reserve for slow moving and obsolete products and raw materials based upon, among other things, an assessment of historical and anticipated sales of our products. In the event that actual results differ from our estimates, the results of future periods may be impacted.

Inventories were comprised of the following at:

	September 30, 2018	December 31, 2017
Finished goods	$ 5,852	$ 6,984
Raw materials	2,554	1,811
Inventory reserve for obsolescence	(19)	(8)
	$ 8,387	$ 8,787

(g) Property and Equipment

Property and equipment are recorded at historical cost. Depreciation is provided using the straight-line method over the estimated useful lives of the assets ranging from three to 20 years. Production equipment and production support equipment are estimated to have useful lives of 15 to 20 years and three to 10 years, respectively. Office furniture and office machines are estimated to have useful lives of 10 to 20 years and three to five years, respectively. Maintenance and repairs are expensed as incurred. Improvements that extend the useful lives of the asset or provide improved efficiency are capitalized.

(h) Intangible Assets

Intangible assets consist of customer relationships, trade names, formulas and batching processes and a non-compete agreement. The fair value of the intangible assets is amortized over their estimated useful lives and range from a period of five to 15 years and are reviewed for impairment when changes in market circumstances occur and written down to fair value if impaired.

(i) Goodwill

Goodwill consists of the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests at the reporting unit level, which include the review of factors to determine if it is more-likely-than-not that the fair value of its reporting units were below carrying value. In certain circumstances these assets are written down to fair value if impaired.

(j) Financial Instruments

Financial instruments which potentially subject us to concentrations of credit risk include cash and cash equivalents and accounts receivable. We maintain our cash balances in the form of bank demand deposits with financial institutions that we believe are creditworthy. During the nine months ended September 30, 2018, we have maintained balances in various operating accounts in excess of federally insured limits. We establish an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information. We have no significant financial instruments with off-balance sheet risk of accounting loss, such as foreign exchange contracts, option contracts or other foreign currency hedging arrangements.

The recorded amounts for cash and cash equivalents, receivables, other current assets, accounts payable, accrued expenses, and current maturities of long-term debt approximate fair value due to the short-term nature of these financial instruments. The recorded amount of long-term debt approximates fair value and is estimated primarily based on current market rates for debt with similar terms and remaining maturities. At September 30, 2018, we had no outstanding balances on our long-term debt or on our line-of-credit. At December 31, 2017, we had long-term debt of $1,200 and no outstanding balance on our line-of-credit.

(k) Income Taxes

Income taxes reflect the tax effects of transactions reported in the financial statements and consist of taxes currently payable plus deferred income taxes related to certain income and expenses recognized in different periods for financial and income tax reporting purposes. Deferred income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases. A valuation allowance is provided when it is more-likely-than-not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which related temporary differences become deductible. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Taxes are reported based on tax positions that meet a more-likely-than-not standard and that are measured at the amount that is more-likely-than-not to be realized. Differences between financial and tax reporting which do not meet this threshold are required to be recorded as unrecognized tax benefits or expense. We classify penalty and interest expense related to income tax liabilities as an income tax expense. There are no significant interest and penalties recognized in the Condensed Consolidated Statements of Income or accrued on the Condensed Consolidated Balance Sheets.

The effective tax rate for the nine months ended September 30, 2018 and 2017 was 24.5% and 35.6% respectively, which differs from the statutory income tax rate due to permanent book to tax differences. The decrease in the effective tax rate is a result of the enactment of the Tax Cuts and Jobs Act (“TCJA”) on December 22, 2017 which lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018.

(l) Revenue Recognition

Our revenue recognition policy is significant because the amount and timing of revenue is a key component of our results of operations. Certain criteria are required to be met in order to recognize revenue. If these criteria are not met, then the associated revenue is deferred until it is met. When consideration is received in advance of the delivery of goods or services, a contract liability is recorded. Our revenue contracts are identified when purchase orders are received and accepted from customers and represent a single performance obligation to sell our products to a customer.

Net sales reflect the transaction prices for contracts, which include products shipped at selling list prices reduced by variable consideration. Variable consideration includes estimates for expected customer allowances, promotional programs for consumers, and sales returns.

