

SCOTTS LIQUID GOLD INC
Form 10-Q
August 14, 2017

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 30, 2017

OR

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

For the transition period from _____ to _____

Commission File Number: 001-13458

SCOTT'S LIQUID GOLD-INC.

(Exact name of registrant as specified in its charter)

Colorado
(State or other jurisdiction of
incorporation or organization)

84-0920811
(I.R.S.
Employer
Identification

No.)

4880 Havana Street, Suite 400, Denver, CO
(Address of principal executive offices)

80239
(Zip Code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

As of August 11, 2017, the Registrant had 11,885,839 of its common stock, \$0.10 par value per share, outstanding.

CAUTIONARY NOTE ON FORWARD-LOOKING INFORMATION

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

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

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

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PART I

ITEM 1. FINANCIAL STATEMENTS.

Condensed Consolidated Statements of Income (Unaudited)

Scott's Liquid Gold-Inc. & Subsidiaries

| | Three Months Ended | | Six Months Ended | |
|--------------------------------------|--------------------|--------------|------------------|--------------|
| | June 30, | | June 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Net sales | 9,873,800 | \$6,482,000 | \$20,316,400 | \$14,337,900 |
| Operating costs and expenses: | | | | |
| Cost of sales | 5,606,800 | 3,766,900 | 11,229,000 | 7,624,000 |
| Advertising | 138,700 | 848,800 | 421,300 | 1,334,900 |
| Selling | 1,679,300 | 1,217,200 | 3,295,200 | 2,467,000 |
| General and administrative | 1,023,300 | 1,261,100 | 2,103,600 | 2,214,200 |
| Total operating costs and expenses | 8,448,100 | 7,094,000 | 17,049,100 | 13,640,100 |
| Income (loss) from operations | 1,425,700 | (612,000) | 3,267,300 | 697,800 |
| Other income | - | 5,400 | - | 11,600 |
| Interest expense | (33,200) | (9,700) | (75,100) | (17,100) |
| Income (loss) before income taxes | 1,392,500 | (616,300) | 3,192,200 | 692,300 |
| Income tax (expense) benefit | (517,200) | 269,700 | (1,235,800) | (282,400) |
| Net income (loss) | \$875,300 | \$(346,600) | \$1,956,400 | \$409,900 |
| Net income (loss) per common share | | | | |
| Basic | \$0.07 | \$(0.03) | \$0.17 | \$0.03 |
| Diluted | \$0.07 | \$(0.03) | \$0.16 | \$0.03 |
| Weighted average shares outstanding: | | | | |
| Basic | 11,859,927 | 11,733,734 | 11,818,143 | 11,722,240 |
| Diluted | 12,286,256 | 11,733,734 | 12,158,117 | 11,943,842 |

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

Condensed Consolidated Balance Sheets

Scott's Liquid Gold-Inc. & Subsidiaries

| | June 30, 2017 (Unaudited) | December 31, 2016 |
|--|---------------------------------|-------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$2,638,000 | \$2,097,300 |
| Accounts receivable, net | 3,498,200 | 3,456,400 |
| Inventories, net | 6,435,900 | 5,641,300 |
| Income taxes receivable | - | 7,000 |
| Prepaid expenses | 549,900 | 319,600 |
| Total current assets | 13,122,000 | 11,521,600 |
| Property and equipment, net | 637,500 | 578,400 |
| Deferred tax asset | 815,900 | 1,392,600 |
| Goodwill | 1,520,600 | 1,520,600 |
| Intangible assets, net | 6,458,700 | 6,769,100 |
| Other assets | 49,100 | 51,000 |
| Total assets | \$22,603,800 | \$21,833,300 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$1,238,600 | \$1,939,400 |
| Accrued expenses | 865,800 | 964,800 |
| Income taxes payable | 604,600 | - |
| Current maturities of long-term debt | 800,000 | 800,000 |
| Total current liabilities | 3,509,000 | 3,704,200 |
| Line-of-credit | - | 750,000 |
| Long-term debt, net of current maturities and debt issuance costs | 749,800 | 1,137,300 |
| Total liabilities | 4,258,800 | 5,591,500 |
| Shareholders' equity: | | |
| Preferred stock, no par value, authorized 20,000,000 shares; no shares issued and outstanding | - | - |
| Common stock; \$0.10 par value, authorized 50,000,000 shares; issued and outstanding 11,885,839 shares (2017) and 11,749,589 shares (2016) | 1,188,600 | 1,175,000 |
| Capital in excess of par | 6,311,000 | 6,177,800 |
| Retained earnings | 10,845,400 | 8,889,000 |
| Total shareholders' equity | 18,345,000 | 16,241,800 |
| Total liabilities and shareholders' equity | \$22,603,800 | \$21,833,300 |

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

Condensed Consolidated Statements of Cash Flows (Unaudited)

Scott's Liquid Gold-Inc. & Subsidiaries

| | Six Months Ended June 30, | |
|--|------------------------------|-------------|
| | 2017 | 2016 |
| Cash flows from operating activities: | | |
| Net income | \$1,956,400 | \$409,900 |
| Adjustment to reconcile net income to net cash provided (used) by operating activities: | | |
| Depreciation and amortization | 388,500 | 75,100 |
| Stock-based compensation | 112,000 | 127,900 |
| Deferred income taxes | 576,700 | 265,600 |
| Change in operating assets and liabilities: | | |
| Accounts receivables | (41,800) | (1,075,000) |
| Inventories | (794,600) | (948,200) |
| Prepaid expenses and other assets | (228,400) | 92,100 |
| Income taxes payable (receivable) | 611,600 | (22,400) |
| Accounts payable and accrued expenses | (799,800) | (16,000) |
| Total adjustments to net income | (175,800) | (1,500,900) |
| Net cash provided (used) by operating activities | 1,780,600 | (1,091,000) |
| Cash flows from investing activities: | | |
| Cash paid for Acquisition | - | (9,000,000) |
| Purchase of property and equipment | (124,700) | (175,700) |
| Net cash used by investing activities: | (124,700) | (9,175,700) |
| Cash flow from financing activities: | | |
| Borrowing under line-of-credit | - | 3,694,200 |
| Repayments under line-of-credit | (750,000) | - |
| Proceeds from issuance of long-term debt | - | 2,400,000 |
| Repayments of long-term debt | (400,000) | - |
| Debt issuance costs | - | (75,200) |
| Proceeds from exercise of stock options | 34,800 | 27,200 |
| Net cash (used) provided by financing activities: | (1,115,200) | 6,046,200 |
| Net increase (decrease) in cash and cash equivalents | 540,700 | (4,220,500) |
| Cash and cash equivalents, beginning of period | 2,097,300 | 7,165,100 |
| Cash and cash equivalents, end of period | \$2,638,000 | \$2,944,600 |
| Supplemental disclosures: | | |
| Cash paid during the period for interest | \$75,100 | \$17,100 |

