THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

KMG - Q1 2015 KMG Chemicals Inc Earnings Call

EVENT DATE/TIME: DECEMBER 10, 2014 / 9:30PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Eric Glover *KMG - IR - Manager*

Christopher T. Fraser *KMG - Chairman, President, CEO*

Malinda Passmore *KMG - CFO*

CONFERENCE CALL PARTICIPANTS

Rosemarie Morbelli *Gabelli & Company - Analyst*

Richard O'Reilly *Revere & Associates - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the KMG First Quarter 2015 Earnings Conference Call. My name is Jackie, and I will be your coordinator for today. At this time, all participants are in a listen-only mode. And we will facilitate a question-and-answer session towards the end of the presentation.

(Operator Instructions)

I'd now like to turn the conference over to Mr. Eric Glover, Investor Relations Manager. Please proceed.

Eric Glover - *KMG - IR - Manager*

Thank you, Jackie. Good afternoon and welcome to the KMG Chemicals Incorporated first quarter fiscal 2015 financial results conference call. I'm joined today by Chris Fraser, our Chairman and CEO; and Mindy Passmore, our CFO. In a moment, we'll hear remarks from them followed by Q&A.

During today's call, we will refer to financial measures not calculated according to generally accepted accounting principles. Please refer to today's earnings release available on our Web site for the reasons we're presenting non-GAAP financial information and for the appropriate tables that reconcile these measures to our GAAP results.

Before we begin, I'd like to remind everyone that the information on this conference call includes certain forward-looking statements that are based upon assumptions that in the future may prove not to have been accurate and are subject to significant risks and uncertainties, including statements as to the future performance of the Company.

I'll now turn the call over to Chris Fraser, Chairman and CEO. Please go ahead, Chris.

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Thank you, Eric. Good afternoon and thank you everyone for joining us today. Our Q1 earnings release was issued today at 4 PM Eastern Time and our 10-Q will be available this evening. After my remarks, I'll turn the call over to Mindy for a review of the Q1 financials and our outlook for fiscal 2015. After our comments, we'll take your questions.

KMG had a solid first quarter with continued progress operationally, financially, and organizationally. Our adjusted EBITDA grew 10% year-over-year to $8.8 million and adjusted EPS improved approximately 10% to $0.24 per share.

We remain focused on maximizing cash flow and in the first quarter we generated $9.6 million in cash from operations more than double that of last year's first quarter. Similar to our fourth quarter, our first quarter electronic chemical performance was characterized by continued positive semiconductor industry demand for our high purity process chemicals.

Regionally we saw strong growth in both North America and in Asia with continued softness in Europe. Overall, first quarter consolidated Electronic Chemical segment sales grew 3% on a year-over-year basis and in line with our record fourth quarter. Increased corporate IT spending and renewed strength in the PC and server markets has helped drive growth within our EC business.

We've also benefited from rising semiconductor production for our key end markets including automotive, mobile and Internet of Things. In North America we achieved record quarterly volume and sales growth in the first quarter. Sales were up 5% sequentially and 7% over last year's first quarter.

Electronic Chemical sales in Asia increased sequentially as well over strong Q4 and reached the highest level since we acquired the UPC business. We continue to expand our business with large global semiconductor customers and the positive momentum we're experiencing underscores the value our customers placed on our global distribution capabilities, comprehensive product offering, and enduring commitment to the highest levels of quality and reliability.

Although our consolidated Electronic Chemical sales grew year-over-year in Q1, we continue experience weakness in the Eurozone economy, negatively affecting our European sales. While this market is likely to remain sluggish in near-term, we're nonetheless gaining traction with key customers in this region.

When we evaluate the global semiconductor landscape today, one of the key trends we see is continued consolidation among multinational semiconductor manufacturers, because the technological complexity and costs of semiconductor manufacturing have continued to escalate, semiconductor makers have sort to gain economies of scale through consolidation. As these multinational manufacturer combine operations throughout the world they prefer to partner with the strategic suppliers who possess similar global reach and distribution capabilities.

KMG, the world's leading supplier of high purity process chemicals with a truly global presence is in a unique position to meet our customer's complex needs and to partner and grow with them on a global scale. Our Electronic Chemicals manufacturing consolidation plan continues to progress on schedule.

