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Heritage-Crystal Clean, Inc.
Form 10-Q
July 28, 2016

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

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO
SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 18, 2016
OR
 TRANSITION REPORT PURSUANT TO
SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from
_____ to _____

Commission File Number 001-33987

HERITAGE-CRYSTAL CLEAN, INC.
(Exact name of registrant as specified in its charter)

Delaware 26-0351454
State or other jurisdiction of (I.R.S. Employer
Incorporation Identification No.)

2175 Point Boulevard
Suite 375
Elgin, IL 60123
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (847) 836-5670

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

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

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

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

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

On July 25, 2016, there were outstanding 22,407,811 shares of Common Stock, \$0.01 par value, of Heritage-Crystal Clean, Inc.

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PART I

ITEM 1. FINANCIAL STATEMENTS

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

	June 18, 2016 (unaudited)	January 2, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 25,325	\$ 23,608
Accounts receivable - net	43,487	41,592
Inventory - net	21,553	24,774
Other current assets	6,578	4,810
Total Current Assets	96,943	94,784
Property, plant and equipment - net	130,997	131,365
Equipment at customers - net	23,148	23,172
Software and intangible assets - net	21,539	22,202
Goodwill	31,511	30,325
Total Assets	\$ 304,138	\$ 301,848
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 25,116	\$ 25,129
Current maturities of long-term debt	6,659	6,700
Accrued salaries, wages, and benefits	4,775	4,330
Taxes payable	7,223	6,735
Other current liabilities	5,310	3,617
Total Current Liabilities	49,083	46,511
Long term debt, less current maturities	61,426	62,778
Deferred income taxes	2,843	2,726
Total Liabilities	\$ 113,352	\$ 112,015
STOCKHOLDERS' EQUITY:		
Common stock - 26,000,000 shares authorized at \$0.01 par value, 22,259,042 and 22,213,364 shares issued and outstanding at June 18, 2016 and January 2, 2016, respectively	\$ 223	\$ 222
Additional paid-in capital	183,525	182,558
Retained earnings	6,449	6,385
Total Heritage-Crystal Clean, Inc. Stockholders' Equity	190,197	189,165
Noncontrolling interest	589	668
Total Equity	\$ 190,786	\$ 189,833
Total Liabilities and Stockholders' Equity	\$ 304,138	\$ 301,848

See accompanying notes to financial statements.

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

	Second Quarter Ended,		First Half Ended,	
	June 18, 2016	June 20, 2015	June 18, 2016	June 20, 2015
Revenues				
Product revenues	\$24,695	\$32,223	\$48,399	\$66,620
Service revenues	55,857	50,718	110,606	100,357
Total revenues	\$80,552	\$82,941	\$159,005	\$166,977
Operating expenses				
Operating costs	\$61,711	\$64,363	\$125,959	\$134,077
Selling, general, and administrative expenses	11,521	10,615	23,729	21,681
Depreciation and amortization	4,118	4,298	8,246	8,631
Other (income) - net	(142)	(154)	(201)	(253)
Operating income	3,344	3,819	1,272	2,841
Interest expense – net	451	408	969	962
Income before income taxes	2,893	3,411	303	1,879
Provision for income taxes	1,062	1,413	197	781
Net income	1,831	1,998	106	1,098
Income attributable to noncontrolling interest	—	28	42	69
Net income attributable to Heritage-Crystal Clean, Inc. common stockholders	\$1,831	\$1,970	\$64	\$1,029
Net income per share: basic	\$0.08	\$0.09	\$—	\$0.05
Net income per share: diluted	\$0.08	\$0.09	\$—	\$0.05
Number of weighted average shares outstanding: basic	22,246	22,138	22,236	22,129
Number of weighted average shares outstanding: diluted	22,419	22,403	22,392	22,374

See accompanying notes to financial statements.

Heritage-Crystal Clean, Inc.
Condensed Consolidated Statement of Stockholders' Equity
(In Thousands, Except Share Amounts)
(Unaudited)

	Shares	Par Value Common	Additional Paid-in Capital	Retained Earnings	Total Heritage-Crystal Clean, Inc. Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance at January 2, 2016	22,213,364	\$ 222	\$ 182,558	\$ 6,385	\$ 189,165	\$ 668	\$ 189,833
Net income	—	—	—	64	64	42	106
Distribution	—	—	—	—	—	(121)	(121)
Issuance of common stock – ESPP	23,040	—	222	—	222	—	222
Share-based compensation	22,638	1	745	—	746	—	746
Balance at June 18, 2016	22,259,042	\$ 223	\$ 183,525	\$ 6,449	\$ 190,197	\$ 589	\$ 190,786

See accompanying notes to financial statements.