Variable consideration is primarily comprised of customer allowances. Customer allowances primarily include reserves for trade promotions to support price features, displays, slotting fees, and other merchandising of our products to our customers. Promotional programs for consumers primarily include coupons, rebates, and certain other promotional programs, and do not represent a significant portion of variable consideration. The costs of customer allowances and promotional programs for consumers are estimated using either the expected value or most likely amount approach, depending on the nature of the allowance, using all reasonably available information, including our historical experience and current expectations. Customer allowances and promotional programs for consumers are reflected in the transaction price when sales are recorded. We may adjust our estimates based on actual results and consideration of other factors that cause allowances. In the event that actual results differ from our estimates, the results of future periods may be impacted. Adjustments to the costs of customer allowances and promotional programs for consumers in subsequent periods are generally not material, as our promotions are typically of short duration, thereby reducing the uncertainty inherent in such estimates.

Sales returns are generally not material to our financial statements, and do not comprise a significant portion of variable consideration. Estimates for sales returns are based on, among other things, an assessment of historical trends, information from customers, and anticipated returns related to current sales activity. These estimates are established in the period of sale and reduce our revenue in that period.

Sales are recorded at the time that control of the products is transferred to customers. In evaluating the timing of the transfer of control of products to customers, we consider several indicators, including significant risks and rewards of products, our right to payment, and the legal title of the products. Based on the assessment of control indicators, sales are generally recognized when products are delivered to customers.

We have also established an allowance for doubtful accounts. We estimate this allowance based upon, among other things, an assessment of the credit risk of specific customers and historical trends. We believe our allowance for doubtful accounts is adequate to absorb any losses which may arise. In the event that actual losses differ from our estimates, the results of future periods may be impacted.

At September 30, 2018 and December 31, 2017 approximately $1,130 and $1,070, respectively, had been reserved as a reduction of accounts receivable. Trade promotions to our customers and incentives such as coupons to our consumers are deducted from gross sales and totaled $1,990 and $1,854 for the nine months ended September 30, 2018 and 2017, and totaled $718 and $522 for the three months ended September 30, 2018 and 2017 respectively.

(m) Advertising Costs
We expense advertising costs as incurred.

(n) Stock-based Compensation
We account for share based payments by recognizing compensation expense based upon the estimated fair value of the awards on the date of grant. We determine the estimated grant-date fair value of stock options using the Black-Scholes option pricing model. In order to calculate the fair value of the options, certain assumptions are made regarding the components of the model, including the estimated fair value of underlying common stock, risk-free interest rate, volatility, expected dividend yield and expected option life. Changes to the assumptions could cause significant adjustments to the valuation. We recognize compensation costs ratably over the vesting period using the straight-line method.

(o) Operating Costs and Expenses Classification
Cost of sales includes costs associated with manufacturing and distribution including labor, materials, freight-in, purchasing and receiving, quality control, internal transfer costs, repairs, maintenance and other indirect costs, as well as warehousing and distribution costs. We classify shipping and handling costs comprised primarily of freight-out as selling expenses. Other selling expenses consist primarily of wages, benefits, and travel expenses for sales and sales support personnel, brokerage commissions and promotional costs, as well as certain other indirect costs. Shipping and handling costs totaled $1,966 and $1,864 for the nine months ended September 30, 2018 and 2017, and totaled $806 and $611 for the three months ended September 30, 2018 and 2017 respectively.

General and administrative expenses consist primarily of wages and benefits associated with management and administrative support departments, business insurance costs, professional fees, office facility related expenses, and other general support costs.

The Company entered into a confidential separation agreement, waiver and release with the former Chief Financial Officer of the Company effective June 1, 2018 (the “Separation Agreement”). The Company agreed to pay the former Chief Financial Officer severance pay over nine months in conjunction with terms set forth in the Separation Agreement. Severance costs of $287 were recognized in the second quarter of 2018 and are included in general and administrative expenses for the nine months ended September 30, 2018. Accrued severance costs are included in accrued expenses on the Condensed Consolidated Balance Sheets as of September 30, 2018.