Supplemental disclosure of non-cash activity:

In connection with the Company's Acquisition (defined in Note 5) during the six months ended June 30, 2016, the Company acquired \$400,000 of inventory, intangible assets of \$7,079,400, and goodwill of \$1,520,600 for a total of \$9,000,000.

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

Notes to Condensed Consolidated Financial Statements (Unaudited)

Scott's Liquid Gold-Inc. & Subsidiaries

Note 1. Organization and Summary of Significant Accounting Policies

(a) Company Background

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

(b) Principles of Consolidation

Our condensed consolidated financial statements include our accounts and those of our wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

(c) Basis of Presentation

The Condensed Consolidated Statements of Income, Condensed Consolidated Balance Sheets, and the Condensed Consolidated Statements of Cash Flows included in this Report have been prepared by the Company. In our opinion, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position at June 30, 2017 and results of operations and cash flows for all periods have been made.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These condensed consolidated financial statements should be read in conjunction with our financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016. The results of operations for the period ended June 30, 2017 are not necessarily indicative of the operating results for the full year.

(d) Use of Estimates

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

(e) Cash Equivalents

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

(f) Sale of Accounts Receivable

On March 16, 2011, we entered into a financing agreement with Wells Fargo Bank, National Association ("Wells Fargo") for the purpose of lowering the cost of borrowing associated with the financing of our accounts receivable. Pursuant to this agreement, we were able to sell accounts receivable from Wal-Mart Stores, Inc. ("Wal-Mart") at a discount to Wells Fargo. On January 29, 2016 we terminated our agreement with Wells Fargo due to Wal-Mart

changing its accounts payable policy.

During the six months ended June 30, 2017 and 2016, we sold approximately \$0 and \$306,800, respectively, of our relevant accounts receivable to Wells Fargo for approximately \$0 and \$305,200, respectively. The difference between the invoiced amount of the receivable and the cash that we received from Wells Fargo is a cost to us. This cost is in lieu of any cash discount our customer would have been allowed and, thus, is treated in a manner consistent with standard trade discounts granted to our customers.

The reporting of the sale of accounts receivable to Wells Fargo is treated as a sale rather than as a secured borrowing. As a result, affected accounts receivable are relieved from the Company's financial statements upon receipt of the cash proceeds.

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(g) Inventories Valuation and Reserves

Inventories consist of raw materials and finished goods and are stated at the lower of cost (first-in, first-out method) or market. We record a reserve for slow moving and obsolete products and raw materials. We estimate this reserve based upon historical and anticipated sales.

Inventories were comprised of the following at:

| | June 30, 2017 | December 31, 2016 |
|------------------------------------|------------------|----------------------|
| Finished goods | \$4,996,900 | \$ 2,668,700 |
| Raw materials | 1,482,000 | 3,035,000 |
| Inventory reserve for obsolescence | (43,000) | (62,400) |
| | \$6,435,900 | \$ 5,641,300 |

(h) Property and Equipment

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

(i) Intangible Assets

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

(j) Goodwill

Goodwill consists of the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired in the Acquisition discussed in Notes 5 and 6. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests, and in certain circumstances these assets are written down to fair value if impaired.

(k) Financial Instruments

Financial instruments which potentially subject us to concentrations of credit risk include cash and cash equivalents and accounts receivable. We maintain our cash balances in the form of bank demand deposits with financial institutions that we believe are creditworthy. During the six months ended June 30, 2017, we have maintained balances in various operating accounts in excess of federally insured limits. We establish an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information. We have no significant financial instruments with off-balance sheet risk of accounting loss, such as foreign exchange contracts, option contracts or other foreign currency hedging arrangements.

The recorded amounts for cash and cash equivalents, receivables, other current assets, accounts payable, accrued expenses, and current maturities of long-term debt approximate fair value due to the short-term nature of these financial instruments. The recorded amount of long-term debt approximates fair value and is estimated primarily based on current market rates for debt with similar terms and remaining maturities. At June 30, 2017, we had long-term debt of \$1,600,000 and no outstanding balance on our line-of-credit. At December 31, 2016 we had

long-term debt of \$2,000,000 and a \$750,000 outstanding balance on our line-of-credit.

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(l) Income Taxes

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

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

The effective tax rate for the six months ended June 30, 2017 and 2016 was 38.7% and 40.7% respectively, which differs from the statutory income tax rate due to permanent book to tax differences.

(m) Revenue Recognition

Our revenue recognition policy is significant because the amount and timing of revenue is a key component of our results of operations. Certain criteria are required to be met in order to recognize revenue. If these criteria are not met, then the associated revenue is deferred until it is met. In our case, the criteria generally are met when: (i) we have an arrangement to sell a product; (ii) we have delivered the product in accordance with that arrangement; (iii) the sales price of the product is determinable; and (iv) we believe that we will be paid for the sale.

We establish reserves for customer returns of our products and customer allowances. We estimate these reserves based upon, among other things, an assessment of historical trends, information from customers and anticipated returns related to current sales activity. These reserves are established in the period of sale and reduce our revenue in that period.

Our reserve for customer allowances includes primarily reserves for trade promotions to support price features, displays, slotting fees and other merchandising of our products to our customers. The actual level of returns and customer allowances is influenced by several factors, including the promotional efforts of our customers, changes in mix of our customers, changes in the mix of the products we sell and the maturity of the product. We may change our estimates based on actual results and consideration of other factors that cause returns and allowances. In the event that actual results differ from our estimates, the results of future periods may be impacted.