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

	For the First Half Ended,	
	June 18, 2016	June 20, 2015
Cash flows from Operating Activities:		
Net income	\$106	\$1,098
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	8,246	8,631
Non-cash inventory impairment	1,651	4,415
Bad debt provision	361	721
Share-based compensation	746	590
Deferred taxes	117	647
Amortization of deferred gain on lease conversion	(189)	(176)
Other, net	324	6
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	(1,895)	1,483
Decrease (increase) in inventory	1,598	(2,191)
(Increase) decrease in other current assets	(1,768)	6,149
Increase (decrease) increase in accounts payable	2,620	(8,237)
Increase (decrease) in accrued expenses	2,474	(3,720)
Cash provided by operating activities	\$14,391	\$9,416
Cash flows from Investing Activities:		
Capital expenditures	\$(8,671)	\$(10,158)
Business acquisitions, net of cash acquired	(2,400)	—
Cash used in investing activities	\$(11,071)	\$(10,158)
Cash flows from Financing Activities:		
Payments on term loan	\$(1,704)	\$(1,152)
Payments of notes payable	—	(158)
Payments of contingent consideration	—	(96)
Proceeds from the issuance of common stock	222	222
Distributions to noncontrolling interest	(121)	(240)
Cash used in financing activities	\$(1,603)	\$(1,424)
Net increase (decrease) in cash and cash equivalents	1,717	(2,166)
Cash and cash equivalents, beginning of period	23,608	21,555
Cash and cash equivalents, end of period	\$25,325	\$19,389
Supplemental disclosure of cash flow information:		
Income taxes paid	\$242	\$61
Cash paid for interest, net of capitalized interest of \$ — and \$304, respectively	956	724
Supplemental disclosure of non-cash information:		
Payables for construction in progress	\$284	\$222
See accompanying notes to financial statements.		

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

June 18, 2016

(1) ORGANIZATION AND NATURE OF OPERATIONS

Heritage-Crystal Clean, Inc., a Delaware corporation and its subsidiaries (collectively the “Company”), provides parts cleaning and hazardous and non-hazardous waste services primarily to small and mid-sized customers in both the manufacturing and vehicle maintenance sectors. The Company's service programs include parts cleaning, containerized waste management, used oil collection, vacuum truck services, waste antifreeze collection and recycling, and field services. The Company also owns and operates a used oil re-refinery through which it recycles used oil into high quality base oil for lubricants as well as other re-refinery byproducts. The Company also has multiple locations where it dehydrates used oil to be sold as recycled fuel oil. The Company's locations are in the United States and Ontario, Canada. The Company conducts its primary business operations through Heritage-Crystal Clean, LLC, its wholly owned subsidiary, and all intercompany balances have been eliminated in consolidation.

The Company's fiscal year ends on the Saturday closest to December 31. The most recent fiscal year ended on January 2, 2016. Each of the Company's first three fiscal quarters consists of twelve weeks while the last fiscal quarter consists of sixteen or seventeen weeks.

In the Company's Environmental Services segment, product revenues include sales of solvent, machines, antifreeze, and accessories; and service revenues include drum waste removal services, servicing of parts cleaning machines, vacuum truck services, field services, and other services. In the Company's Oil Business segment, product revenues include sales of re-refined base oil, byproducts, recycled fuel oil, and used oil; and service revenues include revenues from collecting used oil, collecting and recycling of oil filters and collecting and disposing of waste water. Due to the Company's integrated business model, it is impracticable to separately present costs of tangible products and costs of services.

2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2, "Summary of Significant Accounting Policies," in the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2016. There have been no material changes in these policies or their application.