(p) Recently Issued Accounting Standards
In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). This guidance, as amended by subsequent ASUs on the topic, requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with such classification affecting the pattern of expense recognition in the income statement. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for

lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We anticipate that most of our operating leases will result in recognition of additional assets and the corresponding liabilities on the Consolidated Balance Sheets. We have not determined the amount of these transactions or the final impact to our earnings as the actual impact will depend on the Company's lease portfolio at the time of adoption.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments —Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). Among other things, these amendments require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. ASU 2016-13 is not expected to have a material impact on our financial statements.

In August 2018, the FASB issued ASU No. 2018-13, “Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement” (“ASU 2018-13”). The new guidance modifies disclosure requirements related to fair value measurement. The amendments in ASU 2018-13 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Implementation on a prospective or retrospective basis varies by specific disclosure requirement. Early adoption is permitted. The standard also allows for early adoption of any removed or modified disclosures upon issuance of this ASU while delaying adoption of the additional disclosures until their effective date. ASU 2018-13 is not expected to have a material impact on our financial statements.

In August 2018, the FASB issued ASU No. 2018-15, “Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract” (“ASU 2018-15”). The new guidance reduces complexity for the accounting for costs of implementing a cloud computing service arrangement and aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). For public companies, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Implementation should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. ASU 2018-15 is not expected to have a material impact on our financial statements.

Note 2. Stock-Based Compensation

During the nine months ended September 30, 2018, we granted options to acquire: (i) 40,056 shares of our common stock to employees at prices ranging from $2.17 to $3.35 per share; (ii) 105,000 shares of our common stock to executive officers at prices ranging from $2.09 to $2.17 per share; and (iii) 90,000 shares of our common stock to non-employee board members at a price of $2.17 per share.

During the nine months ended September 30, 2017, we granted options to acquire: 16,560 shares of our common stock to employees at prices ranging from $1.80 and $2.25 per share; and (ii) 30,000 shares of our common stock to a non-employee board member at a price of $2.25 per share.

The weighted average fair market value of the options granted during the nine months ended September 30, 2018 and 2017 were estimated on the date of grant, using a Black-Scholes option pricing model with the following assumptions:

	September 30, 2018	September 30, 2017
Expected life of options (using the “simplified” method)	4 years	4 years
Average risk-free interest rate	2.63%	1.44%
Average expected volatility of stock	69%	78%
Expected dividend rate	None	None
Fair value of options granted	$246	$55

Compensation cost related to stock options recognized in operating results (included in general and administrative expenses) totaled $184 in the nine months ended September 30, 2018 and 2017, respectively. Approximately $384 of total unrecognized compensation costs related to non-vested stock options is expected to be recognized over the next four years, depending on the vesting provisions of the options. There was no tax benefit from recording the non-cash expense as it relates to the options granted to employees, as these were qualified stock options which are not normally tax deductible.

Note 3. Earnings per Share

Per share data is determined by using the weighted average number of common shares outstanding. Common equivalent shares are considered only for diluted earnings per share, unless considered anti-dilutive. Common equivalent shares, determined using the treasury stock method, result from stock options with exercise prices that are below the average market price of the common stock.

Basic earnings per share include no dilution and are computed by dividing income available to common shareholders by the weighted-average number of shares outstanding during the period. Diluted earnings per share reflect the potential of securities that could share in our earnings.

A reconciliation of the weighted average number of common shares outstanding is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Common shares outstanding, beginning of the period	12,024	11,886	11,886	11,750
Weighted average common shares issued	138	-	153	91
Weighted average number of common shares outstanding	12,162	11,886	12,039	11,841
Dilutive effect of common share equivalents	378	474	542	377
Diluted weighted average number of common shares outstanding	12,540	12,360	12,581	12,218

Common stock equivalents that have been excluded from the calculation of earnings per share because they would have been anti-dilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	252	47	252	89

Note 4. Segment Information

We operate in two different segments: household products and skin and hair care products. Our products are sold nationally and internationally (primarily China and Canada), directly through our sales force (or pursuant to exclusive distribution agreements for our international sales) and indirectly through independent brokers and manufacturer's representatives, to mass merchandisers, drugstores, supermarkets, hardware stores, e-commerce retailers, and other retail outlets and to wholesale distributors. We have chosen to organize our business around these segments based on differences in the products sold.

