

MGP INGREDIENTS INC  
Form 10-Q  
November 13, 2013

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, 2013

or

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

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

Commission File Number: 0-17196

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

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

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

(913) 367-1480  
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer

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Non-accelerated filer

Smaller Reporting Company

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

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

17,851,535 shares of Common Stock, no par value as of October 31, 2013

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## FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements as well as historical information. All statements, other than statements of historical facts, included in this Quarterly Report on Form 10-Q regarding the prospects of our industry and our prospects, plans, financial position and business strategy may constitute forward-looking statements. In addition, forward-looking statements are usually identified by or are associated with such words as “intend,” “plan”, “believe,” “estimate,” “expect,” “anticipate,” “hopeful,” “should,” “may,” “will”, “could”, “encouraged”, “opportunities”, “potentials”, “negatives of these terms or variations of them or similar terminology. They reflect management’s current beliefs and estimates of future economic circumstances, industry conditions, Company performance and financial results and are not guarantees of future performance. All such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those contemplated by the relevant forward-looking statement. Important factors that could cause actual results to differ materially from our expectations include, among others: (i) disruptions in operations at our Atchison facility or Indiana Distillery, (ii) the availability and cost of grain and fluctuations in energy costs, (iii) the effectiveness of our hedging strategy, (iv) the competitive environment and related market conditions, (v) the ability to effectively pass raw material price increases on to customers, (vi) the viability of the Illinois Corn Processing, LLC (“ICP”) joint venture and its ability to obtain financing, (vii) our ability to maintain compliance with all applicable loan agreement covenants, (viii) our ability to realize operating efficiencies, (ix) potential adverse affects to the business, operations and profitability, as well as the rights of our common shareholders as a result of a proxy contest initiated by a dissident shareholder group, (x) litigation that we have launched against the co-trustees of the MGP Ingredients, Inc. Voting Trust and the Cray Family Trust, (xi) actions of governments, (xii) and consumer tastes and preferences. For further information on these and other risks and uncertainties that may affect our business, including risks specific to our Distillery and Ingredient segments, see Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2012, as updated by Item 1A. Risk Factors of this Quarterly Report on Form 10-Q.

## METHOD OF PRESENTATION

All amounts in this report, except for share, bushels, gallons, pounds, mmbtu, per share, per bushel, per gallon and percentage amounts, are shown in thousands.

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## MGP INGREDIENTS, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(Dollars in thousands, except per share amounts)

	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Sales	\$80,709	\$76,189	\$253,134	\$251,882
Less: excise taxes	538	82	7,164	3,897
Net sales	80,171	76,107	245,970	247,985
Cost of sales (a)	79,356	70,047	232,645	230,382
Gross profit	815	6,060	13,325	17,603
Selling, general and administrative expenses	6,760	6,037	17,405	20,070
Other operating costs and losses on sale of assets	1	38	59	288
Gain on sale of assets, net	—	(889	) —	(841
Income (loss) from operations	(5,946	) 874	(4,139	) (1,914
Gain on sale of joint venture interest	—	—	—	4,055
Interest expense	(269	) (226	) (829	) (709
Equity in earnings (loss) of Joint Ventures	(91	) (130	) (962	) 164
Income (loss) from continuing operations before income taxes	(6,306	) 518	(5,930	) 1,596
Provision for income taxes	19	100	44	152
Net income (loss) from continuing operations	(6,325	) 418	(5,974	) 1,444
Discontinued operations, net of tax (Note 9)	—	—	1,406	—
Net income (loss)	(6,325	) 418	(4,568	) 1,444
Other comprehensive income (loss), net of tax	(111	) 826	(401	) 1,011
Comprehensive income (loss)	\$(6,436	) \$1,244	\$(4,969	) \$2,455
Basic and diluted earnings (loss) per share				
Income (loss) from continuing operations	\$(0.37	) \$0.02	\$(0.35	) \$0.08
Income from discontinued operations	—	—	0.08	—
Net income (loss)	\$(0.37	) \$0.02	\$(0.27	) \$0.08
Dividends per common share	\$—	\$—	\$0.05	\$0.05

Includes related party purchases of \$702 and \$9,806 for the quarters ended September 30, 2013 and 2012, (a) respectively. Includes related party purchases of \$5,494 and \$40,931 for the year to date periods ended September 30, 2013 and 2012, respectively. See Note 2. Equity Method Investments.

See accompanying notes to unaudited condensed consolidated financial statements

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

	September 30, 2013	December 31, 2012
Current Assets		
Cash and cash equivalents	\$—	\$—
Restricted cash	—	12
Receivables (less allowance for doubtful accounts: September 30, 2013 - \$20; December 31, 2012 - \$12)	31,796	35,325
Inventory	36,801	36,532
Prepaid expenses	1,238	697
Deferred income taxes	6,349	5,283
Refundable income taxes	226	242
Total current assets	76,410	78,091
Property and equipment	192,361	190,519
Less accumulated depreciation and amortization	(122,061	) (115,128
Property and equipment, net	70,300	75,391
Equity method investments	6,352	7,301
Other noncurrent assets	2,153	2,388
Total assets	\$155,215	\$163,171
Current Liabilities		
Current maturities of long-term debt	\$1,558	\$1,683
Accounts payable	19,689	18,860
Accounts payable to affiliate, net	517	4,008
Accrued expenses	7,145	5,220
Total current liabilities	28,909	29,771
Long-term debt, less current maturities	4,005	5,168
Revolving credit facility	24,867	25,893
Deferred credit	3,793	4,133
Accrued retirement health and life insurance benefits	4,884	5,096
Other noncurrent liabilities	946	1,000
Deferred income taxes	6,349	5,283
Total liabilities	73,753	76,344
Commitments and Contingencies – See Note 4		
Stockholders' Equity		
Capital stock		
Preferred, 5% non-cumulative; \$10 par value; authorized 1,000 shares; issued and outstanding 437 shares	4	4
Common stock		
No par value; authorized 40,000,000 shares; issued 18,115,965 shares at September 30, 2013 and December 31, 2012, 17,827,135 and 17,934,233 shares outstanding at September 30, 2013 and December 31, 2012, respectively	6,715	6,715
Additional paid-in capital	8,844	7,894
Retained earnings	67,047	72,531
Accumulated other comprehensive loss, net of tax	(634	) (233
Treasury stock, at cost	(514	) (84

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288,830 and 181,732 shares at September 30, 2013 and December 31, 2012,  
respectively

Total stockholders' equity	81,462	86,827
Total liabilities and stockholders' equity	\$155,215	\$163,171

See accompanying notes to unaudited condensed consolidated financial statements

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

	Year to Date Ended	
	September 30, 2013	September 30, 2012
Cash Flows from Operating Activities		
Net income (loss)	\$(4,568	) \$1,444
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,955	8,680
Gain on sale of bioplastics manufacturing business	(1,453	) —
Gain on sale of joint venture interest	—	(4,055
Gain on sale of assets, net	—	(841
Share based compensation	970	628
Equity in (earnings) loss of Joint Ventures	962	(164
Changes in operating assets and liabilities:		
Restricted cash	12	7,476
Receivables, net	3,529	(2,490
Inventory	(342	) (3,423
Prepaid expenses	(541	) (621
Refundable income taxes	16	152
Accounts payable	(509	) (8,031
Accounts payable to affiliate, net	(3,491	) (3,595
Accrued expenses	1,478	1,311
Change in derivatives	—	(2,492
Deferred credit	(340	) (448
Accrued retirement health and life insurance benefits and other noncurrent liabilities	(680	) (826
Other	6	(158
Net cash provided by (used by) operating activities	4,004	(7,453
Cash Flows from Investing Activities		
Proceeds from sale of bioplastics manufacturing business	2,797	—
Proceeds from sale of joint venture interest	—	9,103
Proceeds from the disposition of property and equipment	—	3,215
Additions to property and equipment	(3,571	) (7,712
Investment in and advances to unconsolidated subsidiaries	—	(500
Net cash provided by (used by) investing activities	(774	) 4,106
Cash Flows from Financing Activities		
Payment of dividends	(916	) (914
Loan fees incurred with borrowings	—	(100
Principal payments on long-term debt	(1,288	) (1,248
Proceeds from revolving credit facility	83,031	99,239
Payments on revolving credit facility	(84,057	) (94,013
Net cash provided by (used by) financing activities	(3,230	) 2,964
Decrease in cash and cash equivalents	—	(383
Cash and cash equivalents, beginning of year	—	383
Cash and cash equivalents, end of period	\$—	\$—

See accompanying notes to unaudited condensed consolidated financial statements

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

(Unaudited)

(Dollars in thousands)

	Capital Stock Preferred	Issued Common	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance, December 31, 2012	\$4	\$6,715	\$7,894	\$72,531	\$(233 )	\$(84 )	\$86,827
Comprehensive income:							
Net loss	—	—	—	(4,568 )	—	—	(4,568 )
Change in pension plans, net of tax (a)	—	—	—	—	50	—	50
Change in post employment benefits, net of tax (a)	—	—	—	—	(464 )	—	(464 )
Change in translation adjustment on non-consolidated foreign subsidiary, net of tax	—	—	—	—	13	—	13
Dividends declared and paid	—	—	—	(916 )	—	—	(916 )
Share-based compensation	—	—	970	—	—	—	970
Common shares reacquired due to taxes derived from vesting of restricted stock and restricted stock units	—	—	(20 )	—	—	(430 )	(450 )
Balance, September 30, 2013	\$4	\$6,715	\$8,844	\$67,047	\$(634 )	\$(514 )	\$81,462

(a) See Note 7. Employee Benefit Plans for amounts reclassified from Accumulated Other Comprehensive Income (Loss).