As noted last quarter, we closed our Fremont, California facility and successfully transition production to our Pueblo, Colorado and Hollister, California sites. This manufacturing consolidation has had a positive impact on our segment profitability as first quarter Electronic Chemical sales segment EBITDA margins improved.

In Europe, we continue to work closely with our customers on the transition of our products to our alternate manufacturing locations in France and in the U.K. The realignment of our North American hydrofluoric acid operations is also proceeding smoothly and we expect that production at our Bay Point, California plant will seize in the first quarter.

As planned, we will transition our HF operations to our manufacturing facility in Pueblo, fully leveragize -- leveraging those assets and enhancing our overall quality offering to our customers.

Now turning to our Wood Treating Chemical segment. Our net sales were essentially flat sequentially and down 16% year-over-year, reflecting continued challenging market conditions in the creosote market. As we've discussed previously, reduction in hardwood availability combined with a railroad industries preference for borate-treated rail ties has contributed to reduced demand, excess supply and continued downward pressure on prices.

While overall Wood Treating Chemical sales were down in the first quarter and due to reduced creosote volumes, segment operating profit margins and resulting EBITDA improved on a year-to-year basis, driven primarily by reduced supply chain costs and a more favorable product mix.

Our Penta business continues to produce healthy cash flow benefiting from consistent steady demand and utility pole replacement programs in the Western U.S. As noted in our 10-K and this quarter's 10-Q we're in discussion with one of our large creosote customers regarding future shipment volumes. These discussions are ongoing and we're continuing to ship creosote to this customer during this time.

Overall, I'm pleased with the progress we're achieving both operationally and financially. In numerous areas we're -- we significantly expanded our internal capabilities and fundamentally strengthen our business. We are well positioned for growth in fiscal 2015 and the year is off to a promising start led by strength in our Electronic Chemicals businesses both in North America and Asia.

Our restructuring and realignment programs remain on schedule and our recent financial results have reflected a portion of our targeted restructuring cost savings. The implementation of our global ERP system is also on schedule and we have had several important milestones since this initiative kicked off in February 2014.

We are on track to go live in the U.S this coming February, which will enhance our overall efficiency, further improving our working capital management and facilitate more streamline integration of future acquisitions with one common platform.

Regarding our growth strategy through acquisition, we continue to identify and pursue potential candidates that would enhance our existing businesses and drive incremental cash flow. With our continued strong operational cash flow coupled with our recently refinanced debt we're fortunate to have ample balance sheet capacity to close on these opportunities. We remain overly highly -- overall highly selective in our evaluation process, pursuing those select companies and businesses that meet our financial and strategic criteria.

Now I'll turn the call over to Mindy for financial discussion.

Malinda Passmore - *KMG - CFO*

Thank you, Chris, and good afternoon, everyone. In my remarks, I'll discuss adjusted or non-GAAP numbers as we believe non-GAAP information can provide useful insight into the underlying operating performance of our business. The non-GAAP numbers I reference are reconciled to the corresponding GAAP numbers in today's earnings release.

First quarter consolidated net sales were $90.8 million, essentially flat on a sequential basis and down 3% compared to last year's first quarter sales of $93.6 million. As Chris explained, sales declined on a year-over-year basis due to lower creosote volume in the Wood Treating Chemicals segment.

Gross profit margin in the first quarter was 30.4%, up 310 basis points from last year's first quarter. Gross profit margins improved year-over-year primarily due to higher sales volumes in Electronic Chemicals as well as cost savings resulting from the restructuring of our North American Electronic Chemicals operations.

First quarter distribution expense was $13 million versus $12.1 million last year. Distribution expense increased from last year due to higher shipment volumes and reduced availability of preferred carriers in our North American Electronic Chemicals business.

First quarter SG&A expense was $9.2 million, or 10.1% of sales, down from $10.4 million or 11.1% of sales in the prior year period. The majority of this decrease was due to the absence of CEO transition costs and integration expenses in Q1 2015. Adjusting for these items, SG&A expense increased $580,000 year-over-year primarily due to increased stock-based compensation.