Accounting policies for our segments are the same as those described in Note 1. We evaluate segment performance based on segment income or loss before income taxes.

The following provides information on our segments for the three and nine months ended September 30:

	Three Months Ended September 30, 2018		
	Household Products	Skin and Hair Care Products	Total
Net sales	$1,165	$ 8,521	$9,686
(Loss) income from operations	(414)	1,826	1,412
Capital and intangible asset expenditures	-	161	161
Depreciation and amortization	29	164	193

	Three Months Ended September 30, 2017		
	Household Products	Skin and Hair Care Products	Total
Net sales	$1,409	$ 8,932	$10,341
Income from operations	11	2,154	2,165
Capital and intangible asset expenditures	32	196	228
Depreciation and amortization	34	169	203

	Nine Months Ended September 30, 2018		
	Household Products	Skin and Hair Care Products	Total
Net sales	$3,881	$24,040	$27,921
(Loss) income from operations	(1,309)	4,240	2,931
Capital and intangible asset expenditures	18	184	202
Depreciation and amortization	97	529	626

	Nine Months Ended September 30, 2017		
	Household Products	Skin and Hair Care Products	Total
Net sales	$4,189	$26,468	$30,657
(Loss) income from operations	(199)	5,631	5,432
Capital and intangible asset expenditures	157	196	353
Depreciation and amortization	88	503	591

Note 5. Goodwill and Intangible Assets

Goodwill and intangible assets, which are related to our acquisition of our Prell®, Denorex®, and Zincon® brands, consisted of the following:

	As of September 30, 2018			As of December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Intangible assets:						
Customer relationships	$4,022	$ 905	$ 3,117	$4,022	$ 604	$ 3,418
Trade names	2,363	354	2,009	2,363	236	2,127
Formulas and batching processes	669	126	543	669	84	585
Non-compete agreement	26	12	14	26	8	18
	7,080	1,397	5,683	7,080	932	6,148
Goodwill			1,521			1,521
Total intangible assets			$ 7,204			$ 7,669

The amortization expense for the nine months ended September 30, 2018 and 2017 was $465, respectively. The amortization expense for the three months ended September 30, 2018 and 2017 was $155, respectively.

Estimated amortization expense for 2018 and subsequent years is as follows:

2018 (remaining)	$155
2019	621
2020	621
2021	618
Thereafter	3,668
Total	$5,683

Note 6. Long-Term Debt and Line-of-Credit

On June 30, 2016, the Company and Neoteric Cosmetics, Inc., a wholly-owned subsidiary of the Company, collectively as borrowers, entered into a credit agreement, as amended (the “Credit Agreement”) with JPMorgan Chase Bank, N.A. (“Chase”), as lender, pursuant to which Chase provided a term loan and a revolving credit facility that were related to our acquisition of the Prell®, Denorex®, and Zincon® brands.

In June 2018, we paid the remaining principal balance of the term loan in the amount of $1,000. There were no additional costs incurred associated with the prepayment of the term loan.

The revolving credit facility amount is $4 million with interest of: (i) the LIBO Rate + 2.5%; or (ii) the Prime Rate, with a floor of the one month LIBO Rate + 2.5%, and will terminate on June 30, 2019 or any earlier date on which the revolving commitment is otherwise terminated pursuant to the Credit Agreement. Under the Credit Agreement we are obligated to pay quarterly an unused commitment fee equal to 0.5% per annum on the daily amount of the undrawn portion of the revolving line-of-credit. The loans are collateralized by all of the assets of the Company and its subsidiaries.

The Credit Agreement requires, among other things, that beginning on December 31, 2016 and subsequently on a quarterly basis, the Company is subject to affirmative, negative, and financial covenants. The Company was in compliance with the covenants in the Credit Agreement as of September 30, 2018 and December 31, 2017.