We also establish reserves for coupons, rebates and certain other promotional programs for consumers. We estimate these reserves based upon, among other things, an assessment of historical trends and current sales activity. These reserves are recorded as a reduction of revenue at the later of the date at which the revenue is recognized or the date at which the sale incentive is offered.

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

At June 30, 2017 and December 31, 2016 approximately \$1,042,200 and \$1,184,700, respectively, had been reserved as a reduction of accounts receivable. Trade promotions to our customers and incentives such as coupons to our consumers are deducted from gross sales and totaled \$1,331,800 and \$968,200 for the six months ended June 30, 2017 and 2016, respectively.

(n) Advertising Costs

Advertising costs are expensed as incurred.

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(o) Stock-based Compensation

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

(p) Operating Costs and Expenses Classification

Cost of sales includes costs associated with manufacturing and distribution including labor, materials, freight-in, purchasing and receiving, quality control, internal transfer costs, repairs, maintenance and other indirect costs, as well as warehousing and distribution costs. We classify shipping and handling costs comprised primarily of freight-out as selling expenses. Other selling expenses consist primarily of wages and benefits for sales and sales support personnel, travel, brokerage commissions and promotional costs, as well as certain other indirect costs. Shipping and handling costs totaled \$1,253,200 and \$710,600 for the six months ended June 30, 2017 and 2016, respectively.

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

(q) Recently Issued Accounting Standards

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. We anticipate that most of our operating leases will result in recognition of additional assets and the corresponding liabilities on the Consolidated Balance Sheets. We have not determined the amount of these transactions or the final impact to our earnings as the actual impact will depend on the Company’s lease portfolio at the time of adoption.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 amends the guidance for revenue recognition to replace numerous industry-specific requirements and converges areas under this topic with those of the International Financial Reporting Standards. The ASU implements a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts and customers. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. The amendments in this ASU are effective for reporting periods beginning after December 15, 2017, and early adoption is prohibited. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of the adoption. The guidance is not expected to have a material impact on our financial statements and we are currently assessing the need for expanded financial disclosures, if any.

In June 2016, FASB issued ASU No. 2016-13, “Financial Instruments —Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). Among other things, these amendments require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience,

current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019 (i.e., January 1, 2020, for calendar year entities). The ASU is not expected to have a material impact on our financial statements.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows: Classification of Certain Cash Receipts and Payments” (“ASU 2016-15”), which provides guidance on eight specific cash flow issues with the objective of reducing diversity in practice. Application of the standard, which should be applied prospectively, is required for the annual and interim periods beginning after December 15, 2017. Early adoption is permitted. The ASU is not expected to have a material impact on our financial statements.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business” (“ASU 2017-01”), which provides a more defined framework to use in determining when a set of assets and activities is a business. ASU 2017-01 also provides greater consistency in applying the guidance, making the definition of a business more operable. ASU 2017-01 is effective for public companies for annual periods, including interim periods, beginning after December 15, 2017. The ASU is not expected to have a material impact on our financial statements.

In January 2017, the FASB issued ASU 2017-04, “Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”). This ASU simplifies the accounting for goodwill impairment by elimination of the Step 2 requirement to calculate the implied fair value of goodwill. Instead, if a reporting unit’s carrying amount exceeds its fair value, an impairment charge will be recorded based on that difference. The impairment charge will be limited to the amount of goodwill allocated to that reporting unit. The ASU will be applied prospectively and is effective for impairment tests performed after December 15, 2019, with early adoption permitted. The ASU is not expected to have a material impact on our financial statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”), clarifying when a change to the terms or conditions of a share-based payment award must be accounted for as a modification. The new guidance requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change to the terms and conditions of the award. ASU 2017-09 is effective for public companies for annual periods, including interim periods, beginning after December 15, 2017, with early adoption permitted. The ASU is not expected to have a material impact on our financial statements.

Note 2. Stock-Based Compensation

During the six months ended June 30, 2017, we granted options to acquire 7,536 shares of our common stock to an employee at a price of \$1.80 per share. During the six months ended June 30, 2016, we granted options to acquire 3,000 shares of our common stock to an employee at a price of \$1.20 per share.

The weighted average fair market value of the options granted in the six months ended June 30, 2017 and 2016 was estimated on the date of grant, using a Black-Scholes option pricing model with the following assumptions:

| | June 30, 2017 | June 30, 2016 |
|--|---------------|---------------|
| Expected life of options (using the “simplified” method) | 6 years | 6 years |
| Average risk-free interest rate | 1.82% | 1.50% |
| Average expected volatility of stock | 107% | 134% |
| Expected dividend rate | None | None |
| Fair value of options granted | \$11,100 | \$3,488 |

Compensation cost related to stock options recognized in operating results (included in general and administrative expenses) was \$112,000 and \$127,900 in the six months ended June 30, 2017 and 2016, respectively. Approximately

\$522,600 of total unrecognized compensation costs related to non-vested stock options is expected to be recognized over the next 12 – 60 months, depending on the vesting provisions of the options. There was no tax benefit from recording the non-cash expense as it relates to the options granted to employees, as these were qualified stock options which are not normally tax deductible.

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In 2005, we adopted a stock option plan for our employees, officers and directors (the “2005 Plan”). In 2015, we adopted a stock option plan for our employees, officers and directors (the “2015 Plan”) to replace the 2005 Plan, which expired on March 31, 2015. At the Annual Shareholders’ Meeting in June 2015, shareholders approved the adoption of the 2015 Plan.