Excluding $2 million of realignment charges at Bay Point and $577,000 of restructuring charges consolidated adjusted EBITDA in the first quarter was $8.8 million, up 10% from $8 million in last year's first quarter. The improvement in adjusted EBITDA was primarily in our Electronic Chemicals business and to a lesser extend improved profitability in our Wood Treating Chemical segment.

In October we refinanced $20 million of term notes and $38 million of debt drawn on a former revolving credit facility with a new credit facility which features a significantly lower interest rate compared to the rate on the term note.

First quarter interest expense was $803,000 versus $663,000 in the first quarter of fiscal 2014. The 2015 increase was due to a $288,000 charge for early repayment of our term notes, partially offset by reduced interest rates from the refinancing of our revolving credit facility and lower debt levels.

Our income tax rate was 40.4% in the first quarter, versus 34.9% in the first quarter of fiscal 2014. Our tax rate increased primarily due to restructuring charges and operational results in Italy for which we will not be able to realize a tax benefit. With the consolidation of our European manufacturing facilities it is more likely to note that our subsidiary in Italy will not generate a sufficient profit in the near future to recovery the restructuring charges.

Excluding the Italian results, the estimated effective tax rate on ordinary income was 33.7% for the three months ended October 31, 2014 as proportionately more of our income was earned in higher rate jurisdiction. We projected fiscal 2015 tax rate of 30% to 33% excluding any tax impact from the restructuring in Italy.

On a GAAP basis, first quarter fiscal 2015 net earnings was $0.10 per share versus $0.12 per share in last year's first quarter, reflecting restructuring and realignment charges of $2.6 million or about $0.14 per diluted share.

Adjusted EPS for the first quarter in fiscal 2015 was $0.24, up from $0.22 in the first quarter of fiscal 2014. Adjusted EPS increased year-over-year primarily due to higher margins in both our business segments.

Turning to our segment results. First quarter Electronic Chemicals sales were $66.3 million, up 2.9% from $64.5 million last year. The year-over-year increase reflected higher sales in North America and Asia partially offset by lower sales in Europe.

Q1 adjusted EBITDA in the Electronic Chemicals segment was $7.4 million compared to $6.8 million in last year's first quarter. Adjusted EBITDA margins improved 20 basis points year-over-year due to enhancement in fracturing efficiency in North America partially offset by the weakness in Europe that Chris discussed earlier.

In our Wood Treating Chemicals segment, Q1 sales were $24.4 million, down from $29.1 million in the comparable quarter last year. The sales decrease reflected lower creosote volumes, while Penta remains steady. Wood Treating Chemicals EBITDA was $2.7 million or 10.9% of segment sales versus $2.6 million or 8.8% of segment sales in last year's first quarter. Segment EBITDA margin benefited from reduced supply chain costs and from a more favorable product mix.

During Q1 we used our strong cash flow to pay down our debt by $4 million and for capital expenditures of $4.2 million, and over the past 12 months we reduced our long-term debt by $27 million. As of October 31, 2014, we had long-term debt of $56 million, resulting in a debt to equity ratio of 48% versus 68% in the first quarter of fiscal 2014.

I'll now briefly review our Bay Point realignment and restructuring program. In the first quarter, we incurred $2 million in realignment charges related to the closure of the Bay Point, California facility. These charges were primarily for accelerated depreciation of fixed assets that are currently being used in the production of hydrofluoric acid.

In total, for fiscal 2014 and fiscal 2015, we estimate incurring Bay Point realignment charges of approximately $6 million to $7.5 million, including accelerated depreciation and severance. We project annual savings of $1 million to $3 million from this realignment starting in fiscal 2016.

With the -- with respect to the consolidation of our Electronic Chemicals operations, we recorded 577,000 in first quarter 2015 restructuring charges mainly for accelerated depreciation of equipment in Milan, Italy. We estimate that total restructuring charges will be at the lower end of our projected range of $7 million to $9 million. Additionally, we expect accelerated depreciation to be less than $4 million.

Consistent with our prior guidance, we forecast fiscal 2015 net benefits to operating income of $6 million to $8 million on an annualized basis resulting from this restructuring.