Recently Issued Accounting Pronouncements

Accounting standards not yet adopted

Standard	Issuance Date	Description	Our Effective Date	Effect on the Financial Statements
ASU 2016-09 Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting. (Topic 718)	March 2016	This update addresses the simplification of accounting for employee share-based payment transactions as it pertains to income taxes, the classification of awards as equity or liabilities, accounting for forfeitures, statutory tax withholding requirements, and certain classifications on the statement of cash flows. Early adoption is permitted. This update was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Early application of the amendments in this update is permitted for all entities.	January 1, 2017	The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations.
ASU 2016-02 Leases (Topic 842)	February 2016	This update provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Early adoption is permitted.	January 4, 2019	The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations.
ASU 2014-15 Presentation of Financial Statements - Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. (Subtopic 205-40)	August 2014	This update provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Early adoption is permitted.	December 31, 2016	The adoption of ASU 2014-15 is not expected to have an impact on the Company's consolidated financial statements.
ASU 2014-09 Revenue from Contracts with Customers, and ASU 2015-14 Revenue from Contracts with Customers: Deferral of the Effective Date (Topic 606)	May 2014	The underlying principle of this update is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Entities have the option of using either a full retrospective or a modified approach to adopt the guidance. Early adoption is	December 31, 2017	This update could impact the timing and amounts of revenue recognized. The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations upon adoption.

not permitted.

Recently issued accounting standards adopted

Standard	Issuance Date	Description	Effective Date	Effect on the Financial Statements
2015-03 Interest—Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs, and 2015-15 Interest—Imputation of Interest (Subtopic 835-30)	April 2015	These updates require debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt, and allows for the presentation of debt issuance costs as an asset regardless of whether or not there is an outstanding balance on the line-of-credit arrangement.	January 3, 2016	The adoption of ASU 2015-03 resulted in the reclassification of \$1.4 million of unamortized debt issuance costs from "Other current assets" to "Term loan, less current maturities" as of January 2, 2016.

(3) BUSINESS COMBINATIONS

On March 24, 2016, the Company purchased the assets of Phoenix Environmental Services, Inc. and Pipeline Video and Cleaning North Corporation (together "Phoenix Environmental"). The purchase price for the acquisition was \$2.7 million, including \$0.3 million placed into escrow and including contingent consideration of up to \$0.3 million based on subsequent business performance.

The Company is continuing to evaluate the purchase price allocations. Preliminary purchase price allocations are tentative and subject to revision as the Company finalizes appraisals and other analyses. Measurement period adjustments reflect new information obtained about facts and circumstances that existed as of the acquisition date. Final determination of the fair values may result in further adjustments to the values presented. The Company believes that the preliminary allocations provide a reasonable basis for estimating the fair values of assets acquired based on the information available. The Phoenix Environmental purchase price allocation is preliminary as the Company is still in the process of obtaining information to finalize the purchase price, net cash paid, and estimated fair values of the assets presented below. The Company expects to finalize the purchase price allocation no later than one year from the purchase date.

The following table summarizes the estimated fair values of the assets acquired related to the acquisition:

(Thousands)	Phoenix Environmental Services
Accounts receivable	\$ 361
Inventory	27
Property, plant, & equipment	374
Equipment at customers	55
Intangible assets	710
Goodwill ^(a)	1,173
Total purchase price	2,700
Less: contingent consideration	(300)
Net cash paid	\$ 2,400

^(a)Goodwill recognized from the acquisition of Phoenix Environmental represents the excess of the fair value of the net assets acquired over the purchase price, and is based upon the Company's expectations of synergies from combining the operations of Phoenix Environmental and the Company, and the value of intangible assets that are not separately recognized, such as the assembled workforce. All of the goodwill was assigned to the Environmental

Services reporting unit. All goodwill is expected to be deductible for income tax purposes.

Unaudited Pro Forma Financial Information

The pro forma financial information in the table below presents the combined results of the Company as if the Phoenix Environmental acquisition that occurred in fiscal 2016 had occurred January 3, 2015. The pro forma information is shown for illustrative purposes only and is not necessarily indicative of future results of operations of the Company or results of operations of the Company that would have actually occurred had the transactions been in effect for the period presented.