Debt issuance costs recognized as a component of interest expense for the nine months ended September 30, 2018 and 2017 were $38 and $19, respectively. Debt issuance costs recognized as a component of interest expense for the three months ended September 30, 2018 and 2017 were $0 and $6, respectively. In conjunction with the prepayment of the remaining principal balance of the term loan, $25 of unamortized debt issuance costs were recognized as a component of interest expense. Prior to the prepayment of the term loan, these costs were amortized using the effective interest method over the term of the Credit Agreement.

SCOTT’S LIQUID GOLD-INC. & SUBSIDIARIES

(in thousands)

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

Results of Operations

Three months ended September 30, 2018 compared to three months ended September 30, 2017

	Three Months Ended September 30,		Increase / (Decrease)	
	2018	2017	$	%
Net sales	$9,686	$10,341	$(655)	(6.3 %)
Cost of sales	4,808	5,420	(612)	(11.3 %)
Gross profit	4,878	4,921	(43)	(0.9 %)
Gross margin	50.4 %	47.6 %		
Operating expenses:				
Advertising	324	110	214	194.5 %
Selling	2,063	1,583	480	30.3 %
General and administrative	1,079	1,063	16	1.5 %
Total operating expenses	3,466	2,756	710	25.8 %
Income from operations	1,412	2,165	(753)	(34.8 %)
Interest expense	(5)	(26)	21	80.8 %
Income before income taxes	1,407	2,139	(732)	(34.2 %)
Income tax expense	(340)	(664)	324	48.8 %
Net income	$1,067	$1,475	$(408)	(27.7 %)

Net income decreased primarily due to the following:

- Lower net sales, primarily driven by lower sales of distributed skin and hair care products that were partially offset by an increase in sales of Alpha® Skin Care products.
- Gross profit was consistent due to the increase in sales of Alpha® Skin Care products, which feature higher gross margins and offset lower sales of our other products. In the fourth quarter of 2018, we expect lower overall gross margins due to higher sales of our distributed products and lower sales of our Alpha® Skin Care products, based on the timing of orders from our international customers in order to meet their consumer demand.
- Advertising costs increased due to airing a television campaign for Scott’s Liquid Gold® Wood Care products.
- Selling costs increased due to increases in brokerage commissions for international sales of Alpha® Skin Care products. Shipping and handling costs also increased due to an increase in international sales of Alpha® Skin Care products as well as a slight rise in shipping rates.
- This was partially offset by a decrease in income tax expense due to the enactment of the TCJA, which lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018, as well as a decrease in income before taxes.

Segment results

Household products

The following table shows comparative net sales, gross margin, gross profit, income (loss) from operations, volume and percentage changes for household products between periods:

	Three Months Ended September 30,			
			Increase / (Decrease)	
	2018	2017	$	%
Net sales	$1,165	$1,409	$(244)	(17.3 %)
Gross profit	$540	$748	$(208)	(27.8 %)
Gross margin	46.4 %	53.1 %		
(Loss) income from operations	$(414)	$11	$(425)	(3,863.6%)

- Net sales of household products decreased primarily due to lower sales of the Scott’s Liquid Gold® Wood Care product line in part due to an increase in competition through the introduction of similar products. Net sales also decreased due to the discontinuation of sales of our Touch of Scent® Air Freshener products in the second quarter of 2018.
- The loss from operations occurred due to lower gross profit and gross margin from the decrease in sales as well as an increase in advertising costs related to airing a television campaign for Scott’s Liquid Gold® Wood Care products.

Skin and hair care products

The following table shows comparative net sales, gross margin, gross profit, income (loss) from operations, volume and percentage changes for skin and hair care products between periods:

	Three Months Ended September 30,			
			Increase / (Decrease)	
	2018	2017	$	%
Net sales - distributed products	$3,593	$5,012	$(1,419)	(28.3%)
Net sales - manufactured products	$4,928	$3,920	$1,008	25.7 %
Gross profit	$4,338	$4,173	$165	4.0 %
Gross margin	50.9 %	46.7 %		
Income from operations	$1,826	$2,154	$(328)	(15.2%)

- Net sales of distributed skin and hair care products decreased due to lower sales of Batiste Dry Shampoo from the elimination of sales to TJ Maxx as well as a decrease in sales of 7th Heaven skin care products from a strong sales trend throughout 2017 that returned to historical levels in 2018. We also saw a substantial increase in competitive products for 7th Heaven skin care products in 2018.
- Net sales of manufactured skin and hair care products increased due to higher international sales of Alpha® Skin Care products related to our exclusive distribution agreement.