See accompanying notes to unaudited condensed consolidated financial statements

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MGP INGREDIENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, unless otherwise noted)

Note 1. Accounting Policies and Basis of Presentation.

MGP Ingredients, Inc. (“Company”) is a Kansas corporation headquartered in Atchison, Kansas. It was incorporated in 2011 and is a holding company with no operations of its own. Its principal directly-owned operating subsidiaries are MGPI Processing, Inc. (“Processing”) and MGPI of Indiana, LLC (“MGPI-I”). Processing was incorporated in Kansas in 1957 and is the successor to a business founded in 1941 by Cloud L. Cray, Sr. On January 3, 2012, MGP Ingredients, Inc. reorganized into a holding company structure (the “Reorganization”) through a series of steps involving various legal entities, which is discussed in greater detail in the Company’s Report on Form 10-K for the year ended December 31, 2012. Prior to the Reorganization, Processing was named MGP Ingredients, Inc.

MGPI-I acquired substantially all the beverage alcohol distillery assets of Lawrenceburg Distillers Indiana, LLC (“LDI”) at its Lawrenceburg and Greendale, Indiana facility (“Indiana Distillery”) on December 27, 2011.

Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements of the Company reflect all adjustments (consisting only of normal adjustments) which, in the opinion of the Company’s management, are necessary to fairly present the financial position, results of operations and cash flows of the Company. All intercompany balances and transactions have been eliminated in consolidation.

These unaudited condensed consolidated financial statements as of and for the period ended September 30, 2013 should be read in conjunction with the consolidated financial statements and notes thereto in the Company’s Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Inventory

Inventory includes finished goods, barreled distillate, raw materials in the form of agricultural commodities used in the production process, work in process, and certain maintenance and repair items. Inventories are stated at the lower of cost or market on the first-in, first-out (“FIFO”) method. Inventory consists of the following:

	September 30, 2013	December 31, 2012
Finished goods	\$12,579	\$14,272
Barreled distillate	12,038	9,080
Work in process	2,204	2,571

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Raw materials	4,783	5,959
Maintenance materials	4,670	4,116
Other	527	534
Total	\$36,801	\$36,532

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### Equity Method Investments

The Company accounts for its investment in non-consolidated subsidiaries under the equity method of accounting when the Company has significant influence, but does not have more than 50% voting control, and is not considered the primary beneficiary. Under the equity method of accounting, the Company reflects its investment in non-consolidated subsidiaries within the Company's Condensed Consolidated Balance Sheets as "Equity method investments"; the Company's share of the earnings or losses of the non-consolidated subsidiaries are reflected as "Equity in earnings (loss) of Joint Ventures" in the Condensed Consolidated Statements of Comprehensive Income (Loss).

The Company reviews its investments in non-consolidated subsidiaries for impairment whenever events or changes in business circumstances indicate that the carrying amount of the investments may not be fully recoverable. Evidence of a loss in value that is other than temporary include, but are not limited to, the absence of an ability to recover the carrying amount of the investment, the inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment, or, where applicable, estimated sales proceeds which are insufficient to recover the carrying amount of the investment. If the fair value of the investment is determined to be less than the carrying value and the decline in value is considered to be other than temporary, an appropriate write-down is recorded based on the excess of the carrying value over the best estimate of fair value of the investment. The Company considered the losses incurred by ICP during the year to date period ended September 30, 2013 and the Company's election to provide notice to shutdown the plant (as more fully described in Note 2. Equity Method Investments), however these circumstances did not cause the Company to determine that its investment in ICP was not fully recoverable.

### Revenue Recognition

Except as discussed below, revenue from the sale of the Company's products is recognized as products are delivered to customers according to shipping terms and when title and risk of loss have transferred.

The Company's distillery segment produces unaged distillate, and this product is frequently barreled and warehoused at a Company location for an extended period of time in accordance with directions received from the Company's customers. This product must meet customer acceptance specifications, the risks of ownership and title for these goods must be passed, and requirements for bill and hold revenue recognition must be met prior to the Company recognizing revenue for this product. Separate warehousing agreements are typically maintained for customers who store their product with the Company after purchase, and warehouse revenues are recognized as the service is provided.

Sales include customer-paid freight costs billed to customers of \$3,153 and \$2,537 for the quarters ended September 30, 2013 and 2012, respectively, and \$8,789 and \$7,656 for the year to date periods ended September 30, 2013 and 2012, respectively.

### Income Taxes

The effective tax rates for the quarters ended September 30, 2013 and 2012 were (0.3) percent and 19.3 percent, respectively. The effective tax rates for the year to date periods ended September 30, 2013 and 2012 were (0.2) percent and 9.5 percent, respectively, consisting of state income taxes for which no net operating loss carryforwards are currently available. The \$47 of taxes related to discontinued operations were included in the computation of the effective rate for the year to date period ended September 30, 2013.

For the quarters and year to date periods ended September 30, 2013 and September 30, 2012, the effective rates differed from the Company's statutory rate primarily due to the expected utilization of available net operating losses. At this time, management is unable to conclude it is more likely than not that deferred tax assets will be realized. As a result of this analysis, the Company continues to record a full valuation allowance on net deferred tax

assets. Management will continue to evaluate the available positive and negative evidence in future periods.

#### Earnings per Share

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



## Impairment

The Company tests its long-lived assets for impairment whenever events or conditions and circumstances indicate a carrying amount of an asset may not be recoverable. No events or conditions occurred during the quarterly or year to date periods ended September 30, 2013 that required the Company to test for impairment.

## Fair Value Measurements

The fair value of an asset is considered to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Accounting guidance also establishes a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. The fair value hierarchy gives the highest priority to quoted market prices (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of inputs used to measure fair value are as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities accessible by the reporting entity.
- Level 2 - observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets and liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 - unobservable inputs for an asset or liability. Unobservable inputs should only be used to the extent observable inputs are not available.

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

The fair value of the Company's debt is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair values of the Company's debt were \$30,585 and \$32,596 at September 30, 2013 and December 31, 2012, respectively. The financial statement carrying value was \$30,430 and \$32,744 at September 30, 2013 and December 31, 2012, respectively. These fair values are considered Level 2 under the fair value hierarchy.

## Dividends

On February 28, 2013, the Board of Directors declared a dividend of \$0.05 per share of the Company's common stock, no par value (the "Common Stock"), payable to stockholders of record of Common Stock, restricted stock and restricted stock units on March 18, 2013. The \$916 dividend was paid on April 10, 2013.

On March 1, 2012, the Board of Directors declared a dividend of \$0.05 per share of the Company's Common Stock, no par value, payable to stockholders of record of Common Stock, restricted stock and restricted stock units on March 22, 2012. The \$914 dividend was paid on April 19, 2012.

## Line of Credit

On November 2, 2012, we entered into an Amended and Restated Credit Agreement, and ancillary documents with Wells Fargo (the "Credit Agreement").

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The amount of borrowings which we may make is subject to borrowing base limitations. As of September 30, 2013, our outstanding borrowings under this facility were \$24,867, leaving \$19,463 available for additional borrowings after giving effect to a \$2,000 outstanding letter of credit that we have with one of our vendors.

As of and for the year to date period ended September 30, 2013, we are in compliance with the Credit Agreement's financial covenants and other restrictions.

Note 2. Equity Method Investments.