THOMSON REUTERS

Now I'll provide our outlook for fiscal 2015. We expect fiscal 2015 Electronic Chemicals segment sales to increase compared to the level reported in fiscal 2014, but lower creosote sales in the Wood Treating Chemicals segment are likely to cause fiscal 2015 consolidated net sales to decline on a year-over-year basis.

We maintain our fiscal 2015 adjusted EBITDA guidance range of $32 million to $35 million. As a reminder, adjusted EBITDA excludes and Bay Point realignment charges.

Fiscal 2015 depreciation and amortization expense is forecast at approximately $16 million excluding restructuring and realignment. Fiscal 2015 capital expenditures are forecast at $14 million to $16 million including expenses related to our ERP system implementation and UPC integration. Our CapEx budget for fiscal 2015 is projected to increase on a year-over-year basis primarily due to ERP project costs and the carryover of integration costs from fiscal 2014.

Operator let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Rosemarie Morbelli. Please proceed.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Thank you and good afternoon everyone.

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Good afternoon.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

I was wondering Chris, if you could give us a little more on the volume discussion with your creosote largest customer, and then help us see where you can get the margins given the lower revenue levels.

I was looking at the margin for that particular business and it was separated between penta and creosote; but going from something that looks like close to 28% in 2009, all the way down to 8.4% last year. So, how much of a gap can you close by self help?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes. So, as we reported in the K and then well, you'll see it in the Q later today. So, one of our largest customers decided that they wanted to terminate our existing agreement that happened in October. And we didn't think they had the right to terminate the contract. And ultimately after several discussions we allowed them to cancel the contract.

And we are retaining all of our rights under the agreement that we have that customers continue to buy from us, and we've had recent discussions with them about supply for 2015 and beyond. So, I don't want to go into too much more detail on that, but that gives you kind of a flavor for it. So, as many talk about, we're projecting that our overall sales level will be down because of the continued pricing pressure on creosote, and also some lower volumes.

But having said that, Rosemarie we've been very aggressive over the last year by reducing our supply chain costs in creosote specifically, and so, as the market has changed around demand, and pricing pressure has continued, we've downsized our supply chain in order to optimize it and better align it with the current market place.

So that's creosote, and as we've said before, we don't see those headwinds changing. We see the demand for creosote continue to be under pressure and it continue to be in an over supplied situation.

On the penta side, on the other hand we continue to improve the margins on penta. That product continues to remain healthy and strong. The volumes are consistent, and we do see some continued growth in that with the pole replacement programs that we see going on in the West.

So, yes we have been blending and having one segment with creosote and penta we don't break out the specific for each one. So you can't see how each one is moving, but clearly penta is improving and creosote has been declining.

But overall we're -- and as we've said before we see those businesses specifically creosote it's we're a distributor in that business and we'll continue to manage that business for cash flow. Penta, we're the North American -- only, North American producer of it. We have a very good position with the continued solid demand of that product and we produce that very efficiently and have good margins on it.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay. That is helpful. Thank you. So, I mean -- I suppose you have down the number. The numbers in Q1, your wood margin was 10.6%. Do you think that with the current trend in what you are doing you could actually hit that margin for the full year or do better which would be great? But are there situations in the market place which would prevent you from doing that such as seasonality and so on?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes. So, as you know Rosemarie, we don't give specific guidance along those lines -- around our margin. But having said that, there's clearly seasonality in the business, and I think we'll experience the typical seasonality. But there is some relief on the creosote side, and we do see there is more hardwood becoming more available.

So we think that will improve the demand situation slightly on creosote, and so that will provide some relief. In addition we're constantly looking at ways to improve our cost positions whether it's new potential suppliers, new additional customers as well. So, we're -- as I said before, we're working in earnest to maximize that business and I feel good about all the steps we're taking.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Given the circumstance, I think that you are moving in the right direction for whatever it is, Chris. And then if we look at the electronic industry, could you give us a little more feel -- of a feel as to where the demand is? It is mostly going to the chip manufacturer. So, do you have a feel for where those chips are going?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes. So, there's been lot's of reports in the industry about the growth over from '14 into '13 and, so we saw a fairly strong first quarter in demand and we see that continuing into this fourth quarter and into next year.

