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KMG - Q3 2015 KMG Chemicals Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the KMG Third Quarter 2015 Earnings Conference Call.

At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will follow at that time.

(Operator Instructions).

As a reminder, this call is being recorded.

I would now like to introduce your host for today's conference, Eric Glover, Investor Relations Manager. Sir, please go ahead.

Eric Glover - *KMG Chemicals - IR Manager*

Thank you, Malory. Good afternoon and welcome to the KMG Chemicals Incorporated third 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 website 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.

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Thank you, Eric. Good afternoon and thank you everyone for joining us today. Our Q3 earnings release was issued today at 4 o'clock 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 Q3 financials and our outlook for the remainder of fiscal 2015. After our comments, we'll take your questions.

Fiscal 2015 is shaping up to be a very solid and productive year for KMG as we continue to make important progress financially, operationally and strategically. From a financial standpoint reported another strong quarter of growth in adjusted EBITDA and adjusted EPS driven by continued robust performance in North American electronic chemicals and favorable results from our Penta business.

Third quarter adjusted EBITDA grew 20% from last year, we reported 75% growth in our adjusted EPS to $0.35 per share. This marks our fifth consecutive quarter of double-digit adjusted EBITDA growth on a year-over-year basis.

Despite the fact that foreign currency translation higher stock-based compensation expense, we continue to strike for greater efficiency throughout our global operations. Our consolidation in realignment continue to yield cost savings enabling significant year-over-year margin improvement.

Sometime ago I discussed our plan to implement a new expanded global ERP system to integrate and provide the infrastructure backbone for the Company's financial systems. I am pleased to say that we achieved an important milestone going live in the US, May 1st as planned. While we still have work to do to fully implement this ERP system across our global operations, this technology will provide an excellent tool to enhance our overall efficiency and further improve our working capital management.

Strategically, as we announced previously, we completed the acquisition of Val-Tex May 1st, which provides us with an exciting new growth platform in the industrial valve lubricants and sealants market.

We've been looking at acquisition opportunities within this particular market for some time and Val-Tex is a great strategic fit for KMG. We're thrilled that Val-Tex team has joined KMG and we look forward to supporting Val-Tex's pursuit of growth opportunities in North America and overseas.

Val-Tex is already making a positive financial contribution leading us to increase our fiscal 2015 adjusted EBITDA guidance range. During the third quarter our electronic chemicals business continue to operate at higher level generating 8% year-on-year sales growth, adjusted EBITDA grew approximately 45% from the same period last year reaching a quarterly record of $9.4 million with adjusted margins improving as well.

These strong results reflect our ongoing efforts to optimize our operations while maintaining intense focus on reliably supplying the highest quality products and services to our customers throughout the world.

From a regional perspective, we continue to experience robust demand in North America benefitting from semiconductor production for data center service, memory, mobility and Internet of Things applications.

Once again our Pueblo and Hollister facilities operate at record levels of production during the quarter, aided by growing demand for high purity chemicals to manufacture increasingly complex semiconductors.

In Asia our third quarter electronic chemical sales were up solidly benefitting from increased sales to our strategic global partners with operations in Asia.

On a sequential basis our Q3 sales in Asia declined slightly from a record second quarter due to the impact that the weak Singapore dollar as well as lower revenue from total chemicals management services.

In contrast to our electronic chemicals operations elsewhere in the world, chemical management services are more meaningful portion of our results in Asia.

Due to the competitive nature of this service we consistently evaluate this performance to ensure that the returns we earn are consistent with our long-term financial objectives. While with our physical presence in Singapore, Asia remains an important focus for KMG and we continue to pursue opportunity to expand our presence and capability in this important region, in majority of the world semiconductors are manufactured in Asia and we seek to capitalize on the substantial growth opportunities we see in key markets like China and Taiwan.

In Europe market conditions remain soft characterized by sluggish customer demand and unfavorable foreign currency trends.