As of September 30, 2013, the Company's investments accounted for on the equity method of accounting consist of the following: (1) 30 percent interest in ICP, which manufactures alcohol for fuel, industrial and beverage applications, and (2) 50 percent interest in D.M. Ingredients, GmbH, ("DMI"), which produces certain specialty starch and protein ingredients.

Processing completed a series of related transactions on November 20, 2009 pursuant to which Processing contributed its Pekin plant and certain maintenance and repair materials to a newly-formed company, ICP, and then sold 50 percent of the membership interest in ICP to Illinois Corn Processing Holdings ("ICP Holdings"), an affiliate of SEACOR Energy Inc.

On February 1, 2012, ICP Holdings exercised its option to purchase an additional 20 percent of the membership interest in ICP. The sales price was \$9,103 and was determined in accordance with the LLC Interest Purchase Agreement. Following its exercise, ICP Holdings owns 70 percent of ICP, is entitled to name 4 of ICP's 6 advisory board members, and generally has control of ICP's day to day operations. Processing owns 30 percent of ICP and is entitled to name 2 of ICP's 6 advisory board members.

Under a marketing agreement between ICP and the Company, (the "Marketing Agreement"), ICP manufactured and supplied food grade and industrial-use alcohol products for the Company, and the Company purchased, marketed and sold such products for a marketing fee. Effective January 1, 2013, the Marketing Agreement expired. The Company has sourced minimal product from ICP since April 2013.

ICP's term loan and revolving credit agreement with an affiliate of SEACOR Energy Inc. expired as of December 31, 2012 and has not been renewed. The Company has no further funding requirement to ICP.

The ICP Limited Liability Company Agreement gives the Company and its joint venture partner, ICP Holdings, certain rights to shut down the Pekin plant if ICP operates at an EBITDA loss of \$500 in any quarter. Such rights are conditional in certain instances, but are certain if EBITDA losses aggregate \$1,500 over any three consecutive quarters or if ICP's net working capital is less than \$2,500. For the quarter ended March 31, 2013, ICP experienced an EBITDA loss in excess of the \$500 threshold. Such shutdown notice was provided by the Company on April 18, 2013 under the terms of the ICP Limited Liability Company Agreement, and such notice was rejected by ICP Holdings. The Company has not withdrawn its election as of the date of this filing.

The ICP Limited Liability Company Agreement provides for a new allocation of profit and loss when notice of shutdown is rejected by ICP Holdings. From an accounting perspective, the Company will continue to allocate profit and loss 30 percent to the Company and 70 percent to ICP Holdings in accordance with U.S. generally accepted accounting principles.

Summary Financial Information

Condensed unaudited financial information related to the Company's non-consolidated equity method investment in ICP is shown below.

	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
ICP's Operating results:				
Net sales (a)	\$52,580	\$47,813	\$146,807	\$164,804

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Gross profit	148	45	(900	) 2,075
Net income (loss)	\$(585	) \$(448	) \$(3,472	) \$311

Includes related party sales to MGPI of \$110 and \$9,697 for the quarters ended September 30, 2013 and 2012, (a) respectively, and \$3,510 and \$40,331 for the year to date periods ended September 30, 2013 and 2012, respectively.

The Company's equity in earnings (loss) of Joint Ventures based on unaudited financial statements is as follows:

	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
ICP (30% interest) (a)	\$ (135	) \$ (134	) \$ (1,042	) \$ 229
DMI (50% interest)	44	4	80	(65
	\$ (91	) \$ (130	) \$ (962	) \$ 164

The Company's ownership percentage of ICP was 50 percent through February 1, 2012, when the Company sold 20 (a) percent of its investment. From February 2, 2012 through September 30, 2013, the Company's ownership percentage in ICP and accounting profit and loss was 30 percent.

The Company's investment in joint ventures is as follows:

	September 30, 2013	December 31, 2012
ICP (30% interest)	\$5,856	\$6,898
DMI (50% interest)	496	403
	\$6,352	\$7,301

## Note 3. Earnings (Loss) per Share.

The computations of basic and diluted earnings (loss) per share from continuing and discontinued operations are as follows:

	Quarter Ended		Year to Date Ended	
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
Continuing Operations:				
Net income (loss) from continuing operations attributable to shareholders	\$ (6,325	) \$ 418	\$ (5,974	) \$ 1,444
Less: Amounts allocated to participating securities (nonvested shares and units) <sup>(i)</sup>	—	26	—	91
Net income (loss) from continuing operations attributable to common shareholders	\$ (6,325	) \$ 392	\$ (5,974	) \$ 1,353
Discontinued Operations:				
Discontinued operations attributable to shareholders	\$ —	\$ —	\$ 1,406	\$ —
Less: Amounts allocated to participating securities (nonvested shares and units) <sup>(i)</sup>	—	—	—	—
Discontinued operations attributable to common shareholders	\$ —	\$ —	\$ 1,406	\$ —
Share information:				
Basic weighted average common shares <sup>(ii)</sup>	17,127,523	16,976,054	17,045,001	16,936,366
Potential dilutive securities <sup>(iii)</sup>	—	66	—	313
Diluted weighted average common shares	17,127,523	16,976,120	17,045,001	16,936,679
Basic earnings (loss) per share				
Income (loss) from continuing operations	\$ (0.37	) \$ 0.02	\$ (0.35	) \$ 0.08
Income from discontinued operations	—	—	0.08	—
Net income (loss)	\$ (0.37	) \$ 0.02	\$ (0.27	) \$ 0.08
Diluted earnings (loss) per share				
Income (loss) from continuing operations	\$ (0.37	) \$ 0.02	\$ (0.35	) \$ 0.08
Income from discontinued operations	—	—	0.08	—
Net income (loss)	\$ (0.37	) \$ 0.02	\$ (0.27	) \$ 0.08

(i) Participating securities include 699,612 and 956,207 nonvested restricted shares for the quarters and year to date periods ended September 30, 2013 and 2012, respectively, as well as 413,764 and 196,264 restricted share units for the quarters and year to date periods ended September 30, 2013 and 2012, respectively. Participating securities do not receive an allocation in periods when a loss is experienced.

(ii) Under the two-class method, basic weighted average common shares exclude outstanding nonvested participating securities consisting of restricted share awards of 699,612 and 956,207 for the quarters and year to date periods ended September 30, 2013 and 2012, respectively.

(iii) Anti-dilutive shares related to stock options totaled 18,000 and 30,000 for the quarters ended September 30, 2013 and 2012, respectively, and 18,667 and 22,667 for the year to date periods ended September 30, 2013 and 2012, respectively. Potential dilutive securities have not been included in the earnings (loss) per share computation in a period when a loss is experienced.



Note 4. Commitments and Contingencies.

Commitments

The Company has grain supply agreements with a single supplier to purchase its corn requirements. These grain supply agreements expire December 31, 2014. At September 30, 2013, the Company had commitments to purchase corn to be used in operations through December 2014 totaling \$31,687.

The Company has commitments to purchase natural gas needed in production at fixed prices at various dates through March 2014. The commitment for these contracts at September 30, 2013 totaled \$3,498.

The Company has a supply contract for flour for use in the production of protein and starch ingredients. The initial term of the agreement, as amended, expires October 23, 2015. At September 30, 2013, the Company had purchase commitments aggregating \$11,986 through March 2014.

As of September 30, 2013, the Company had contracts of approximately \$842 to acquire capital assets.

At September 30, 2013, the Company had \$2,000 outstanding on a letter of credit for a vendor, which reduced the amount available to the Company under its revolving line of credit.

Contingencies

There are various legal proceedings involving the Company and its subsidiaries. Management believes that the aggregate liabilities, if any, arising from such actions would not have a material adverse effect on the consolidated financial position or overall trends in results of operations of the Company.