Memory has been very strong. Automotive has been strong. The mobile communication side has been not as strong, but has been fairly strong, and we see both automotive and communications kind of flattening out a little bit into 2015, but I think memory will continue to be fairly strong.

PC has seen the resurgence, and then the server industry has picked up as we talk about IT spending in corporations and we're seeing that in several areas.

The interesting thing for us is I touched on the regional perspective. So, there's lots of data around where the semiconductors and the chips are consumed, and not as much data as how much are actually produced in what region versus what where they're consumed.

And so, well we obviously supply the manufacturers and producers, and we saw a very strong demand in North America, a very strong demand in Asia and a weakened demand for production in Europe, and as we talked about.

So our overall sales were muted by Europe. One of our major customers produces a lot of microcontrollers and is in the logic space. And they were down year-over-year and down from one quarter to the next, actually had some of their fabs not operating for part of the time in a quarter. The section in Europe that we see operating the strongest is those that are in the automotive space.

So, Europe has been a mixed bag but overall down, whereas North America has been strong in almost all fronts as well as Asia has been very strong. So, we don't break out our earnings or our actual sales by region. But I gave you a little bit of flavor about North America just the kind of growth we're seeing which I think is inline with what the industry is stating it is.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Now that was very helpful. And just as a follow-up, since you are seeing stronger demand in North America. Are you seeing some of your customers going ahead with their -- either their plans for either new fabs or fab expansions in the region?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes and no. There is -- as you know there was a lot of fabs announced, a lot of expansions announced and then they slow down coming from '13 into 2014.

But as we see these fabs operating at higher level, we don't have anything specific to say about that, but indications are that, there will be some rebound in some of those fab openings and reloading. There is still a considerable amount of movement of production around the world and for example a European customer has shifted some production to Asia. They're loading up their Asian plants.

We've seen some of that in other areas. So, there is still excess capacity globally. The consolidation I think will help that. But as production is shifted around the world, we see some movement of our sales as well.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay. Thank you very much.

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Okay. You are welcome.

Operator

And at this time we have no questions. (Operator Instructions) And your next question comes from the line of Richard O'Reilly. Please proceed.

Richard O'Reilly - *Revere & Associates - Analyst*

Okay. Thank you. Good afternoon everyone.

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Richard.

Richard O'Reilly - *Revere & Associates - Analyst*

Hi. On your prepared comments about the distribution cost, you said something about the preferred shippers, a few -- I don't remember the exact word. Can you go over and maybe explain what's going on there? Is it your shipping costs are rising or you're having trouble finding shippers or what's going on?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes and yes. So, what's happening is, there's a shortage of drivers in North America, and there's lots of equipment availability, but there's a shortage of drivers. So what we do is, when we have an order to ship, we have a priority list of transport companies that we use and obviously the priority a lot of it has to do with the lower cost ones.

And so, we try and give as much business we can to the most cost effective carrier. But because of their limitation on drivers, they're not able to ship all of the products that we'd like them to. So we move down the priority list and end up having to ship more products with higher cost providers.

So that has had an impact on our overall distribution cost. It's something we've been experiencing for probably over the last 9 to 12 months, and we don't see it lighting up. So that has driven our distribution cost higher. We're able to get equipment to haul our material, that's not the issue.

The issue is, from which carrier and having to pay and some times a premium to get those loads done as the shortage of drivers continues. Just one other comment I would make, with oil prices moving as they have and even more aggressively today, we're beginning to see a lowering of diesel cost although clearly not the 30 somewhat percent of oil, there's a lag factor.

So we're anticipating and starting to see some of the fuel surcharges beginning to come down. And we anticipate we'll see more of that as the effects of lower oil cost start to affect the diesel price as well.

Richard O'Reilly - *Revere & Associates - Analyst*

Right. Okay. Are you actually seeing delays in shipments arriving because of the issues or is it just a matter of spending the money?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

It's a matter of spending the money.

Richard O'Reilly - *Revere & Associates - Analyst*

Okay, fine. Okay, thanks a lot for your help.