Activity under our two stock option plans is as follows:

| | Number of Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life | Aggregate Intrinsic Value |
|--------------------------------|-------------------------|--|---|---------------------------------|
| 2005 Plan | | | | |
| Outstanding, December 31, 2016 | 628,313 | \$ 0.63 | 3.8 years | \$510,000 |
| Granted | - | | | |
| Exercised | (136,250) | | | |
| Cancelled/Expired | - | | | |
| Outstanding, June 30, 2017 | 492,063 | \$ 0.73 | 4.3 years | \$963,700 |
| Exercisable, June 30, 2017 | 357,690 | \$ 0.69 | 3.5 years | \$716,400 |
| 2015 Plan | | | | |
| Outstanding, December 31, 2016 | 787,615 | \$ 1.27 | 7.2 years | \$136,000 |
| Granted | 7,536 | | | |
| Exercised | - | | | |
| Cancelled/Expired | (49,491) | | | |
| Outstanding, June 30, 2017 | 745,660 | \$ 1.27 | 6.9 years | \$1,056,200 |
| Exercisable, June 30, 2017 | 323,422 | \$ 1.27 | 6.4 years | \$459,800 |

Note 3. Earnings per Share

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

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

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

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| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------|------------------|------------|
| | June 30, | | June 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Common shares outstanding, beginning of the period | 11,857,026 | 11,710,745 | 11,749,589 | 11,710,745 |
| Weighted average common shares issued | 2,901 | 22,989 | 68,554 | 11,495 |
| Weighted average number of common shares outstanding | 11,859,927 | 11,733,734 | 11,818,143 | 11,722,240 |
| Dilutive effect of common share equivalents | 426,329 | - | 339,974 | 221,602 |
| Diluted weighted average number of common shares outstanding | 12,286,256 | 11,733,734 | 12,158,117 | 11,943,842 |

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

| | Three Months | | Six Months Ended | |
|---------------|----------------|---------|------------------|---------|
| | Ended June 30, | | June 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Stock options | 7,500 | 659,000 | 525,600 | 909,000 |

Note 4. Segment Information

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

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

The following provides information on our segments for the three and six months ended June 30:

| | Three Months Ended June 30, | | | |
|-------------------------------------|-----------------------------|-----------------------------------|-----------------------|-----------------------------------|
| | 2017 | | 2016 | |
| | Household Products | Skin and Hair Care Products | Household Products | Skin and Hair Care Products |
| Net sales | \$1,330,700 | \$8,543,100 | \$1,444,200 | \$5,037,800 |
| Operating costs and expenses: | | | | |
| Cost of sales | 691,600 | 4,915,200 | 783,800 | 2,983,100 |
| Advertising expenses | 102,200 | 36,500 | 589,500 | 259,300 |
| Selling expenses | 336,500 | 1,342,800 | 468,600 | 748,600 |
| General and administrative expenses | 330,700 | 692,600 | 385,500 | 875,600 |
| Total operating costs and expenses | 1,461,000 | 6,987,100 | 2,227,400 | 4,866,600 |
| (Loss) income from operations | (130,300) | 1,556,000 | (783,200) | 171,200 |
| Other income | - | - | 2,100 | 3,300 |
| Interest expense | - | (33,200) | (3,400) | (6,300) |
| (Loss) income before income taxes | \$(130,300) | \$1,522,800 | \$(784,500) | \$168,200 |

| | Six Months Ended June 30, | | | |
|-------------------------------------|---------------------------|-----------------------------------|-----------------------|-----------------------------------|
| | 2017 | | 2016 | |
| | Household Products | Skin and Hair Care Products | Household Products | Skin and Hair Care Products |
| Net sales | \$2,780,300 | \$17,536,100 | \$3,036,900 | \$11,301,000 |
| Operating costs and expenses: | | | | |
| Cost of sales | 1,349,100 | 9,879,900 | 1,458,500 | 6,165,500 |
| Advertising expenses | 316,300 | 105,000 | 878,800 | 456,100 |
| Selling expenses | 645,000 | 2,650,200 | 841,600 | 1,625,400 |
| General and administrative expenses | 679,100 | 1,424,500 | 808,000 | 1,406,200 |
| Total operating costs and expenses | 2,989,500 | 14,059,600 | 3,986,900 | 9,653,200 |
| (Loss) income from operations | (209,200) | 3,476,500 | (950,000) | 1,647,800 |
| Other income | - | - | 3,400 | 8,200 |
| Interest expense | - | (75,100) | (5,000) | (12,100) |

(Loss) income before income taxes \$(209,200) \$3,401,400 \$(951,600) \$1,643,900

The following is a reconciliation of segment information to consolidated information:

| | Three Months Ended | | Six Months Ended June 30, | |
|--|--------------------|-------------|---------------------------|--------------|
| | June 30, 2017 | 2016 | 2017 | 2016 |
| Net sales | \$9,873,800 | \$6,482,000 | \$20,316,400 | \$14,337,900 |
| Consolidated income (loss) before income taxes | \$1,392,500 | \$(616,300) | \$3,192,200 | \$692,300 |

| | June 30, 2017 | December 31, 2016 |
|----------------------------|------------------|----------------------|
| Assets: | | |
| Household Products | \$2,218,500 | \$1,850,000 |
| Skin and Haircare Products | 19,446,200 | 18,371,500 |
| Corporate | 939,100 | 1,611,800 |
| Consolidated | \$22,603,800 | \$21,833,300 |

Corporate assets noted above are comprised primarily of our deferred tax assets and property and equipment not directly associated with our manufacturing, warehousing, shipping and receiving activities.

Note 5. Acquisition

On June 30, 2016, Neoteric Cosmetics, Inc. (“Neoteric”), a wholly-owned subsidiary of the Company, entered into an Asset Purchase Agreement (the “Purchase Agreement”) with Ultimark Products, Inc. (“Ultimark”) and consummated the transaction contemplated thereby, pursuant to which Neoteric purchased from Ultimark all intellectual property assets and certain related assets owned by Ultimark as well as inventory of finished goods owned by Ultimark and used in connection with the manufacture, sale and distribution of the Prell[®], Denorex[®], and Zincon[®] brands of hair and scalp care products (collectively, the “Brands”). The total consideration Neoteric paid for the Brands was approximately \$9.0 million, plus the assumption by Neoteric of certain specific liabilities of Ultimark related to the performance of certain purchase orders and contracts following June 30, 2016 (the “Acquisition”).