	Second Quarter Ended, June 18, 2016	Second Quarter Ended, June 20, 2015
(In thousands, except per share data)		
Total revenues	\$80,552	\$83,670
Net income	1,831	2,023
Income per share		
Basic	\$0.08	\$0.09
Diluted	0.08	0.09
	First Half Ended, June 18, 2016	First Half Ended, June 20, 2015
(In thousands, except per share data)		
Total revenues	\$159,709	\$168,480
Net income	43	1,209
Income per share		
Basic	\$—	\$0.05
Diluted	—	0.05

(4) ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following:

(Thousands)	June 18, 2016	January 2, 2016
Trade	\$41,164	\$38,379
Less: allowance for doubtful accounts	2,227	2,207
Trade - net	38,937	36,172
Related parties	972	1,250
Other	3,578	4,170
Total accounts receivable - net	\$43,487	\$41,592

The following table provides the changes in the Company's allowance for doubtful accounts for the first half ended June 18, 2016 and the fiscal year ended January 2, 2016:

(Thousands)	For the First Half Ended, June 18, 2016	For the Fiscal Year Ended, January 2, 2016
Balance at beginning of period	\$2,207	\$3,927
Balance acquired from FCC Environmental, including measurement period adjustments	—	2,701
Provision for bad debts	361	1,009
Accounts written off, net of recoveries	(341)	(5,430)
Balance at end of period	\$2,227	\$2,207

(5) INVENTORY

The carrying value of inventory consisted of the following:

(Thousands)	June 18, 2016	January 2, 2016
Used oil and processed oil	\$7,918	\$ 9,045
Solvents and solutions	4,658	6,285
Machines	3,408	3,827
Drums and supplies	4,222	4,226
Other	1,678	1,681
Total inventory	21,884	25,064
Less: machine refurbishing reserve	331	290
Total inventory - net	\$21,553	\$ 24,774

Inventory consists primarily of used oil, processed oil, solvents and solutions, new and refurbished parts cleaning machines, drums and supplies, and other items. Inventories are valued at the lower of first-in, first-out (FIFO) cost or market, net of any reserves for excess, obsolete, or unsalable inventory. The Company continually monitors its inventory levels at each of its locations and evaluates inventories for excess or slow-moving items. If circumstances indicate the cost of inventories exceed their recoverable value, inventories are reduced to net realizable value. The Company wrote down the value of inventory by \$0.2 million in the second quarter of 2016, compared to a write down of \$1.8 million in the second quarter of 2015. Total inventory write-downs for the first half of fiscal 2016 and the first half of fiscal 2015 were \$1.7 million and \$4.4 million, respectively. Write-downs in the second quarter of 2016 pertain to solvents and solutions inventory. Write-downs in 2015 and the first quarter of 2016 pertain to used oil and processed oil inventory as well as solvents and solutions inventory.

(6) PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consisted of the following:

(Thousands)	June 18, 2016	January 2, 2016
Machinery, vehicles, and equipment ^(a)	\$77,024	\$75,129
Buildings and storage tanks	69,569	69,317
Land	9,308	9,295
Leasehold improvements ^(a)	4,585	4,523
Construction in progress	6,546	4,474
Assets held for sale	148	189
Total property, plant and equipment	167,180	162,927
Less: accumulated depreciation	(36,183)	(31,562)
Property, plant and equipment - net	\$130,997	\$131,365

(Thousands)	June 18, 2016	January 2, 2016
Equipment at customers ^(a)	\$61,233	\$59,216
Less: accumulated depreciation	(38,085)	(36,044)
Equipment at customers - net	\$23,148	\$23,172

(a) Numbers include preliminary fair values of assets acquired in the acquisition described in Note 3 that may be adjusted as additional information becomes known.

Depreciation expense for the second quarters ended June 18, 2016 and June 20, 2015 was \$3.4 million and \$3.6 million, respectively. Depreciation expense for the first half ended June 18, 2016 and the first half ended June 20, 2015 was \$6.7 million and \$7.4 million, respectively.

(7) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is measured as a residual amount as of the acquisition date, which in most cases results in measuring goodwill as an excess of the purchase consideration transferred plus the fair value of any noncontrolling interest in the acquiree over the fair value of the net assets acquired, including any contingent consideration. The Company tests goodwill for impairment annually in the fourth quarter and in interim periods if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company's determination of fair value requires certain assumptions and estimates, such as margin expectations, market conditions, growth expectations, expected changes in working capital, etc., regarding expected future profitability and expected future cash flows. The Company tests goodwill for impairment at each of its two reporting units, Environmental Services and Oil Business, and the Company does not aggregate reporting units for purposes of impairment testing.