Despite the slow European economy, our Q3 sales in Europe improve slightly on sequential basis excluding the impact of foreign currency translation. While we're encourage by the third quarter improvement in shipment volume we expect foreign currency remain a drag on our European results going forward.

Overall, the outlook for the global semiconductor issue remains positive supported by continued growth in the server, Internet of Things and communications markets. We continue to work closely with our customers as they develop the next generation of semiconductor devices that are smaller, faster, more integrated and consume less power.

These trends drive a growing need for higher purity process chemicals and KMG remains uniquely positioned as the only supplier able to meet these increasingly stringent requirements on a global basis.

Turning now to our Wood Treating Chemical segment, sales declined from last year's quarter due to the divestiture of our creosote business this past January; however, Penta product sales increased both sequentially and on a year-to-year basis.

The sequential improvement was driven primarily by a seamless seasonal uptick in demand as warmer weather facilitated increased harvesting and treating of wood used for utility poles.

Segment operating margins were unusually strong this quarter temporarily benefiting from substantial lower cost for raw materials.

Before I turn the call over to Mindy, I'd like to share my thoughts on the acquisition of Val-Tex and why we're so enthusiastic about this transaction. We take a disciplined approach to M&A evaluating a wide range of opportunities to find only those who satisfy our strict criteria.

Val-Tex met all of these requirements we look for strong management, track record of growth, strong cash flow, margin expansion potential, modest CapEx requirements, a market leading brand along with opportunities for growth both domestically and internationally.

One of Val-Tex's unique strengths that the Company offers complete solutions for valve maintenance.

Val-Tex not only supplies high quality valve lubricants and sealants but also provides the training and support customers need to safely maintain the facilities and pipelines.

As a result Val-Tex has developed significant long-term customer relations, become the market recognized provider, superior products and solutions.

These are the advantages that separate Val-Tex from competition and will enable continued success in the years to come.

We've already begun the integration of Val-Tex in the KMG utilizing our existing corporate systems and capabilities perform some administrative functions for Val-Tex. On a longer term basis being the leverage our global distribution capabilities and infrastructure to expand Val-Tex's participation in Europe and Asia. As indicated in our earnings release, we're raising our physical 2015 adjusted EBITDA range to $35 million to $37 million from $34 million to $36 million previously which includes accretion from Val-Tex.

With that, I'll turn the call over to Mindy for the financial discussion outlook.

Mindy Passmore - *KMG Chemicals - CFO*

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

Third quarter consolidated net sales were $74 million down 12% compared to last year's third quarter sales of $84.4 million. Sales declined on the year-over-year basis due to our divestiture of the creosote business in January.

Gross profit margin in the third quarter was 36.3% up 700 basis points from last year's third quarter. Gross profit margins improved year-over-year due to higher sales volume in Electronic Chemicals, the absence of creosote sales in the wood treating chemical segment and cost savings resulting from the restructuring of our electronic chemicals operation.

Third quarter distribution expense was $11.7 million or 15.8% of sales versus $12 million or 14.2% of sales last year although electronic chemicals volume shipments increased in North America distribution cost and dollar term decreased from last year primarily due to lower volume shipments in Europe. As a percentage of sales distribution cost increased due to the absence of revenue associated with our creosote business.

Third quarter SG&A expense was $9.3 million versus $8.8 million in the prior year period.

SG&A expense increased primarily due to increased accruals for short-term incentive and stock based compensation, excluding $1.1 million in CEO transition costs in fiscal 2014, short-term incentive and stock based compensation expenses were $1.1 million on a year-over-year basis.

This increase was partially offset by lower professional fees in fiscal 2015.

Excluding $441,000 in acquisition and integration expenses and $338,000 in restructuring and realignment charges, consolidated adjusted EBITDA in the third quarter was $9.1 million, up 20% from $7.6 million in last year's third quarter.