Note 6. Goodwill and Intangible Assets

Intangible assets consisted of the following:

| As of June 30, 2017 | | | As of December 31, 2016 | | |
|---------------------|--------------------------|--------------|-------------------------|--------------------------|--------------|
| Gross Carrying | Accumulated Amortization | Net Carrying | Gross Carrying | Accumulated Amortization | Net Carrying |

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| | Amount | | Value | | Amount | | Value | |
|---------------------------------|-------------|------------|-------------|-------------|------------|-------------|-------|--|
| Intangible assets: | | | | | | | | |
| Customer relationships | \$4,022,100 | \$ 402,200 | \$3,619,900 | \$4,022,100 | \$ 201,100 | \$3,821,000 | | |
| Trade names | 2,362,400 | 157,400 | 2,205,000 | 2,362,400 | 78,700 | 2,283,700 | | |
| Formulas and batching processes | 668,600 | 55,800 | 612,800 | 668,600 | 27,900 | 640,700 | | |
| Non-compete agreement | 26,300 | 5,300 | 21,000 | 26,300 | 2,600 | 23,700 | | |
| | 7,079,400 | 620,700 | 6,458,700 | 7,079,400 | 310,300 | 6,769,100 | | |
| Goodwill | | | 1,520,600 | | | 1,520,600 | | |
| Total intangible assets | | | \$7,979,300 | | | \$8,289,700 | | |

The amortization expense for the three and six months ended June 30, 2017 was \$155,200 and \$310,400, respectively. There was no amortization expense for the three and six months ended June 30, 2016.

Estimated amortization expense for 2017 and subsequent years is as follows:

| | |
|------------------|-------------|
| 2017 (remaining) | \$310,300 |
| 2018 | 620,700 |
| 2019 | 620,700 |
| 2020 | 620,700 |
| 2021 | 617,600 |
| Thereafter | 3,668,700 |
| Total | \$6,458,700 |

Note 7. Long-Term Debt and Line-of-Credit

On June 30, 2016, Neoteric and the Company, as borrowers, entered into the Credit Agreement (the “Credit Agreement”) with JPMorgan Chase Bank, N.A. (“Chase”), as lender, pursuant to which Chase provided a term loan and a revolving credit facility that was used to finance a portion of the Acquisition and for the Company’s general corporate purposes and working capital. The term loan amount is \$2.4 million with quarterly payments fully amortized over three years and interest of (i) the LIBO Rate + 3.75% or (ii) the Prime Rate + 1.00%, with a floor of the one month LIBO Rate + 2.5%. At June 30, 2017, our rate was 4.79%. The revolving credit facility amount is \$4 million with interest of (i) the LIBO Rate + 3.00% or (ii) the Prime Rate + 0.25%, with a floor of the one month LIBO Rate + 2.5%. At June 30, 2017, our rate was 4.04%. The revolving credit facility will terminate on June 30, 2019 or any earlier date on which the revolving commitment is otherwise terminated pursuant to the Credit Agreement. Under the Credit Agreement we are obligated to pay quarterly an unused commitment fee equal to 0.5% per annum on the daily amount of the undrawn portion of the revolving line-of-credit. The loans are secured by all of the assets of the Company and all of its subsidiaries.

The Credit Agreement requires, among other things, that beginning on December 31, 2016 and subsequently on a quarterly basis, the Company maintain a Debt Service Coverage Ratio of no less than 1.25 to 1.0 and a Funded Indebtedness to Adjusted EBITDA Ratio of no greater than 3.0 to 1.0. The Credit Agreement also contains covenants typical of transactions of this type, including among others, limitations on the Company’s ability to: create, incur or assume any indebtedness or lien on Company assets; pay dividends or make other distributions; redeem, retire or acquire the Company’s outstanding common stock, options, warrants or other rights; make fundamental changes to the Company’s corporate structure or business; make investments or asset sales; or engage in certain other activities as set forth in the Credit Agreement. The Company was in compliance with the covenants in the Credit Agreement as of June 30, 2017 and December 31, 2016. Capitalized terms used but not defined shall have the meanings provided in the Credit Agreement.

Maturities of long-term debt are as follows as of June 30, 2017:

| | |
|------------------|-----------|
| 2017 (remaining) | \$400,000 |
| 2018 | 800,000 |
| 2019 | 400,000 |

| | |
|--------------------------------------|--------------|
| | 1,600,000 |
| Less unamortized debt issuance costs | (50,200) |
| Total | \$ 1,549,800 |

We recognized \$6,200 and \$12,500 of debt issuance costs as a component of interest expense for the three and six months ended June 30, 2017, respectively. Debt issuance costs are amortized using the effective interest method over the term of the loan.

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

Results of Operations

Our consolidated net sales for the first six months ended June 30, 2017 were \$20,316,400 versus \$14,337,900 for the first six months ended June 30, 2016, an increase of \$5,978,500 or 41.7%. We saw a 118.5% increase in net sales of our own lines of skin and hair care products and a 35.8% increase in net sales of the skin and hair care products that we distribute for other companies. We saw an 8.4% decrease in net sales of our household products. The reasons for the foregoing changes in net sales are described below.

Our consolidated net sales for the three months ended June 30, 2017 were \$9,873,800 versus \$6,482,000 for the three months ended June 30, 2016, an increase of \$3,391,800 or 52.3%. We saw a 133.3% increase in net sales of our own line of skin care products and a 47.7% increase in net sales of the skin and hair care products that we distribute for other companies. We saw a 7.9% decrease in net sales of our household products. The reasons for the foregoing changes in net sales are described below.

Our net income for the first six months ended June 30, 2017 was \$1,956,400 versus net income of \$409,900 in the first six months ended June 30, 2016. Our net income for the second quarter of 2017 was \$875,300 versus a net loss of \$346,600 in the second quarter of 2016. The increase in net income for the first six months ended June 30, 2017 compared to the net income for the same period in 2016 resulted primarily from: (1) increased sales as a result of the Acquisition and further growth of the skin and hair care products that we distribute; and (2) the incurrence of professional fees in the first six months of 2016 related to the Acquisition. These increases were offset in part by an increase in income tax expense and the amortization of the acquired intangible assets. Our income tax expense for the first six months ended June 30, 2017 was \$1,235,800 versus an income tax expense of \$282,400 in the first six months ended June 30, 2016. Our income tax expense in the second quarter of 2017 was \$517,200 versus an income tax benefit of \$269,700 in the second quarter of 2016.