The following table shows changes to our goodwill balances by segment from January 2, 2016, to June 18, 2016:

(Thousands)	Oil Business	Environmental Services	Total
Balance at January 2, 2016	\$ —	\$ 30,325	\$ 30,325
Phoenix Environmental acquisition	—	1,173	1,173
Currency translation adjustments	—	13	13
Balance at June 18, 2016	\$ —	\$ 31,511	\$ 31,511

Following is a summary of software and other intangible assets:

(Thousands)	June 18, 2016			January 2, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer & supplier relationships	\$ 22,933	\$ 5,408	\$ 17,525	\$ 22,202	\$ 4,369	\$ 17,833
Software	4,573	3,500	1,073	4,455	3,382	1,073
Non-compete agreements	2,940	1,936	1,004	2,930	1,713	1,217
Patents, formulae, and licenses	1,769	541	1,228	1,769	510	1,259
Other	1,349	640	709	1,354	534	820
Total software and intangible assets	\$ 33,564	\$ 12,025	\$ 21,539	\$ 32,710	\$ 10,508	\$ 22,202

Amortization expense was \$0.7 million for the second quarter ended June 18, 2016 and \$0.7 million for second quarter ended June 20, 2015. Amortization expense was \$1.5 million for the first half ended June 18, 2016 and \$1.2 million for first half ended June 20, 2015. The weighted average useful lives of software; customer & supplier relationships; patents, formulae, and licenses; non-compete agreements, and other intangibles were 9 years, 11 years, 15 years, 5 years, and 6 years, respectively.

The expected amortization expense for the remainder of fiscal 2016 and for fiscal years 2017, 2018, 2019, and 2020 is \$1.8 million, \$3.2 million, \$2.9 million, \$2.6 million, and \$2.5 million, respectively. The preceding expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, disposal of intangible assets, accelerated amortization of intangible assets,

and other events.

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(8) DEBT AND FINANCING ARRANGEMENTS

Bank Credit Facility

On October 16, 2014, the Company amended its Amended and Restated Credit Agreement ("Credit Agreement", or "Credit Facility"). The Credit Agreement, as amended, allows for up to \$140.0 million in borrowings. As of June 18, 2016 and January 2, 2016, the Company's total borrowings were \$69.2 million and \$70.9 million, respectively, under the term loan which has a maturity date of February 5, 2018. The remaining portion of the Credit Facility is a revolving loan which expires on February 5, 2018. There were no amounts outstanding under the revolver at June 18, 2016 and January 2, 2016. Unamortized debt issuance costs were \$1.1 million and \$1.4 million as of June 18, 2016 and January 2, 2016, respectively.

During the second quarter of fiscal 2016, the Company recorded interest of \$0.5 million on the term loan and capitalized less than \$0.1 million for various capital projects. During the first half of fiscal 2016, the Company recorded interest of \$1.0 million on the term loan, of which less than \$0.1 million was capitalized for various capital projects. During the second quarter of fiscal 2015, the Company recorded interest of \$0.4 million on the term loan and capitalized \$0.2 million for various capital projects. During the first half of fiscal 2015, the Company recorded interest of \$0.8 million on the term loan and capitalized \$0.3 million for various capital projects.

As of June 18, 2016 and January 2, 2016, the Company was in compliance with all covenants under the Credit Agreement. As of June 18, 2016 and January 2, 2016, the Company had \$3.0 million and \$4.4 million of standby letters of credit issued, respectively, and \$19.8 million and \$34.5 million was available for borrowing under the Credit Facility. The actual amount available under the revolving loan portion of the Credit Agreement is limited by the Company's total leverage ratio.

The Company's weighted average interest rate for all debt as of June 18, 2016 and June 20, 2015 was 3.2% and 3.2%, respectively.

(9) SEGMENT INFORMATION

The Company reports in two segments: "Environmental Services" and "Oil Business." The Environmental Services segment consists of the Company's parts cleaning, containerized waste management, vacuum truck service, antifreeze recycling activities, and field services. The Oil Business segment consists of the Company's used oil collection, used oil re-refining activities, and the dehydration of used oil to be sold as recycled fuel oil.

No single customer in either segment accounted for more than 10.0% of consolidated revenues in any of the periods presented. There were no intersegment revenues.