Income from operations decreased due to lower sales of distributed products but was partially offset by the increase in sales of Alpha® Skin Care products, which have higher gross margins and lower trade promotion costs than the products we distribute for other companies. Gross margins decreased for Prell® Shampoo, which we began manufacturing in the fourth quarter of 2017. Brokerage commissions increased from international sales of Alpha® Skin Care products. Shipping and handling costs also increased due a slight rise in shipping rates as well as the increase in international sales of Alpha® Skin Care products.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017

	Nine Months Ended September 30,			
			Increase / (Decrease)	
	2018	2017	$	%
Net sales	$27,921	$30,657	$(2,736)	(8.9 %)
Cost of sales	14,644	16,649	(2,005)	(12.0 %)
Gross profit	13,277	14,008	(731)	(5.2 %)
Gross margin	47.6 %	45.7 %		
Operating expenses:				
Advertising	1,206	531	675	127.1 %
Selling	5,536	4,879	657	13.5 %
General and administrative	3,604	3,166	438	13.8 %
Total operating expenses	10,346	8,576	1,770	20.6 %
Income from operations	2,931	5,432	(2,501)	(46.0 %)
Interest expense	(77)	(102)	25	24.5 %
Income before income taxes	2,854	5,330	(2,476)	(46.5 %)
Income tax expense	(699)	(1,899)	1,200	63.2 %
Net income	$2,155	$3,431	$(1,276)	(37.2 %)

Net income decreased primarily due to the following:

- Lower net sales and gross profit, primarily driven by lower sales of distributed skin and hair care products that were partially offset by an increase in sales of Alpha® Skin Care products. The decrease in gross profit was partially offset by the increase in sales of Alpha® Skin Care products, which feature higher gross margins and lower trade promotion costs than our other products. In the fourth quarter of 2018, we expect lower overall gross margins due to higher sales of our distributed products and lower sales of our Alpha® Skin Care products, based on the timing of orders from our international customers in order to meet their consumer demand.
- Advertising costs increased due to producing and airing a television campaign for Scott's Liquid Gold® Wood Care as well as airing a television campaign for Prell® Shampoo.
- Selling costs increased due to increases in brokerage commissions for international sales of Alpha® Skin Care products. Shipping and handling costs also increased due to an increase in international sales of Alpha® Skin Care products as well as a slight rise in shipping rates.
- General and administrative costs increased primarily due to to the incurrence of severance costs related to the Separation Agreement and recruiting fees to fill positions across the Company.
- This was partially offset by a decrease in income tax expense due to the enactment of the TCJA, which, lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018, as well as a decrease in income before taxes.

Segment results

Household products

The following table shows comparative net sales, gross margin, gross profit, income (loss) from operations, volume and percentage changes for household products between periods:

	Nine Months Ended September 30,			
			Increase / (Decrease)	
	2018	2017	$	%
Net sales	$3,881	$4,189	$(308)	(7.4%)
Gross profit	$1,853	$2,179	$(326)	(15.0%)
Gross margin	47.7%	52.0%		
Loss from operations	$(1,309)	$(199)	$(1,110)	(557.8%)

- Net sales of household products decreased primarily due to lower sales of the Scott's Liquid Gold® Wood Care product line in part due to an increase in competition through the introduction of similar products. Net sales also decreased due to the discontinuation of sales of our Touch of Scent® Air Freshener products in the second quarter of 2018.
- The loss from operations increased due to lower gross profit and gross margin from the decrease in sales as well as an increase in advertising costs related to producing and airing a television campaign for Scott's Liquid Gold® Wood Care products.