On June 14, 2013, the Company filed a petition for declaratory judgment in the District Court of Johnson County, Kansas, against Richard B. Cray, Thomas Cray, Cloud L. Cray Jr., Karen Seaberg, Laidacker M. Seaberg, and Timothy Newkirk, as co-trustees of either MGP Ingredients Inc. Voting Trust or the Cray Family Trust. The Company has requested a declaratory judgment determining the parties' legal rights and obligations in the context of proxies for the Annual Meeting and the status of the Voting Trust. The petition alleges that the co-trustees may be unqualified to serve as co-trustees and asks the Court to resolve the resulting controversy. The defendants filed a Motion to Dismiss on August 1, 2013. On October 2, 2013, the Court dismissed all allegations by the Company and Mr. Newkirk to the extent they implicate any standing to challenge the conduct of the Voting Trust directly. On October 16, 2013, the Company filed a motion to amend the October 2, 2013 order on defendants' motion to dismiss in order to include findings allowing interlocutory appeal, or, in the alternative, to enter a journal entry of final judgment as to petitioner. The Hearing is set for November 18, 2013. On October 21, 2013, the defendants filed a motion for summary judgment on the cross-claim of Mr. Newkirk, as well as a motion to dismiss cross-claim of Mr. Newkirk for lack of standing and subject matter jurisdiction due to termination of the trusts. Hearing date for these two motions is December 3, 2013. In its additional definitive proxy soliciting materials filed on October 18, 2013, the Cray Group disclosed that on September 26, 2013, a majority of the trustees of the Cray Family Trust took action to terminate the Cray Family Trust and to distribute its assets upon termination to the three beneficial owners, The Foundation of the Atchison Family YMCA (the "YMCA"), the University of Kansas Endowment Association and Cloud L. Cray, Jr. In connection with the termination of the Cray Family Trust, on September 23, 2013, Karen Seaberg entered into an option to purchase the Voting Trust Certificates distributed to the YMCA and exercised the option on October 16, 2013. On July 10, 2013, Cloud L. Cray, Jr. and Karen Seaberg filed a petition for inspection of corporate records pursuant to K.S.A. §17-6510 by a shareholder in the District Court of Atchison County. The plaintiffs as shareholders of the Company made demand to inspect corporate records pursuant to K.S.A §17-6510. The Company did not produce some of the records requested by the plaintiffs. The plaintiffs filed the petition to compel the production of the



remaining records. On July 26, 2013, the Atchison County District Court granted the plaintiffs' petition and ordered the Company to produce the remaining records. The Company complied with the Court order. The Court also ordered the plaintiffs to submit their request for attorney fees and expenses. A separate hearing will be held to determine whether the plaintiffs should be awarded attorney fees and expenses in connection with the request of corporate records. This amount has not been reflected in the Company's financial statements as the amount of plaintiff attorney fees is estimated to be immaterial to the Company's financial statements.

On July 11, 2013, Cloud L. Cray, Jr. and Karen Seaberg filed a petition for an order requiring the Company to conduct the Annual Meeting in the District Court of Atchison County, Kansas. On July 26, 2013, the Atchison County District Court granted the plaintiffs' petition and ordered the Company to hold the Annual Meeting on or before August 26, 2013 at 9 a.m. The Court also ordered the plaintiffs to submit their request for attorney fees and expenses. A separate hearing will be held to determine whether the plaintiffs should be awarded attorney fees and expenses in connection with the litigation concerning the holding of our Annual Meeting. This amount has not been reflected in the Company's financial statements as the amount of plaintiff attorney fees is estimated to be immaterial to the Company's financial statements. On August 1, 2013, the Company and the defendants filed separate motions to amend and or modify the July 26 Order with respect to the record date and after a telephone hearing on August 2, the Court ordered that the Annual Meeting was to reconvene on or before August 26, 2013.

On August 1, 2013, Cloud L. Cray, Jr. and Karen Seaberg filed a petition against the Company and the Board of Directors, for a temporary injunction pursuant to K.S.A. § 60-901 et seq. requesting the Court to enter a temporary injunction (i) prohibiting the Company and the board members from continuing to utilize, meet as, or act as the Special Committee that was appointed on May 23, 2013; (ii) prohibiting defendants from excluding plaintiffs from discussions and deliberations of the Special Committee or any other committee concerning any review of strategic alternatives for the Company on which plaintiffs have no conflict of interest; (iii) prohibiting defendants from refusing to provide plaintiffs with all information conveyed to other directors through or by the Special Committee about the exploration of strategic alternatives for the Company; and (iv) requiring defendants to immediately provide to plaintiffs all past, present and future information conveyed to other directors through or by the Special Committee about the exploration of strategic alternatives for the Company. After a hearing on August 13, 2013 and on August 20, 2013, the Court denied in part and granted in part the plaintiff's petition. After negotiations between the parties, the parties agreed to continue with the injunction in place and stay the matter for 180 days. At the conclusion of the 180 day period, the parties will advise the Court if any additional proceedings are necessary.

On August 9, 2013, the Company appealed the July 26 Order in Kansas Court of Appeals. On August 22, 2013, the Appeals Court granted the motion in part for a 60-day stay for the Annual Meeting. Following the dismissal on October 2, 2013 of the Company in the District Court of Johnson County case, the Appeals Court granted the motion to discontinue the stay after October 21, 2013.

In its proxy statement filed with the SEC on July 10, 2013, the Cray Group has disclosed that it will seek reimbursement for the costs and expenses associated with the proxy solicitation in the event that any of the Cray Group's director nominees are elected to the Board of Directors of MGP, and intends to submit the issue of reimbursement to a vote of security holders. The Cray Group has estimated the total expenditures in furtherance of, or in connection with, the solicitation of proxies by the Cray Group to be approximately \$650. This amount, inclusive of the above-mentioned attorneys fees and expenses, has not been reflected in the Company's financial statements as we do not believe reimbursement is probable in occurrence.

## Note 5. Derivative Instruments.

The Company purchases and uses certain commodities that are subject to price volatility. The Company has historically used financial derivative instruments to reduce exposure to market risk in commodity prices, primarily corn, through a combination of forward purchases, long-term contracts with suppliers and exchange traded commodity futures and option contracts. Specifically, the Company sold put options on commodity futures at exercise prices that were deemed attractive to the Company and used the premiums received to reduce the overall cost of inputs utilized in the production process. Between July 2011 and February 2012, management elected to apply hedge accounting for qualifying derivative contracts.

During 2012, the Company entered into a supply contract to purchase corn for delivery up to 12 months in the future, at negotiated prices. The pricing for these contracts is fixed based on a formula using several factors. The Company has determined that the firm commitments to purchase corn under the terms of these contracts meet the normal purchases and sales exception and has excluded the fair value of these commitments from recognition within its condensed consolidated financial statements until the actual contracts are physically settled. Accordingly, given the supply contract to purchase corn, in February 2012, the Company made the decision to close out of the corn futures contracts designated as cash flow hedges prior to their scheduled delivery and simultaneously de-designated 100 percent of these cash flow hedges at that time. As of September 30, 2013, the Company has no derivative contracts designated as cash flow hedges.

## Derivatives Designated as Cash Flow Hedges

Derivatives in Cash Flow Hedging Relationship	Amounts of Gains (Losses) Recognized in Other Comprehensive Income (Loss) on Derivatives			
	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Commodity derivatives	\$—	\$—	\$—	\$(286 )

Location of Losses Reclassified from AOCI into Income	Amounts of Gains (Losses) Reclassified from Accumulated Other Comprehensive Income (Loss) into Earnings			
	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Cost of Sales	\$—	\$—	\$—	\$(413 )

The Company's production process also involves the use of natural gas and flour. The contracts for flour and natural gas range from monthly contracts to multi-year supply arrangements; however, because the quantities involved have always been for amounts to be consumed within the normal production process, the Company has determined that these contracts meet the normal purchases and sales exception and have excluded the fair value of these commitments from recognition within its financial statements until the actual contracts are physically settled. See Note 4. Commitments and Contingencies for discussion on the Company's corn, flour and natural gas purchase commitments.

The following table provides the gain or (loss) for the Company's commodity derivatives not designated as hedging instruments and where it was recognized in the Condensed Consolidated Statements of Comprehensive Income (Loss).

Quarter Ended	Year to Date Ended
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		September 30,	September 30,	September 30,	September 30,
	Classified	2013	2012	2013	2012
Commodity derivatives	Cost of sales	\$—	\$2,670	\$—	\$2,204

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Note 6. Operating Segments.

The Company's operations are classified into three reportable segments: distillery products, ingredient solutions and other. The distillery products segment consists of food grade alcohol, along with fuel grade alcohol and distillers feed, which are co-products of the Company's distillery operations. Ingredient solutions consist of specialty starches and proteins, commodity starch, and vital wheat gluten (commodity protein). The other segment products are comprised of plant-based polymers and composite resins manufactured through the further processing of certain of the Company's proteins and starches and wood. As further discussed in Note 9. Sale of Bioplastics Manufacturing Business, on February 8, 2013, the Company sold this business through a sale of assets included in the other segment.

Operating profit (loss) for each segment is based on net sales less identifiable operating expenses. Non-direct selling, general and administrative, interest expense, investment income and other general miscellaneous expenses have been excluded from segment operations and classified as Corporate. Receivables, inventories and equipment have been identified with the segments to which they relate. All other assets are considered as Corporate.