The improvement in adjusted EBITDA was due to higher profitability in our Electronic Chemicals business partially reduced by $400,000 in foreign exchange translation and increased accruals for stock based compensation and short-term incentive expenses as I previously mentioned.

Third quarter interest expense was $111,000 versus $126,000 in the same period last year. The sequential decrease was due to lower debt levels, and reduced interest rates resulting from the refinancing of the term notes on our revolving credit facility.

Our income tax rate was 24.5% in the third quarter excluding the Italian results and other discrete items, the estimated effective tax rate on ordinary income were 35.6% for the three months ended April 30, 2015. We project a fiscal 2015 tax rate of approximately 35% excluding any tax impact from restructuring in Italy.

Third quarter fiscal 2015 GAAP net earnings were $0.18 per diluted share versus $0.11 per share in last year's third quarter. Adjusted EPS for the third quarter of fiscal 2015 was $0.35, up from $0.20 in the third quarter of fiscal 2014.

Adjusted EPS increased year-over-year primarily due to higher sales of Electronic Chemicals, higher margins in Electronic Chemicals and Wood Treating Chemicals and a lower effective tax rate.

Q3 2015 adjusted EPS excludes restructuring and realignment charges, acquisition and integration expenses, a gain on the sale of the creosote business and reserve for our Star Lake Cana environmental site cleanup.

Turning to our segment results. Third quarter Electronic Chemicals sales were $66.4 million up 8% from $61.5 million last year. The year-over-year increase reflects a higher sales in North America and Asia partially offset by weakness in Europe. Foreign currency translation related to the stronger US dollar negatively impacted our Electronic Chemicals sales by 4.1 on a year-to-date basis-- no I am sorry, on a year-over-year basis.

Q3 adjusted EBITDA in Electronic Chemicals segment was $9.4 million compared to $6.6 million in last year's third quarter. Adjusted EBITDA margins improved 360 basis points year-over-year due to higher volume in North America and Asia as well as enhanced manufacturing efficiency in North America.

This was partially offset by the weakness in Europe that Chris noted earlier. Foreign currency translation negatively impacted EC segment adjusted EBITDA by $400,000 in the third quarter of 2015 as compared to the prior year.

In our Wood Treating Chemicals segment Q3 sales were $7.6 million down from $22.9 million in the comparable quarter last year. The sales decrease reflected the divestiture of the creosote business in January 2015. Penta sales increased on a year-over-year basis due to the increased customer demand and pricing.

Wood Treating Chemicals EBITDA was $2.3 million up from $2.2 million in the prior year. Segment EBITDA margin was 30.8% in Q3 2015 as compared to 9.7% in Q3 2014. Segment EBITDA margin benefited from the divestiture of our creosote business which has lower margins and lower raw materials cost in the Penta business.

During Q3 we used cash generated from operations to reduce our debt. As of April 30, 2015 our long-term debt was $35 million, down from $39 million at the close of the second quarter of fiscal 2015.

Over the past 12 months we used our strong cash generation supplemented by proceeds from the sales of creosote business to reduce our long-term debt by $37 million.

I would note that on May 1st we completed the acquisition of Val-Tex by borrowing $23.5 million under our existing credit facility. Our cash balance was $6.8 million on April 30, 2015, a decrease of $3.7 million from the $10.5 million that we had on hand at the end of our second quarter. This decrease was primarily due to payments for income taxes and restructuring and realignment.

Capital expenditures were $10.8 million for the nine months ended April 30, 2015 compared to $7.1 million in the comparable period last year. CapEx increased on a year-over-year basis due primarily to ERP project cost and integration related expenditures.

In closing, you will see that we have established a liability of $1.25 million in connection with the Environmental Protection Agency's proposed remediation of Star Lake Canal Superfund Site near Beaumont, Texas.

We are currently in discussions with the EPA and approximately seven other parties to assess respective potential liability. We anticipate that the payments for cleanup may extend over a 10 year period. The amount of ultimate liability could change overtime based upon negotiations with other responsible parties and actual site cleanup costs.