Summary of Results as a Percentage of Net Sales

| | Year Ended | | Six Months Ended June 30, | |
|-----------------------------|-------------------------|---|------------------------------|-----------|
| | December 31, 2016 | | 2017 | 2016 |
| Net sales | | | | |
| Household products | 17.0 | % | 13.7 | % 21.2 % |
| Skin and hair care products | 83.0 | % | 86.3 | % 78.8 % |
| Total net sales | 100.0 | % | 100.0 | % 100.0 % |
| Cost of sales | 56.9 | % | 55.3 | % 53.2 % |
| Gross profit | 43.1 | % | 44.7 | % 46.8 % |
| Other revenue | 0.0 | % | 0.0 | % 0.1 % |
| | 43.1 | % | 44.7 | % 46.9 % |
| Operating expenses | 34.0 | % | 28.6 | % 42.0 % |
| Interest expense | 0.4 | % | 0.4 | % 0.1 % |
| | 34.4 | % | 29.0 | % 42.1 % |
| Income before income taxes | 8.7 | % | 15.7 | % 4.8 % |

Our gross margins may not be comparable to those of companies who include all of the costs related to their distribution network in cost of sales because we, like some other companies, exclude a portion of these costs (i.e., freight out to customers) from gross margin. Instead, we include them as part of selling expenses. See Note 1(p), “Operating Costs and Expenses Classification,” to our Condensed Consolidated Financial Statements (Unaudited) in Item 1.

Six Months Ended June 30, 2017 Compared to Six Months Ended June 30, 2016

Comparative Net Sales

| | Six Months Ended June 30, | | Percentage |
|-----------------------------------|---------------------------|--------------|------------------------|
| | 2017 | 2016 | Increase (Decrease) |
| Total household products | \$2,780,300 | \$3,036,900 | (8.4 %) |
| Total skin and hair care products | 17,536,100 | 11,301,000 | 55.2 % |
| Total net sales | \$20,316,400 | \$14,337,900 | 41.7 % |

Sales of household products for the first six months of 2017 accounted for 13.7% of consolidated net sales compared to 21.2% for the same period in 2016. The net sales of these products were \$2,780,300 in the first six months of 2017 compared to \$3,036,900 for the same period in 2016, a decrease of \$256,600 or 8.4%. This decrease is primarily attributable to: (1) lower sales of our Scott's Liquid Gold® Floor Restore product due to the first six months of 2016 including sales at one of our customers who discontinued the product in the second quarter of 2016; and (2) lower sales of our other household products.

Sales of skin and hair care products for the first six months of 2017 accounted for 86.3% of consolidated net sales compared to 78.8% for the same period in 2016. The net sales of these products were \$17,536,100 in the first six months ended June 30, 2017 compared to \$11,301,000 for the same period in 2016, an increase of \$6,235,100 or 55.2%, primarily as a result of the addition of the net sales of Prell®, Denorex®, and Zincon®, which we acquired in the Acquisition on June 30, 2016, and increases in the sales of Montagne Jeunesse face masque sachets and Batiste Dry Shampoo.

The net sales of our own skin and hair care products were \$5,774,900 in the first six months of 2017 compared to \$2,642,900 for the same period in 2016, an increase of \$3,132,000 or 118.5%. This increase is primarily attributable to the addition of the net sales of Prell®, Denorex®, and Zincon®. The net sales of Prell®, Denorex®, and Zincon® were \$3,089,900 in the first six months ended June 30, 2017.

The net sales of Montagne Jeunesse and Batiste Dry Shampoo were \$11,761,200 in the first six months of 2017 compared to \$8,658,100 for the same period in 2016, an increase of \$3,103,100 or 35.8%. This increase is attributable to increased sales of both products.

We paid our customers a total of \$1,331,800 in the first six months of 2017 for trade promotions to support price features, displays, slotting fees and other merchandising of our products compared to \$968,200 for the same period in 2016, an increase of \$363,600 or 37.6%. This increase is primarily attributable to the addition of the sales of Prell®, Denorex®, and Zincon® as well as increased sales of Montagne Jeunesse face masque sachets and Batiste Dry Shampoo.

From time to time, our customers return products to us. For our household products, we permit returns only for a limited time. With regard to our skin and hair care products, returns are more frequent under an unwritten industry standard that permits returns for a variety of reasons. In the event a skin and hair care customer requests a return of a product, we will consider the request, and may grant such request in order to maintain or enhance our relationship with the customer, even in the absence of an enforceable right of the customer to do so. Typically, customers that return products to us take a credit on our invoice equal to the original sale price plus a handling charge ranging from 8-10% of the original sales price. Our product returns (as a percentage of net sales) were 0.12% for the first six months of 2017 and less than 0.1% for the same period in 2016.

On a consolidated basis, cost of sales was \$11,229,000 during the first six months of 2017 compared to \$7,624,000 for the same period in 2016, an increase of \$3,605,000 or 47.3%, on a net sales increase of 41.7%. As a percentage of consolidated net sales, cost of sales was 55.3% in the first six months of 2017 compared to 53.2% for the same period in 2016.

As a percentage of net sales of our household products, the costs of sales for our household products increased to 48.5% in the first six months of 2017 compared to 48.0% for the same period in 2016.

As a percentage of net sales of our skin and hair care products, the cost of sales for our skin and hair care products increased to 56.3% in the first six months of 2017 compared to 54.6% for the same period in 2016. This change varies from period to period based on product mix and trade promotions of the products we make versus the products we distribute for other companies, which have higher costs and higher trade promotions. The underlying costs of the products did not significantly change in the first six months of 2017 compared to the same period in 2016, except for an increase in certain overhead costs incurred from leasing additional warehouse space starting in the second quarter of 2016.