	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Net Sales to Customers				
Distillery products	\$66,059	\$61,513	\$200,775	\$205,194
Ingredient solutions	14,112	14,184	44,997	41,852
Other	—	410	198	939
Total	80,171	76,107	245,970	247,985
Depreciation and Amortization				
Distillery products	2,064	1,433	6,102	4,201
Ingredient solutions	572	567	1,742	1,863
Other	—	61	21	183
Corporate	368	776	1,090	2,433
Total	3,004	2,837	8,955	8,680
Income (Loss) from Continuing Operations before Income Taxes				
Distillery products	(1,647	) 3,513	5,836	9,960
Ingredient solutions	1,279	2,184	3,944	4,760
Other	—	(85	) (90	) (332
Corporate	(5,938	) (5,094	) (15,620	) (16,847
Gain on sale of assets and joint venture interest(i)	—	—	—	4,055
Total	\$(6,306	) \$518	\$(5,930	) \$1,596

The Company's management reporting does not assign or allocate special charges to the Company's operating (i) segments. For purposes of comparative analysis, the gain on sale of joint venture interest for the year to date period ended September 30, 2012 has been excluded from the Company's segments.

	As of September 30, 2013	As of December 31, 2012
Identifiable Assets		
Distillery products	\$101,519	\$107,140
Ingredient solutions	27,616	27,038
Other	—	1,247
Corporate	26,080	27,746
Total	\$155,215	\$163,171



## Note 7. Employee Benefit Plans.

Post Retirement Benefits. The Company and its subsidiaries provide certain post-retirement health care and life insurance benefits to certain retired employees. The liability for such benefits is unfunded.

The components of the Net Periodic Benefit Cost/Income for the quarter and year to date periods ended September 30, 2013 and 2012, respectively, are as follows:

	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Service cost	\$32	\$48	\$96	\$159
Interest cost	41	52	123	169
Amortization of prior service cost	(162	) (57	) (485	) (65
Amortization of net actuarial loss	7	(79	) 21	(79
Total post-retirement benefit cost / (income)	\$(82	) \$(36	) \$(245	) \$184

The Company disclosed in its financial statements for the year ended December 31, 2012, amounts expected to be paid to plan participants. There have been no revisions to these estimates and there have been no changes in the estimate of total employer contributions expected to be made for the year ended December 31, 2013. The Company reclassified \$464 of prior service cost and net actuarial loss from accumulated other comprehensive income (loss) into post-retirement benefit income for the year to date period ended September 30, 2013.

Total employer contributions accrued for the quarter ended September 30, 2013 were \$0.

Pension Benefits. The Company and its subsidiaries also provide defined retirement benefits to certain employees covered under collective bargaining agreements. Under the collective bargaining agreements, the Company's pension funding contributions are determined as a percentage of wages paid. The funding is divided between the defined benefit plans and a union 401(k) plan. It has been management's policy to fund the defined benefit plans in accordance with the collective bargaining agreements. The collective bargaining agreements allow the plans' trustees to develop changes to the pension plan to allow benefits to match funding, including reductions in benefits. The benefits under these pension plans are based upon years of qualified credited service; however, benefit accruals under the defined benefit plans were frozen in 2009.

The components of the Net Periodic Benefit Cost/(Income) for the quarter periods ended September 30, 2013 and 2012, respectively, are as follows:

	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Interest cost	\$21	\$51	\$62	\$153
Expected return on plan assets	(29	) (57	) (86	) (171
Amortization of net actuarial loss	17	28	50	84
Total pension benefit cost / (income)	\$9	\$22	\$26	\$66

The Company reclassified \$50 of net actuarial loss from accumulated other comprehensive income (loss) into pension benefit income for the year to date period ended September 30, 2013.

The Company previously disclosed in its financial statements for the year ended December 31, 2012, the assumptions used to determine accumulated benefit obligation.

The Company has made employer contributions to its pension plan and union 401(k) during the quarter ended September 30, 2013, of \$0.



Equity-Based Compensation Plans. The Company's equity based compensation plans provide for the awarding of stock options, stock appreciation rights, and shares of restricted common stock ("restricted stock") for senior executives and salaried employees as well as outside directors. As of September 30, 2013, 1,113,376 shares of restricted common stock and restricted stock units (net of forfeitures) were outstanding under the Company's long-term incentive plans. Compensation expense related to these awards is based on the market price of the stock on the date the Board of Directors approved the grant and is amortized over the vesting period of the restricted stock award.

As of September 30, 2013, the Company was authorized to issue 40,000,000 shares of Common Stock. In connection with the Reorganization described in Note 1, the Company retired its treasury stock, which had historically been used for issuance of Common Stock under the Company's equity-based compensation plans. With the retirement of these treasury shares, the Company reserved certain authorized shares for issuance of Common Stock under its equity-based compensation plans. Reserved shares of Common Stock at September 30, 2013 were as follows:

Stock options granted but not exercised	20,000
Restricted stock to non-employees (authorized but not granted)	39,797
Restricted stock to employees and executives (authorized but not granted)	1,338,012
Total	1,397,809

Note 8. Industrial Revenue Bond.

On December 28, 2006, the Company engaged in an industrial revenue bond transaction with the City of Atchison, Kansas (the "City") in order to receive ten-year real property tax abatement on its newly constructed office building and technical center in Atchison, Kansas. At the time of this transaction, the facilities were substantially completed and had been financed with internally-generated cash flow. The Company recorded the office building and technical center assets as property and equipment on the consolidated balance sheets. Pursuant to this transaction, the City issued \$7,000 principal amount of bonds to the Company and then the City used the proceeds to purchase the office building and technical center from the Company. The City then leased the facilities back to the Company under a capital lease, the terms of which provide for the payment of basic rent in an amount sufficient to pay interest at a rate 4.9 percent on the bonds, payable annually on December 1<sup>st</sup> of each year. A balloon payment of \$7,000 will be due upon maturity on December 1, 2016. The Company's obligation to pay rent under the lease provides for the both the same interest and balloon payment amounts and the same due dates as the City's obligation to pay debt service on the bonds, which the Company holds. The lease permits the Company to present the bonds at any time for cancellation, upon which our obligation to pay basic rent would be cancelled. The Company does not intend to do this until their maturity date on December 1, 2016, at which time the Company may elect to purchase the facilities for \$100. Because the Company owns all the outstanding bonds, management considers the debt de-facto cancelled and, accordingly, no investment or related obligation under the capital lease is reflected on our balance sheet. In connection with this transaction, the Company agreed to pay the city an administrative fee of \$50, which is payable over 10 years. If the Company were to present the bonds for cancellation prior to maturity, the \$50 fee would be accelerated.

Below is a summary of the financial asset and liability that are offset at September 30, 2013 and December 31, 2012, respectively.

Description	(i) Gross Amounts of Recognized Assets (Liabilities)	(ii) Gross Amounts offset in the Balance Sheet	(iii) = (i) - (ii) Net Amounts of Assets (Liabilities) presented in the Balance Sheet
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September 30, 2013

Investment in bonds	\$7,000	\$7,000	\$—
Capital lease obligation	\$(7,000)	) \$(7,000)	) \$—

December 31, 2012

Investment in bonds	\$7,000	\$7,000	\$—
Capital lease obligation	\$(7,000)	) \$(7,000)	) \$—

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Note 9. Sale of Bioplastics Manufacturing Business.

On February 8, 2013, the Company sold its bioplastics manufacturing business through a sale of substantially all of the assets included in its other segment, including all of the Company's assets at its bioplastics manufacturing facility in Onaga, Kansas and certain assets of the Company's extruder bio-resin laboratory located in Atchison, Kansas. These net assets had a net book value of \$1,344. The sales price totaled \$2,797 and resulted in a gain, net of \$47 of taxes, of \$1,406 that was recognized as a gain on sale of discontinued operations in the quarter ended March 31, 2013.

The remaining income statement activity for the quarter and year to date periods ended September 30, 2013 and 2012 are not presented as discontinued operations due to their immateriality relative to the consolidated financial statements as a whole.

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

(Dollar amounts in thousands, unless otherwise noted)

MGP Ingredients, Inc. ("Company") is a Kansas corporation headquartered in Atchison, Kansas. It was incorporated in 2011 and is a holding company with no operations of its own. Its principal directly-owned operating subsidiaries are MGPI Processing, Inc. ("Processing") and MGPI of Indiana, LLC ("MGPI-I"). Processing was incorporated in Kansas in 1957 and is the successor to a business founded in 1941 by Cloud L. Cray, Sr. On January 3, 2012, MGP Ingredients, Inc. reorganized into a holding company structure (the "Reorganization") through a series of steps involving various legal entities. Prior to the Reorganization, Processing was named MGP Ingredients, Inc.