Operating segment results for the second quarters and first halves ended June 18, 2016, and June 20, 2015 were as follows:

Second Quarter Ended,
June 18, 2016

(Thousands)	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Revenues				
Product revenues	\$ 5,106	\$ 19,589	\$ —	\$ 24,695
Service revenues	47,331	8,526	—	55,857
Total revenues	\$ 52,437	\$ 28,115	\$ —	\$ 80,552
Operating expenses				
Operating costs	35,631	26,080	—	61,711
Operating depreciation and amortization	1,710	1,591	—	3,301
Profit before corporate selling, general, and administrative expenses	\$ 15,096	\$ 444	\$ —	\$ 15,540
Selling, general, and administrative expenses			11,521	11,521
Depreciation and amortization from SG&A			817	817
Total selling, general, and administrative expenses			\$ 12,338	\$ 12,338
Other (income) - net			(142)	(142)
Operating income				3,344
Interest expense – net			451	451
Income before income taxes				\$ 2,893

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Second Quarter Ended,
June 20, 2015

(Thousands)	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Revenues				
Product revenues	\$ 5,370	\$26,853	\$ —	\$ 32,223
Service revenues	47,600	3,118	—	50,718
Total revenues	\$ 52,970	\$29,971	\$ —	\$ 82,941
Operating expenses				
Operating costs	35,591	28,772	—	64,363
Operating depreciation and amortization	1,671	1,840	—	3,511
Profit (loss) before corporate selling, general, and administrative expenses	\$ 15,708	\$(641)	\$ —	\$ 15,067
Selling, general, and administrative expenses			10,615	10,615
Depreciation and amortization from SG&A			787	787
Total selling, general, and administrative expenses			\$ 11,402	\$ 11,402
Other (income) - net			(154)	(154)
Operating income				3,819
Interest expense – net			408	408
Income before income taxes				\$ 3,411

First Half Ended,
June 18, 2016

(Thousands)	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Revenues				
Product revenues	\$ 10,135	\$38,264	\$ —	\$ 48,399
Service revenues	94,663	15,943	\$ —	110,606
Total revenues	\$ 104,798	\$54,207	\$ —	\$ 159,005
Operating expenses				
Operating costs	72,436	53,523	—	125,959
Operating depreciation and amortization	3,424	3,171	—	6,595
Profit (loss) before corporate selling, general, and administrative expenses	\$ 28,938	\$(2,487)	\$ —	\$ 26,451
Selling, general, and administrative expenses			23,729	23,729
Depreciation and amortization from SG&A			1,651	1,651
Total selling, general, and administrative expenses			\$ 25,380	\$ 25,380
Other (income) - net			(201)	(201)
Operating income				1,272

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Interest expense – net	969	969
Income before income taxes		\$ 303

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First Half Ended,
June 20, 2015

(Thousands)	Environmental Services	Oil Business	Corporate and Eliminations	Consolidated
Revenues				
Product revenues	\$ 10,710	\$55,910	\$ —	\$ 66,620
Service revenues	95,145	5,212	—	100,357
Total revenues	\$ 105,855	\$61,122	\$ —	\$ 166,977
Operating expenses				
Operating costs	74,304	59,773	—	134,077
Operating depreciation and amortization	3,398	3,704	—	7,102
Profit (loss) before corporate selling, general, and administrative expenses	\$ 28,153	\$(2,355)	\$ —	\$ 25,798
Selling, general, and administrative expenses			21,681	21,681
Depreciation and amortization from SG&A			1,529	1,529
Total selling, general, and administrative expenses			\$ 23,210	\$ 23,210
Other (income) - net			(253)	(253)
Operating income				2,841
Interest expense – net			962	962
Income before income taxes				\$ 1,879

Total assets by segment as of June 18, 2016 and January 2, 2016 were as follows:

(Thousands)	June 18, 2016	January 2, 2016
Total Assets:		
Environmental Services	\$129,740	\$133,718
Oil Business	135,226	132,556
Unallocated Corporate Assets	39,172	35,574
Total	\$304,138	\$301,848

Segment assets for the Environmental Services and Oil Business segments consist of property, plant, and equipment, intangible assets, accounts receivable, goodwill, and inventories. Assets for the corporate unallocated amounts consist of property, plant, and equipment used at the corporate headquarters, as well as cash and net deferred tax assets.

(10) COMMITMENTS AND CONTINGENCIES

The Company may enter into purchase obligations with certain vendors. They represent expected payments to third party service providers and other commitments entered into during the normal course of our business. These purchase obligations are generally cancelable with or without notice, without penalty, although certain vendor agreements provide for cancellation fees or penalties depending on the terms of the contract.