Christopher T. Fraser - *KMG - Chairman, President, CEO*

You are welcome.

Operator

And your next question is the follow-up of Ms. Rosemarie Morbelli. Please proceed.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Hi, Chris. I do have a follow-up which I think you will be able to help me with. And it is regarding the margin on the electronics, and I think that the target was for a 15% EBITDA margin, and I don't even remember if it was EBITDA versus EBIT. Could you talk about your targeted margin once you are done with all of the restructuring you have underway and rationalization?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes. So, we've not given out that target or any kind of numbers like that. We do have some internal targets that we've not publicized of what they are. Clearly they are an improvement from where we were. We feel like we're making some good headway as many noted in our margins.

We're beginning to see the ramifications of that restructuring we've done in North America and further more in Europe as we start to finish the restructuring that we're doing in Europe and really move all that production.

So, we saw some of that in the first quarter, we'll see more of it in the back end of 2015. So, in addition that's on the operating side. That's on the cost side. In addition we're also improving on the price side. We have gotten some price improvements specifically in North America. Europe continues to remain under pressure as I talked about from a demand standpoint.

But we have seen some slight improvements both in Asia, in North America. So, we are diligent on both ends, both on the price side as well as the -- on the manufacturing efficiency. As we load up our plants we expect to see continued margin improvement. And the higher demands obviously help us fill out our production capabilities at our facilities now that we've consolidated them down to a more centralized base.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Do you have a feel for the level of your capacity utilization?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes. We have a feel for that, and we're not added. We feel like we've got plenty of capacity to handle our customer needs. And our plants also have some flex in them. To the extent if we needed to add a packaging line or add additional people on overtime, we've got plenty of surge capacity to handle our customers.

In fact what's been going on, our sales have been up but in addition our customers have asked for higher inventory levels at our warehouses and their warehouses because they have had higher production levels and they want to make sure we've got a large enough safety stock.

So we've been actually producing in larger amounts than our actual sales volume calls for. So, we have been running our plants in North America specifically at a higher rate than even what our sales levels were.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

And then lastly, as you look at M&A, anything that you have to report, and on the electronic side any M&A will be moved into or production will be moved into the current manufacturing plants not diluting the margin again before you restructure one more time?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes. So we're constantly looking, as you know we are tracking several opportunities and staying rigorous in our discipline and approach to them. So we've got several opportunities identified and we're continuing to pursue those.

The market is challenged right now with the multiples that people are willing to pay plus the rebound in the semiconductor space has obviously made everybody perform a little bit better. So when you couple that it just makes for a more challenging acquisition market.

But that isn't determining us to continue to pursue it. We just want to make sure the economics and the multiples are the right ones for us to make sense on a cash flow standpoint. So to the extent we were to make an acquisition, and there was duplicative manufacturing operations we would look to consolidate and optimize the most beneficial facility.

To the extent it's a geographic expansion where we don't have facilities in that area and obviously we want to maximize those and operate those. So, again it's a pretty focused approach, but it's dynamic if you will to make sure we bring the most to bear in each of those that we look at and ultimately close on.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

And now you're still looking at a third leg?

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Yes, no question. As I think I said before, nine months ago we were looking but not in earnest because I didn't feel like the organization actually was ready, just the right opportunity to present itself, obviously we respond. At this point as I mentioned, our balance sheet, our cash flow, our debt level is all at a very good level right now.

We continue to generate almost $10 million of operating cash flow last quarter paying down our debt and our interest rates, and our capacity of debt a lot better now, as well as the organizations capabilities, internal, our system capabilities once we go to the ERP system in February, will be much more seamless, will be on one system.

So we're much more able and capable. So we've got a lot of energy behind it trying to find those right opportunities. So yes, we want to add a third and ultimately a fourth and beyond leg.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay. Thank you very much, and good luck.

Christopher T. Fraser - *KMG - Chairman, President, CEO*

All right. Thank you.

Operator

And at this time we have no questions.

Christopher T. Fraser - *KMG - Chairman, President, CEO*

Okay. We'll at that time -- we'll end the call. Thank you everybody and look forward to talking to you in the next quarter.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect and have a great day.