MGPI-I acquired substantially all the beverage alcohol distillery assets of Lawrenceburg Distillers Indiana, LLC ("LDI") at its Lawrenceburg and Greendale, Indiana distillery ("Indiana Distillery") on December 27, 2011.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes included in this Form 10-Q, as well as our audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations - General, set forth in our Form 10-K for the year ended December 31, 2012.

## RECENT ACTIVITIES

### ICP Matters

ICP's revolving credit agreement with an affiliate of SEACOR Energy Inc. expired as of December 31, 2012 and has not been renewed.

Under a marketing agreement, ICP manufactured and supplied food grade and industrial-use alcohol products for us and we purchased, marketed and sold such products for a marketing fee (the "Marketing Agreement"). Effective January 1, 2013, the Marketing Agreement expired. We have sourced minimal product from ICP since April 2013.

Rights granted to us under the ICP Limited Liability Company Agreement allow us to shut down the plant if ICP experiences an EBITDA loss of \$500 in a quarter. ICP experienced an EBITDA loss of in excess of the \$500 threshold for the quarter ended March 31, 2013. Such shutdown notice was provided on April 18, 2013 under the terms of the ICP Limited Liability Company Agreement and such notice was rejected by ICP Holdings. The Company has not withdrawn its election as of the date of this filing.

The ICP Limited Liability Company Agreement provides for a new allocation formula for profit and loss when notice of shutdown is rejected by the other joint venture partner. From an accounting perspective, we will continue to allocate profit and loss 30 percent to the Company and 70 percent to ICP Holdings in accordance with U.S. generally accepted accounting principles.

### Sale of Bioplastics Business

On February 8, 2013, we sold the assets at our bioplastics manufacturing facility in Onaga, Kansas and certain assets of our extruder bio-resin laboratory located in Atchison, Kansas. The sales price totaled \$2,797 and resulted in a gain, net of tax, of \$1,406 that was recognized as discontinued operations in the quarter ended March 31, 2013.



## RESULTS OF OPERATIONS

Consolidated results for the quarter ended September 30, 2013 decreased compared to the same period a year ago, with a net loss of \$6,325 on consolidated net sales of \$80,171 versus net income of \$418 on consolidated net sales of \$76,107 in the quarter ended September 30, 2012. We generated a loss from operations of \$5,946 for the quarter ended September 30, 2013, compared to income from operations of \$874 for the quarter ended September 30, 2012.

Our net sales for the quarter ended September 30, 2013 increased \$4,064, or 5.3 percent, compared to the quarter ended September 30, 2012 primarily due to improved pricing in our distillery products segment. Our quarter-versus-quarter earnings decreased for the quarter ended September 30, 2013 primarily due to:

- lower gross margins as further discussed in "-Cost of Sales";
- a \$889 gain on asset sale recorded during the quarter ended September 30, 2012, which we did not have this quarter; and
- increased selling, general and administrative expenses for the September 30, 2013 primarily related to increased professional fees related to the corporate proxy dispute, which we did not have the same period a year ago.

In our distillery products segment, we experienced an increase in unit volume and a decrease in per unit pricing compared to the same period a year ago. The distillery products segment sales were also impacted by the sales price decline of our distillers feed by-product and significantly lower industrial alcohol sales volume. The unit volume increase was primarily in our distillers feed partially offset by a decrease in our high quality food grade alcohol, which was primarily driven by a 99 percent reduction in the supply of industrial alcohol from ICP compared to the same period a year ago. Our return on sales percentage in the distillery product segment decreased from 5.7 percent for the quarter ended September 30, 2012 to a negative 2.5 percent for the quarter ended September 30, 2013, primarily due to a quarter-versus-quarter unfavorable impact to sales from the price decline of our distillers feed, further impacted by significantly lower sales from industrial alcohol. In addition, the year ago quarter had a sizable hedging gain of \$1.8 million. In our ingredient solutions segment we experienced a decrease in volume partially offset by improved pricing. Our return on sales percentage in the ingredient solutions segment remained the same at 9.1 percent quarter-versus-quarter due to improved sales mix, despite our pricing increases being outpaced by increased commodity costs. We had no sales in our other segment due to the sale of the bioplastics manufacturing business on February 8, 2013.

Consolidated results for the year to date period ended September 30, 2013 decreased compared to the same period a year ago, with a net loss of \$4,568 on consolidated net sales of \$245,970 versus net income of \$1,444 on consolidated net sales of \$247,985 in the year to date period ended September 30, 2012. We generated a loss from operations of \$4,139 for the year to date period ended September 30, 2013, compared to loss from operations of \$1,914 for the year to date period ended September 30, 2012.

The decrease in net sales for the year to date period ended September 30, 2013 compared to September 30, 2012 was primarily the result of our decreased total alcohol sales volume in the distillery products segment. Our net income decreased for the year to date period primarily due to:

- lower gross margins as further discussed in "-Cost of Sales";
- an \$841 gain recorded during the year to date period ended September 30, 2012, which we did not have in the current period;
- an unfavorable period-versus-period change in earnings from our equity method investments; and
- a \$4,055 gain recorded related to the sale of a 20 percent interest in our joint venture, ICP, during the year to date period ended September 30, 2012, which we did not have this period.

These decreases to net income were partially offset by a \$1,406 gain on sale of the bioplastics business, which was treated as discontinued operations and decreased selling, general and administrative expenses for the year to date

period ended September 30, 2013. See "-Selling, General and Administrative Expenses" for additional information.

In our distillery products segment, we experienced a decrease in per unit pricing and an increase in unit volume compared to the same period a year ago. Distillery products segment sales were also impacted by significantly lower industrial alcohol sales for the year to date period ended September 30, 2013. The volume decrease in our high quality food grade alcohol was primarily driven by an 90 percent reduction in the supply of industrial alcohol from ICP compared to the same period a year ago. A decrease in sales in our distillery products segment, additional product cost items for the quarter ended September 30, 2013, and the increased cash costs for corn led to a decrease in our return on sales from 4.9 percent for the year to date period ended September 30, 2012, to 2.9 percent for the year to date period ended September 30, 2013. The cash cost for corn increased in the wake of last year's drought. In our ingredient solutions segment we experienced increases in volume and pricing. These increases were out-paced by the increased price of flour, which led to a decrease in ingredient solutions return on sales from 9.4 percent for the year to date period ended September 30, 2012, to 8.8 percent for the year to date period ended September 30, 2013. Other segment sales declined due to the sale of the bioplastics manufacturing business on February 8, 2013.

#### NET SALES

Net sales for the quarter ended September 30, 2013 increased \$4,064, or 5.3 percent, compared to the quarter ended September 30, 2012. This increase was attributable to an increase in distillery product sales partially offset by decreased net sales in the ingredient solutions segment and the other segment. Net sales in the distillery products segment as a whole increased primarily as a result of sales mix, partially offset by lower food grade alcohol volumes and by-product prices. The lower volumes of food grade alcohol sales were primarily driven by a 99 percent reduction in the sourcing of industrial alcohol from ICP to be sold by the Company. Net sales in the ingredient solutions segment as a whole decreased primarily as a result of lower volumes partially offset by higher pricing. We had no net sales in the other segment due to the sale of the bioplastics manufacturing business on February 8, 2013.

Net sales for the year to date period ended September 30, 2013 decreased \$2,015, or 0.8 percent, compared to the year to date period ended September 30, 2012. This decrease was primarily attributable to a decrease in net sales in the distillery products and other segments partially offset by increased net sales in the ingredient solutions segment. Net sales in the distillery products segment as a whole decreased primarily as a result of 90 percent lower supply of industrial alcohol from ICP to be sold by the Company, partially offset by improved pricing. The increase in net sales in the ingredient solutions segment was due to both increased volume and improved pricing. Our other segment experienced a decrease in net sales due to the sale of the bioplastics manufacturing business on February 8, 2013.