Skin and hair care products

The following table shows comparative net sales, gross margin, gross profit, income (loss) from operations, volume and percentage changes for skin and hair care products between periods:

	Nine Months Ended September 30,			
			Increase / (Decrease)	
	2018	2017	$	%
Net sales - distributed products	$11,227	$16,782	$(5,555)	(33.1%)
Net sales - manufactured products	$12,813	$9,686	$3,127	32.3%
Gross profit	$11,424	$11,829	$(405)	(3.4%)
Gross margin	47.5%	44.7%		
Income from operations	$4,240	$5,631	$(1,391)	(24.7%)

- Net sales of distributed skin and hair care products decreased due to lower sales of Batiste Dry Shampoo from the elimination of sales to TJ Maxx as well as a decrease in sales of 7th Heaven skin care products from a strong sales trend throughout 2017 that returned to historical levels in 2018. We also saw a substantial increase in competitive products for 7th Heaven skin care products in 2018.
-

Net sales of manufactured skin and hair care products increased due to higher international sales of Alpha® Skin Care products related to our exclusive distribution agreement.

- Income from operations decreased due to lower sales of distributed products but was partially offset by the increase in sales of Alpha® Skin Care products, which have higher gross margins and lower trade promotion costs than the products we distribute for other companies. Gross margins decreased for Prell® Shampoo, which we began manufacturing in the fourth quarter of 2017. Brokerage commissions increased from international sales of Alpha® Skin Care products. Shipping and handling costs also increased due a slight rise in shipping rates as well as the increase in international sales of Alpha® Skin Care products.

Liquidity and Capital Resources

Financing Agreements

Please see Note 6 to our Condensed Consolidated Financial Statements for information on our Credit Agreement with Chase.

Liquidity and Changes in Cash Flows

At September 30, 2018, we had $4,000 available on our revolving credit facility, and approximately $5,646 in cash on hand, which was $1,532 more compared to December 31, 2017.

The following is a summary of cash provided by or used in each of the indicated types of activities:

	Nine Months Ended September 30,		Increase / (Decrease)	
	2018	2017	$	%
Net cash provided by operating activities	$2,487	$1,960	$527	26.9%
Net cash used in investing activities	(202)	(353)	151	42.8%
Net cash used in financing activities	(753)	(1,315)	562	42.7%

- Net cash provided by operating activities was primarily related to income from operations. Cash provided by operations increased primarily due to the focus on reducing levels of inventories.
- Net cash used in investing activities was primarily related to capital expenditures for production and warehouse equipment. Capital expenditures decreased primarily due to higher additions in 2017 related to production and warehouse equipment related to our acquisition of Prell®, Denorex®, and Zincon® brands.
- Net cash used in financing activities was primarily related to payments on long-term debt and was partially offset by proceeds from the exercise of stock options.

We anticipate that our existing cash and our cash flow from operations, together with our current Credit Agreement with Chase, will be sufficient to meet our cash requirements for the 12 months following the filing date of this Report. During the first nine months of 2018, we spent $202 on routine and maintenance production and warehouse equipment in our manufacturing facility. We expect to make additional capital expenditures of approximately $100 in 2018 to improve our manufacturing capabilities and efficiencies and on production and warehouse equipment.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Not applicable.

ITEM 4. CONTROLS AND PROCEDURES
Disclosure Controls and Procedures

As of September 30, 2018, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 30, 2018.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the nine months ended September 30, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Report, you should carefully consider the factors discussed in Item 1A, “Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 and subsequent quarterly reports on Form 10-Q, which could materially affect our business, financial condition or future results.

ITEM 6. EXHIBITS

Exhibit Number	Document
31.1	Rule 13a-14(a) Certification of the Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of the Chief Financial Officer.
32.1*	Section 1350 Certification.
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.

*Furnished, not filed.

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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.

SCOTT'S LIQUID GOLD-INC.

By: /s/ Mark E. Goldstein
Mark E. Goldstein
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Kevin A. Paprzycki
Kevin A. Paprzycki
Chief Financial Officer
(Principal Financial and Chief Accounting Officer)

Date: November 13, 2018