The Company has purchase obligations in the form of open purchase orders of \$8.0 million as of June 18, 2016, and \$9.8 million as of January 2, 2016, primarily for used oil, solvent, machine purchases, disposal and transportation expenses, and capital expenditures.

The Company may be subject to investigations, claims or lawsuits as a result of operating its business, including matters governed by environmental laws and regulations. The Company may also be subject to tax audits in a variety of jurisdictions. When claims are asserted, the Company evaluates the likelihood that a loss will occur and records a liability for those instances when the likelihood is deemed probable and the exposure is reasonably estimable. The Company carries insurance at levels it believes are adequate to cover loss contingencies based on historical claims activity. When the potential loss exposure is limited to the insurance deductible and the likelihood of loss is determined to be probable, the Company accrues for the amount

of the required deductible, unless a lower amount of exposure is estimated. As of June 18, 2016 and January 2, 2016, the Company had accrued \$5.5 million and \$6.0 million related to loss contingencies and other contingent liabilities, respectively.

(11) INCOME TAXES

The Company deducted for federal income tax purposes accelerated "bonus" depreciation on the majority of its capital expenditures for assets placed in service in fiscal 2011 through fiscal 2015. Therefore, the Company recorded a noncurrent deferred tax liability to reflect difference between the book basis and the tax basis of those assets. In addition, as a result of the federal bonus depreciation, the Company recorded a Net Operating Loss ("NOL") of \$44.7 million, which will begin to expire in 2031. The balance remaining on the NOL, which is primarily the result of bonus depreciation, as of June 18, 2016 was \$50.3 million, and the remaining deferred tax asset related to the Company's state and federal NOL was a tax effected balance of \$18.9 million.

The Company recognizes windfall tax benefits associated with the exercise of stock options directly to stockholders' equity only when realized. Consequently, deferred tax assets are not recognized for NOLs resulting from windfall tax benefits. At June 18, 2016, deferred tax assets do not include \$2.5 million of excess tax benefits from share-based compensation.

The Company's effective tax rate for the second quarter of fiscal 2016 was 36.7% compared to 41.4% in the second quarter of fiscal 2015. The rate difference is principally attributable to the differing treatment for financial reporting and income tax reporting for certain expenditures. These expenditures are shown net of the anticipated reimbursement from an unrelated third party for financial reporting purposes, whereas for income tax purposes the expenditures are recorded on a gross basis.

The Company's effective tax rate for the first half of fiscal 2016 was 65.0% compared to 41.6% in the first half of fiscal 2015. The rate increase is primarily attributed to certain state income taxes which are computed on a tax base that reflects substantial modifications to federal taxable income, and that has created comparatively high tax expense when compared to relatively low year-to-date pre-tax income in the first half of 2016.

The Company establishes reserves when it is more likely than not that the Company will not realize the full tax benefit of a position. The Company had a reserve of \$2.5 million for uncertain tax positions as of June 18, 2016 and January 2, 2016. The gross unrecognized tax benefits would, if recognized, decrease the Company's effective tax rate.

(12) SHARE-BASED COMPENSATION

The aggregate number of shares of common stock which may be issued under the Company's 2008 Omnibus Plan ("Plan") is 1,902,077 plus any common stock that becomes available for issuance pursuant to the reusage provision of the Plan. As of June 18, 2016, the number of shares available for issuance under the Plan was 553,427 shares.

Stock Option Awards

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

Outstanding Stock Options	Number of Options Outstanding	Weighted Average Exercise Price	Weighted Remaining Contractual Term (in years)	Aggregate Average Intrinsic Value as of Date Listed (in thousands)
Options outstanding at January 2, 2016	534,428	\$ 10.97	2.34	\$ 224
Exercised	—	—		
Options outstanding at June 18, 2016	534,428	\$ 10.97	1.88	\$ 1,093

Restricted Stock Compensation/Awards

Annually, the Company grants restricted shares to its Board of Directors. The shares become fully vested one year from their grant date. The fair value of each restricted stock grant is based on the closing price of the Company's stock on the date of grant. The Company amortizes the expense over the service period, which is the fiscal year in which the award is granted. On May 8, 2015, the Company granted 22,638 restricted shares for service in fiscal 2015, which vested in the second quarter of fiscal 2016. On May 5, 2016, the Company granted 28,674 restricted shares to the Board of Directors for service in fiscal 2016. As of June 18, 2016, there was \$0.2 million unrecognized expense associated with these grants, which will be recorded throughout fiscal 2016. Expense related to the Board of Directors' restricted stock in both the first half of fiscal 2016 and the first half of fiscal 2015 was \$0.1 million.