#### COST OF SALES

For the quarter ended September 30, 2013, cost of sales increased \$9,309, or 13.3 percent, compared to the quarter ended September 30, 2012. For the quarter ended September 30, 2013, cost of sales was 99.0 percent of net sales, which generated a gross profit margin of 1.0 percent. For the quarter ended September 30, 2012, cost of sales was 92.0 percent of net sales, which generated a gross margin of 8.0 percent. Our higher overall total cost of sales was primarily the result of higher product costs across all segments. In our distillery segment we saw a \$7,200 increase in cost of sales related to:

- sales price decline in distillers feed by-product, and
- year-ago quarter hedging gain compared to no hedging impact to cost of sales in the current period.

These cost increases were partially offset by sales volume decrease related to the ingredient products segment and other segment. We saw increases in the per-pound cost of flour and the per-million cubic foot cost of natural gas of 13.9 percent and 4.1 percent, respectively, compared to the quarter ended September 30, 2012. In addition, we saw an increase in the per-bushel cost of corn (inclusive of the effect of an update in our standard product costs and exclusive of the impact related to the accounting for open commodity contracts), of approximately 0.1 percent higher than the same period a year ago.





For the year to date period ended September 30, 2013, cost of sales increased \$2,263, or 1.0 percent, compared to the year to date period ended September 30, 2012. For the year to date period ended September 30, 2013, cost of sales was 94.6 percent of net sales, which generated a gross profit margin of 5.4 percent. For the year to date period ended September 30, 2012, cost of sales was 92.9 percent of net sales, which generated a gross profit margin of 7.1 percent. Our higher overall total cost of sales was primarily due to an increase in the cost of natural gas and increases in certain other product costs in our distillery products segment including:

higher corn costs;

- a significant change in sales mix and the associated costs of these sales;
- and

a year-ago hedging gain compared to no hedging impact to cost of sales in current year to date period.

We saw an increase in the per-bushel cost of corn (inclusive of the effect of an update in our standard product costs and exclusive of the impact related to the accounting for open commodity contracts), the per-pound cost of flour, and the per-million cubic foot cost of natural gas, which averaged approximately 10.2 percent, 19.0 percent and 2.8 percent higher, respectively, than the year to date period ended September 30, 2012. During the year to date period ended September 30, 2013, the Company experienced unanticipated operational issues, including incoming power supply interruptions in Atchison, KS, on three different days, which negatively impacted manufacturing output compared to the same period a year ago.

#### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the quarter ended September 30, 2013 increased by \$723, or 12.0 percent, compared to the quarter ended September 30, 2012. This increase was primarily due to bonus accrual over the same period a year ago, as well as increased professional fee expenses related to the dissident shareholder matter, which we did not have in the same period a year ago.

Selling, general and administrative expenses for the year to date period ended September 30, 2013 decreased by \$2,665, or 13.3 percent, compared to the year to date period ended September 30, 2012. This decrease was primarily due to a reduction in accruals associated with our incentive program, synergies in the management of the Lawrenceburg plant and a decrease in professional fees. This overall decrease in professional fees was partially offset by increased professional fee accruals for year to date period ended September 30, 2013 related to the dissident shareholder matter.

#### GAIN ON SALE OF JOINT VENTURE INTEREST

On February 1, 2012, ICP Holdings exercised its option to purchase from the Company an additional 20 percent of the membership interest in ICP. The sales price was \$9,103 and the transaction resulted in a pre-tax gain of \$4,055 for the period ended September 30, 2012.

#### INTEREST EXPENSE

Interest expense for the quarter and year to date periods ended September 30, 2013 increased \$43 and \$120 respectively, compared to the same periods ended September 30, 2012. These increases were primarily the result of higher average daily revolving credit facility balance and interest rate thereon compared to the same period a year ago.

#### EQUITY IN EARNINGS (LOSS) OF JOINT VENTURES

ICP

For the quarter ended September 30, 2013, ICP experienced net loss of \$585. With a 30 percent allocation of net loss for the quarter ended September 30, 2013, our portion (including a year-to-date adjustment) of the net loss was \$135. For the quarter ended September 30, 2012, ICP had a loss of \$448. As a 30 percent owner, our portion of the loss was \$134.

For the year to date periods ended September 30, 2013, ICP had a loss of \$3,472. With an 30 percent allocation of net loss for the year to date period ended September 30, 2013, our portion of the net loss was \$1,042. For the year to date period ended September 30, 2012, ICP had net income of \$311. As a 50 percent owner for the month of January 2012 and a 30 percent owner for the months of February through June 2012, our portion of the net income was \$229.

As previously discussed in "--Recent Activities," the ICP Limited Liability Company Agreement provides for a new allocation formula for profit and loss when notice of shutdown is rejected by the other joint venture partner. From an accounting perspective, we will continue to allocate profit and loss 30 percent to the Company and 70 percent to ICP Holdings in accordance with U.S. generally accepted accounting principles.

## D.M. Ingredients, GmbH (“DMI”)

For the quarters ended September 30, 2013 and 2012, DMI had net income of \$88 and \$7, respectively. As a 50 percent joint venture holder, our equity in net income (loss) was \$44 and \$4 for the quarters ended September 30, 2013 and 2012, respectively.

For the year to date periods ended September 30, 2013 and 2012, DMI had net income (loss) of \$159 and \$(130), respectively. As a 50 percent joint venture holder, our equity in net income (loss) was \$80 and \$(65) for the year to date periods ended September 30, 2013 and 2012, respectively.

## DISCONTINUED OPERATIONS, NET OF TAX

On February 8, 2013, we sold the assets at our bioplastics manufacturing facility in Onaga, Kansas and certain assets of our extruder bio-resin laboratory located in Atchison, Kansas. The sales price totaled \$2,797 and resulted in a net of tax gain of \$1,406 that was recognized as discontinued operations in the quarter ended March 31, 2013.

## NET INCOME (LOSS)

As the result of the factors outlined above, we experienced a net loss of \$6,325 and \$4,568 in the quarter and year to date periods ended September 30, 2013, respectively, compared to net income of \$418 and \$1,444 in the quarter and year to date periods ended September 30, 2012, respectively.

## SEGMENT RESULTS

The following is a summary of revenues and pre-tax profit / (loss) attributed to each reportable operating segment for the quarter and year to date periods ended September 30, 2013 and 2012. For additional information regarding our operating segments, see Note 6. Operating Segments of this Form 10-Q.

	Quarter Ended		Year to Date Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Distillery products				
Net Sales	\$66,059	\$61,513	\$200,775	\$205,194
Pre-Tax Income/(Loss)	(1,647	) 3,513	5,836	9,960
Ingredient solutions				
Net Sales	14,112	14,184	44,997	41,852
Pre-Tax Income	1,279	2,184	3,944	4,760
Other				
Net Sales	—	410	198	939
Pre-Tax Loss	—	(85	) (90	) (332

## DISTILLERY PRODUCTS

Total distillery products net sales for the quarter ended September 30, 2013 increased \$4,546, or 7.4 percent, compared to the quarter ended September 30, 2012. This increase was primarily attributable to a 7.7 percent increase in sales of high quality food grade alcohol, which was due to a 15.8 percent increase in per unit pricing partially offset by a 6.9 percent decrease in volume compared to the same period a year ago. The volume decrease in our high quality food grade alcohol was primarily driven by a 99 percent reduction in the supply of industrial alcohol from ICP compared to the same period a year ago. Also contributing to the increase in distillery products net sales were

increases of \$395 and \$373 in distillers feed and warehousing revenue, respectively, for the quarter ended September 30, 2013, compared to the quarter ended September 30, 2012. Despite increases in volume in our overall distillery products segment, we experienced a decrease in return on sales which was impacted by the \$7,200 unfavorable quarter-versus-quarter cost of sales impact as previously described in "--Cost of Sales." For the quarter ended September 30, 2013, the per-bushel cost of corn averaged approximately 0.1 percent higher (inclusive of the effect of an update in our standard product costs and exclusive of the impact related to the accounting for open commodity contracts) than the quarter ended September 30, 2012.

Total distillery products sales revenue for the year to date period ended September 30, 2013 decreased \$4,419, or 2.2 percent, compared to the year to date period ended September 30, 2012. This decrease was primarily attributable to a decrease in sales of high quality food grade alcohol of 6.4 percent, which was due to a 21.2 percent decrease in volume partially offset by a 18.8 percent increase in per unit pricing compared to the same period a year ago. The volume decrease in our high quality food grade alcohol was primarily driven by a 90 percent reduction in the supply of industrial alcohol from ICP compared to the same period a year ago. The decrease in distillery products sales revenue was partially offset by increases of \$5,461 and \$1,054 in distillers feed and warehousing revenue, respectively, earned at our Indiana Distillery for the year to date period ended September 30, 2013 compared to the prior year to date period. The increase in net sales of distillers feed was due to a 9.2 percent increase in per unit pricing and a 9.0 percent increase in volume compared to the same period a year ago. Despite increases in volume in our overall distillery products segment, we experienced a decrease in return on sales which was impacted by the increase in the cost of natural gas and increases in certain other product costs period-versus-period as previously described in "--Cost of Sales." Our overall distillery segment pricing was out-paced by increased costs for corn, which rose in the wake of last year's drought, as well as increased costs for natural gas. For the year to date period ended September 30, 2013, the per-bushel cost of corn (inclusive of the effect of an update in our standard product costs and exclusive of the impact related to the accounting for open commodity contracts) and the per million cubic foot cost of natural gas averaged 10.2 percent and 2.8 percent higher, respectively, than the year to date period ended September 30, 2012.