Operating Expenses, Interest Expense and Other Income

| | Six Months Ended June 30, | | Percentage Increase (Decrease) |
|----------------------------|------------------------------|-------------|--------------------------------------|
| | 2017 | 2016 | |
| Operating expenses | | | |
| Advertising | \$421,300 | \$1,334,900 | (68.4 %) |
| Selling | 3,295,200 | 2,467,000 | 33.6 % |
| General and administrative | 2,103,600 | 2,214,200 | (5.0 %) |
| Total operating expenses | \$5,820,100 | \$6,016,100 | (3.3 %) |
| Other income | \$- | \$11,600 | (100.0 %) |
| Interest expense | \$75,100 | \$17,100 | 339.2 % |

Our operating expenses for the first six months of 2017 were \$5,820,100 compared to \$6,016,100 for the same period in 2016, a decrease of \$196,000 or 3.3%. These expenses consist primarily of advertising, selling, and general and administrative expenses.

Advertising expenses for the first six months of 2017 were \$421,300 compared to \$1,334,900 for the same period in 2016, a decrease of \$913,600 or 68.4%. This decrease is primarily due to: (1) the one-time expenses we incurred during the first six months of 2016 relating to the repositioning of our Alpha[®] Skin Care products and Scott's Liquid Gold[®] household products in the marketplace, which were not repeated in 2017, and (2) spending less on a national television campaign in the first six months of 2017 compared to the same period in 2016 on our Scott's Liquid Gold[®] Wood Care product.

Selling expenses for the first six months of 2017 were \$3,295,200 compared to \$2,467,000 for the same period in 2016, an increase of \$828,200 or 33.6%. This increase is primarily attributable to: (1) an increase in the commissions that we paid our sales brokers and an increase in our costs of freight-out to our customers due to higher sales volume; and (2) an increase in the accrual of probable bonus payments to personnel within our sales and marketing organization compared to the first six months of 2016.

General and administrative expenses for the first six months of 2017 were \$2,103,600 compared to \$2,214,200 for the same period of 2016, a decrease of \$110,600 or 5.0%. This decrease is due primarily to a decrease in professional fees in the first six months of 2017 compared to higher fees in the same period of 2016 related to the Acquisition. This decrease was offset primarily by: (1) an increase in the accrual of probable bonus payments to our management and administrative personnel, compared to the first six months of 2016; and (2) amortization of the acquired intangible assets.

Other income from interest earned on our cash reserves for the first six months of June 30, 2017 and 2016 was \$0 and \$11,600, respectively.

Interest expense for the first six months of June 30, 2017 and 2016 was \$75,100 and \$17,100, respectively. The increase is due to borrowings under the Credit Agreement on June 30, 2016 to help fund the Acquisition.

Three Months Ended June 30, 2017 Compared to Three Months Ended June 30, 2016

Comparative Net Sales

| | Three Months Ended June 30, | | Percentage Increase (Decrease) | |
|-----------------------------------|--------------------------------|-------------|--------------------------------------|----|
| | 2017 | 2016 | | |
| Total household products | \$1,330,700 | \$1,444,200 | (7.9 | %) |
| Total skin and hair care products | 8,543,100 | 5,037,800 | 69.6 | % |
| Total net sales | \$9,873,800 | \$6,482,000 | 52.3 | % |

Sales of household products for the second quarter of 2017 accounted for 13.7% of consolidated net sales compared to 22.3% for the same period in 2016. The net sales of these products were \$1,330,700 in the second quarter of 2017 compared to \$1,444,200 for the same period in 2016, a decrease of \$113,500 or 7.9%. This decrease is primarily attributable to: (1) lower sales of our Scott's Liquid Gold® Floor Restore product due to the second quarter of 2016 including sales at one of our customers who discontinued the product in the second quarter of 2016; and (2) lower sales of our other household products.

Sales of skin and hair care products for the second quarter of 2017 accounted for 86.5% of consolidated net sales compared to 77.7% for the same period in 2016. The net sales of these products were \$8,543,100 in the second quarter of 2017 compared to \$5,037,800 for the same period in 2016, an increase of \$3,505,300 or 69.6%, primarily as a result of the addition of the net sales of Prell®, Denorex®, and Zincon®, which we acquired in the Acquisition on June 30, 2016, and increases in the sales of Montagne Jeunesse face masque sachets and Batiste Dry Shampoo.

The net sales of our own skin and hair care products were \$3,007,000 in the second quarter of 2017 compared to \$1,288,700 for the same period in 2016, an increase of \$1,718,300 or 133.3%. This increase is primarily attributable to the addition of the net sales of Prell®, Denorex®, and Zincon®. The net sales of Prell®, Denorex®, and Zincon® were \$1,654,200 in the second quarter of 2017.

The net sales of Montagne Jeunesse and Batiste Dry Shampoo were \$5,536,100 in the second quarter of 2017 compared to \$3,749,100 for the same period in 2016, an increase of \$1,787,000 or 47.7%. This increase is attributable to increased sales of both products.

We paid our customers a total of \$712,100 in the second quarter of 2017 for trade promotions to support price features, displays, slotting fees and other merchandising of our products compared to \$516,600 for the same period in 2016, an increase of \$195,500 or 37.8%. This increase is primarily attributable to the addition of the net sales of Prell®, Denorex®, and Zincon® as well as increased sales of Alpha® Skin Care products, Montagne Jeunesse face masque sachets, and Batiste Dry Shampoo.

From time to time, our customers return products to us. For our household products, we permit returns only for a limited time. With regard to our skin and hair care products, returns are more frequent under an unwritten industry standard that permits returns for a variety of reasons. In the event a skin and hair care customer requests a return of a product, we will consider the request, and may grant such request in order to maintain or enhance our relationship with the customer, even in the absence of an enforceable right of the customer to do so. Typically, customers that return products to us take a credit on our invoice equal to the original sale price plus a handling charge ranging from 8-10% of the original sales price. Our product returns (as a percentage of net sales) were less than 0.1% for the second

quarter of 2017 and 2016.

On a consolidated basis, cost of sales was \$5,606,800 during the second quarter of 2017 compared to \$3,766,900 for the same period in 2016, an increase of \$1,839,900 or 48.8%, on a net sales increase of 52.3%. As a percentage of consolidated net sales, cost of sales was 56.8% in the second quarter of 2017 compared to 58.1% for the same period in 2016.

As a percentage of net sales of our household products, the costs of sales for our household products decreased to 52.0% in the second quarter of 2017 compared to 54.3% for the same period in 2016.