In February 2014, the Company granted certain members of management 132,107 restricted shares based on the Company's performance in fiscal 2013. These restricted shares are subject to a graded vesting schedule over a three year period which started January 1, 2015. There was approximately \$0.3 million and \$0.5 million in unrecognized compensation expense remaining related to these awards as of June 18, 2016 and January 2, 2016, respectively. In the first half of fiscal 2016 and the first half of fiscal 2015, \$0.3 million and \$0.2 million of compensation expense was recorded related to these awards, respectively.

In February 2015, the Company granted certain members of management 38,372 restricted shares based on their services in fiscal 2014 and contingent upon continued service. The restricted shares vest over a three year period which started January 1, 2016. As of June 18, 2016 and January 2, 2016, there was approximately \$0.2 million in unrecognized compensation expense remaining related to these awards. In each of the first halves of fiscal 2016 and fiscal 2015, approximately \$0.1 million was recorded as compensation expense related to these awards.

In January 2016, the Company granted certain members of management 42,208 restricted shares based on their services in fiscal 2015 and contingent upon the employees' continued employment with the Company. The restricted shares vest over a period of approximately three years, beginning with the grant date in January 2016 and ending with the final vesting in January 2019. As of June 18, 2016 and January 2, 2016, there was approximately \$0.3 million in unrecognized compensation expense remaining related to these awards. In the first half of fiscal 2016 and fiscal 2015, approximately \$0.1 million and \$0.2 million was recorded as compensation expense related to these awards,

respectively.

The following table summarizes the restricted stock activity for the period ended June 18, 2016:

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Restricted Stock (Nonvested Shares)	Number of Shares	Weighted Average Grant-Date Fair Value Per Share
Nonvested shares outstanding at January 2, 2016	91,529	\$ 14.47
Granted	70,882	9.90
Vested	(22,638)	12.59
Nonvested shares outstanding at June 18, 2016	139,773	\$ 12.46

Employee Stock Purchase Plan

As of June 18, 2016, the Company had reserved 72,944 shares of common stock available for purchase under the Employee Stock Purchase Plan of 2008. In the first half of fiscal 2016, employees purchased 23,040 shares of the Company's common stock with a weighted average fair market value of \$10.12 per share.

(13) EARNINGS PER SHARE

The following table reconciles the number of shares outstanding for the second quarters of fiscal 2016 and 2015, respectively, to the number of weighted average basic shares outstanding and the number of weighted average diluted shares outstanding for the purposes of calculating basic and diluted earnings per share:

(Thousands)	Second Quarter Ended,		First Half Ended,	
	June 18, 2016	June 20, 2015	June 18, 2016	June 20, 2015
Net income	\$1,831	\$1,998	\$106	\$1,098
Less: Income attributable to noncontrolling interest	—	28	42	69
Net income attributable to Heritage-Crystal Clean, Inc. available to common stockholders	\$1,831	\$1,970	\$64	\$1,029
Weighted average basic shares outstanding	22,246	22,138	22,236	22,129
Dilutive shares from share-based compensation plans	173	265	156	245
Weighted average diluted shares outstanding	22,419	22,403	22,392	22,374
Net income per share: basic	\$0.08	\$0.09	\$—	\$0.05
Net income per share: diluted	\$0.08	\$0.09	\$—	\$0.05

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

Disclosure Regarding Forward-Looking Statements

You should read the following discussion in conjunction with our consolidated financial statements and related notes in our Annual Report on Form 10-K filed with the SEC on March 16, 2016. In addition to historical information, this discussion contains forward-looking statements that involve risks, uncertainties and assumptions that could cause actual results to differ materially from our expectations. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as "aim," "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "project," "should," "will be," "will continue," "will likely result," "would" and other words and terms of similar meaning in conjunction with a discussion of future or estimated operating or financial performance. You should read statements that contain these words carefully, because they discuss our future expectations, contain projections of our future results of operations or of our financial position or state other "forward-looking" information. Forward-looking statements speak only as of the date of this quarterly report. Factors that could cause such differences include those described in the section titled "Risk Factors" and elsewhere in our Annual Report on Form 10-K for fiscal 2015 filed with the SEC on