## INGREDIENT SOLUTIONS

Total ingredient solutions net sales for the quarter ended September 30, 2013 decreased by \$72, or 0.5 percent, compared to the quarter ended September 30, 2012. For the segment as a whole, we saw a 6.5 percent decrease in volume, partially offset by a 6.4 percent increase in average price per unit, including product mix effects. There were no significant sales changes in various product lines. As previously discussed in "-Results of Operations", our return on sales percentage in the ingredient solutions segment remained the same quarter-versus-quarter due to improved sales mix, despite our pricing increases being outpaced by increased commodity costs. Offsetting this decrease to gross margins were improved mix of sales. Flour costs averaged approximately 13.9 percent higher per pound compared to the same quarter a year ago.

Total ingredient solutions sales revenue for the year to date period ended September 30, 2013 increased by \$3,145, or 7.5 percent, compared to the year to date period ended September 30, 2012. Specialty starches saw a 7.3 percent increase in revenues compared to the same period a year ago due to a volume increase along with an increase in per unit pricing. Revenues for specialty proteins for the year to date period ended September 30, 2013 increased 2.2 percent compared to the year to date period ended September 30, 2012 due to an increase in per unit pricing partially offset by a decrease in volume. Commodity protein saw an 931.4 percent increase in revenues compared the same period a year ago due to a significant volume increase partially along with an increase in per unit pricing, as tight market conditions for vital wheat gluten created a temporary selling opportunity. Commodity starch saw a 7.7 percent decrease in revenues compared the same period a year ago due to a volume decrease partially offset an increase in per unit pricing. Revenues for commodity starches and proteins totaled 19.0 percent and 17.2 percent of total segment sales for the year to date periods ended September 30, 2013 and 2012, respectively. While we experienced a period-versus-period increase in our commodity products as a percentage of total segment net sales, our focus remains on the production and commercialization of specialty ingredients, which accounted for over 80% of our sales. Our return on sales percentage in the ingredient solutions segment decreased during the year to date period ended September 30, 2013 compared to the year to date period ended September 30, 2012. This was principally due to higher raw material cost for flour outpacing our pricing increases. Similar to commodity cost pressures experienced in our distillery products segment, the commodity costs in our ingredient solutions segment also increased. Flour costs averaged approximately 19.0 percent higher per pound compared to the same period a year ago.

## LIQUIDITY AND CAPITAL RESOURCES

### GENERAL

Our principal uses of cash in the ordinary course are for the cost of raw materials and energy used in our production processes, salaries, and capital expenditures. Generally, during periods when commodities prices are rising, our operations require increased use of cash to support inventory levels. Our principal sources of cash are product sales and borrowing on our revolving credit facility. At September 30, 2013 and December 31, 2012, our cash balance was \$0, and we have used our revolving credit facility for liquidity purposes, with \$19,463 remaining for additional borrowings at September 30, 2013. Historically, we also have used cash for acquisitions and received cash from investment or asset dispositions and tax refunds.

On February 8, 2013, we sold our bioplastics manufacturing business for \$2,797.

On February 1, 2012, we sold a 20 percent interest in ICP to ICP Holdings for \$9,103. The sale resulted when ICP Holdings exercised an option it acquired from the Company when ICP Holdings purchased its existing interest in ICP in 2009.

As we purchase corn for future delivery under grain supply agreements, we no longer have any open corn futures or options at September 30, 2013 and our need for restricted cash is minimal.

During August 2012, we amended our agreements with the third-party logistics company that contracts on our behalf with transportation companies in order that invoices from the logistics company for fees would be submitted to us on a weekly basis with 90 days to pay each invoice. In conjunction with this amendment, we established a \$2,000 letter of credit.

On February 28, 2013, the Board of Directors declared a five (5) cent dividend per share of the Company's common stock, no par value (the "Common Stock"). The \$916 dividend was paid on April 10, 2013, to stockholders of record of Common Stock, restricted stock and restricted stock units on March 18, 2013. On March 1, 2012, the Board of Directors declared a five (5) cent dividend per share of Common Stock. The \$914 dividend was paid on April 19, 2012 to stockholders of record of Common Stock, restricted stock and restricted stock units on March 22, 2012.

We expect \$8,000 to \$10,000 in routine capital expenditures over the twelve month period ending September 30, 2014 related to other improvements in and replacements of existing plant and equipment and information technology. As of September 30, 2013, we had contracts to acquire approximately \$842 of capital assets.

We expect our sources of cash to be adequate to provide for budgeted capital expenditures and anticipated operating requirements.

The following table is presented as a measure of our liquidity and financial condition:

	September 30, 2013	December 31, 2012
Cash and cash equivalents	\$—	\$—
Working capital	47,501	48,320
Credit facility, notes payable and long-term debt outstanding	30,430	32,744
Amounts available under lines of credit	19,463	18,381
Stockholders' equity	81,462	86,827
	Year to Date Periods	
	September 30, 2013	September 30, 2012
Depreciation and amortization	\$8,955	\$8,680
Capital expenditures	(3,571	) (7,712 )
Cash flows from operations	4,004	(7,453 )



## CASH FLOW INFORMATION

Summary cash flow information follows for the year to date periods ended September 30, 2013 and 2012, respectively:

	Year to Date Periods	
	September 30, 2013	September 30, 2012
Cash flows provided by (used for):		
Operating activities	\$4,004	\$(7,453)
Investing activities	(774)	) 4,106
Financing activities	(3,230)	) 2,964
Decrease in cash and cash equivalents	—	\$(383)
Cash and cash equivalents at beginning of year	—	383
Cash and cash equivalents at end of period	\$—	\$—

During the year to date period ended September 30, 2013, our consolidated cash remained \$0 compared to the year to date period ended September 30, 2012, in which there was a \$383 decrease. Increased operating cash flow resulted primarily from a decrease in receivables, a smaller period-versus-period increase in inventory and a smaller period-versus-period decrease in accounts payable. These increases to operating cash flow were partially offset by a period-versus-period change in the derivative valuation, a decrease in restricted cash and a decrease in net income (after giving effect to non-cash gains of \$1,453 and \$4,055 in the periods September 30, 2013 and 2012, respectively, and equity in loss of \$962 for the year to date period ended September 30, 2013 compared to equity earnings of \$164 for the year to date period ended September 30, 2012). Cash outflows related to capital expenditures during the year to date period ended September 30, 2013 decreased compared to the year to date period ended September 30, 2012, and proceeds from the disposition of property decreased (including sales of bioplastics manufacturing business in the year to date period ended September 30, 2013 and our sale of a 20 percent interest in ICP for the year to date period ended September 30, 2012) decreased. During the year to date period ended September 30, 2013, net debt declined by \$2,314 as compared to the year to date period ended September 30, 2012, in which borrowings on debt exceeded payments on debt by \$3,978.

Operating Cash Flows. Summary operating cash flow information for the year to date periods ended September 30, 2013 and 2012, respectively, is as follows:

	Year to Date Period Ended	
	September 30, 2013	September 30, 2012
Cash Flows from Operating Activities		
Net income (loss)	\$(4,568	) \$1,444
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	8,955	8,680
Gain on sale of bioplastics manufacturing business	(1,453	) —
Gain on sale of joint venture interest	—	(4,055
Loss on sale of assets	—	(841
Share based compensation	970	628
Equity in (earnings) loss	962	(164
Changes in operating assets and liabilities:		
Restricted cash	12	7,476
Receivables, net	3,529	(2,490
Inventory	(342	) (3,423
Prepaid expenses	(541	) (621
Refundable income taxes	16	152
Accounts payable	(509	) (8,031
Accounts payable to affiliate, net	(3,491	) (3,595
Accrued expenses	1,478	1,311
Change in derivatives	—	(2,492
Deferred credit		