As a percentage of net sales of our skin and hair care products, the cost of sales for our skin and hair care products decreased to 57.5% in the second quarter of 2017 compared to 59.2% for the same period in 2016. This change varies from period to period based on product mix and trade promotions of the products we make versus the products we distribute for other companies, which have higher costs and higher trade promotions. The underlying costs of the products did not significantly change in the second quarter of 2017 compared to the same period in 2016, except for an increase in certain overhead costs incurred from leasing additional warehouse space starting in the second quarter of 2016.

Operating Expenses, Interest Expense and Other Income

| | Three Months Ended June 30, | | Percentage Increase (Decrease) |
|----------------------------|--------------------------------|--------------|--------------------------------------|
| | 2017 | 2016 | |
| Operating expenses | | | |
| Advertising | \$ 138,700 | \$ 848,800 | (83.7 %) |
| Selling | 1,679,300 | 1,217,200 | 38.0 % |
| General and administrative | 1,023,300 | 1,261,100 | (18.9 %) |
| Total operating expenses | \$ 2,841,300 | \$ 3,327,100 | (14.6 %) |
| Other income | \$- | \$ 5,400 | (100.0 %) |
| Interest expense | \$ 33,200 | \$ 9,700 | 242.3 % |

Our operating expenses for the second quarter of 2017 were \$2,841,300 compared to \$3,327,100 for the same period in 2016, a decrease of \$485,800 or 14.6%. These expenses consist primarily of advertising, selling, and general and administrative expenses.

Advertising expenses for the second quarter of 2017 were \$138,700 compared to \$848,800 for the same period in 2016, a decrease of \$710,100 or 83.7%. This decrease is primarily due to: (1) the one-time expenses we incurred during the second quarter of 2016 relating to the repositioning of our Alpha[®] Skin Care products and Scott's Liquid Gold[®] household products in the marketplace, which were not repeated in 2017, and (2) spending less on a national television campaign in the second quarter of 2017 compared to the same period in 2016 on our Scott's Liquid Gold[®] Wood Care product.

Selling expenses for the second quarter of 2017 were \$1,679,300 compared to \$1,217,200 for the same period in 2016, an increase of \$462,100 or 38.0%. This increase is primarily attributable to: (1) an increase in the commissions that we paid our sales brokers and an increase in our costs of freight-out to our customers due to higher sales volume; and (2) an increase in the accrual of probable bonus payments to personnel within our sales and marketing organization compared to the second quarter of 2016.

General and administrative expenses for the second quarter of 2017 were \$1,023,300 compared to \$1,261,100 for the same period of 2016, a decrease of \$237,800 or 18.9%. This decrease is due primarily to a decrease in professional fees in the second quarter of 2017 compared to higher fees in the same period of 2016 related to the Acquisition. This decrease was offset primarily by: (1) an increase in the accrual of probable bonus payments to our management and administrative personnel, compared to the second quarter of 2016; and (2) amortization of the acquired intangible assets.

Other income from interest earned on our cash reserves for the second quarter of 2017 and 2016 was \$0 and \$5,400, respectively.

Interest expense for the second quarter of 2017 and 2016 was \$33,200 and \$9,700, respectively. The increase is due to borrowings under the Credit Agreement on June 30, 2016 to help fund the Acquisition.

Liquidity and Capital Resources

Financing Agreements

Please see Note 7 to our Condensed Consolidated Financial Statements (Unaudited) for information on our Credit Agreement with Chase. Please see Note 1(f) to our Condensed Consolidated Financial Statements for information on our financing agreement with Wells Fargo, which was terminated during 2016.

Liquidity

At June 30, 2017, we had approximately \$2.6 million in cash on hand, which was \$540,700 more compared to December 31, 2016, primarily due to cash provided by operating activities, and offset by: (1) our use of cash to reduce the outstanding balance on our line-of-credit to zero; (2) repayments of long-term debt; and (3) the payment of performance bonuses in the first six months of 2017 to our management, sales, administrative support and operations personnel that were accrued for in 2016. For the first six months ended June 30, 2017, the primary components of working capital that significantly affected operating cash flows were the following: (1) net accounts receivable were \$41,800 more at June 30, 2017 than at December 31, 2016 due primarily to receivables related to the timing of receiving payment; (2) inventory at June 30, 2017 was \$794,600 more than at December 31, 2016 due primarily to the timing of receiving certain inventory from our vendors and shipping our products to our customers; and (3) accounts payable and accrued expenses at June 30, 2017 were \$799,800 less than at December 31, 2016 due primarily to bonuses paid to certain employees and the timing of payments on our inventory.

We believe that our cash on hand at any time during 2017 could be significantly less than at December 31, 2016 due primarily to the following: (1) costs and capital expenditures related to the integration of the Acquisition; and (2) the timing of receiving and paying for the significant amounts of Batiste Dry Shampoo that we purchase every month from Church & Dwight.

We anticipate that our existing cash and our cash flow from operations, together with our current Credit Agreement with Chase, will be sufficient to meet our cash requirements for the next 12 months from the filing date of this Report. During the first six months of 2017, we spent \$124,700 to purchase production and warehouse equipment to improve our manufacturing capabilities and efficiencies and on additional production and warehouse equipment that is primarily related to the Acquisition, and paid an additional \$200,000 in deposits for future production and warehouse equipment to be received and placed in service in 2017. We expect to make additional capital expenditures of approximately \$130,000 in 2017 on additional production and warehouse equipment that is primarily related to the Acquisition.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of June 30, 2017, we conducted an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of June 30, 2017.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the six months ended June 30, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this Report, you should carefully consider the factors discussed in Item 1A, "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 and subsequent quarterly reports on Form 10-Q, which could materially affect our business, financial condition or future results.

ITEM 6. EXHIBITS

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

*Furnished, not filed.

SIGNATURES

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

SCOTT'S LIQUID GOLD-INC.

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

By: /s/ Barry J. Levine
Barry J. Levine
Treasurer, Chief Financial Officer and Chief Operating Officer
(Principal Financial and Chief Accounting Officer)

Date: August 14, 2017

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