Now I will provide our outlook for fiscal 2015. We are narrowing our fiscal 2015 consolidated net sales forecast approximately $320 million versus our prior forecast of $315 million to $325 million.

Relative to the prior year fiscal 2015 sales reflect growth in Electronic Chemicals segment and the addition of Val-Tex with lower sales in the Wood Treating Chemicals segment due to the divestiture of the creosote product line.

We increased our fiscal 2015 adjusted EBITDA forecast to $35 million to $37 million from $34 million to $36 million previously.

The increase in our adjusted EBITDA forecast includes the addition of Val-Tex. Fiscal 2015 depreciation and amortization expense is forecasted to be approximately $14 million excluding restructuring and realignment charges.

Fiscal 2015 capital expenditures are forecast to be approximately $16 million unchanged from our prior forecast. Capital expenditures include expenses related to our ERP implementation UPC integration and asset investments to support increased shipment volume in our Electronic Chemicals business.

Operator not let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions).

Our first question comes from the line of Mike Harrison with Global Hunter Securities. Your line is open. Please go ahead.

Mike Harrison - *Global Hunter Securities - Analyst*

Hi, good afternoon.

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Good afternoon, Mike.

Mike Harrison - *Global Hunter Securities - Analyst*

Chris you've had the Val-Tex business in the fold now for a little over a month so any surprises there either on the positive or negative side?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Yes. You're right, Mike we just acquired them here in the first month of May and no surprises as we've done actually know the management team better and really meet some of the people what's actually what we thought it would be very good solid people, good operations, well run.

And so I wouldn't say any surprises but just further encouragement of where the business can go and really the basis that it operates in today. So again no surprises either way, just feel really good and enthusiastic about that business.

Mike Harrison - *Global Hunter Securities - Analyst*

And can you talk about whether they had any sort of acquisition pipeline or consolidation playbook in-house or is that something that you're going to have to develop on your own?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

So, I would say, I mean their primary focus was their existing operations in growing that through customer relations as well as a good sales and marketing approach.

As far as acquisitions go, I wouldn't say they had a pipeline, they've got some ideas and we've already had some discussions about those and the opportunities.

As I said earlier, the primary focus is going to be to free them from some of the burdens of the administrative side, and we've already begun it is, so it liberates them to go and pursue the growth opportunities they see.

But at the same time look at international expansion, use our infrastructure that we have, our connections if you will in Asia and Europe and look at expanding there and then further penetration in North American market.

Mike Harrison - *Global Hunter Securities - Analyst*

And then looking at the Wood Treating Chemicals business, we've got a clean number on the Penta business there, but we don't really have a whole lot of context for it. So can you help us frame up where the 30% margin in Penta kind of fits within the historical range of how that business has performed?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Yes. So if -- there was at one-time Penta was separated and if you could go back in time and I think [Gerrick] was at probably 2011, but if you were to look at that time period to today, the margins have improved.

But if I just look at it from where it's been over the last year or so, the margins are doing well on two fronts well one we've been successful in some price increases, as well as we've got some benefit of the lower raw material both phenol and chlorine, our lows right now this past quarter, so we've got the benefit of the raw material costs and as I said earlier we've got some benefit of pricing.

In addition this is a seasonally good quarter.

As I talked about earlier with the treatment industry that's usually, relatively strong quarter as they come out of the winter and harvesting of the polls gets better and the treatment of the polls keep better.

So I would say this is historically one of the better quarters and then you couple that with we've gotten good trends on the raw materials right now.

Mike Harrison - *Global Hunter Securities - Analyst*

All right. And on the electronic chemicals side, you talk about some additional restructuring and integration that's still going on there. Can you just give us an update as to kind of where we are in the process of extracting those benefits, are we closer to the full run rate or there is still quite a bit to come?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Yes, we're closer to full run rate. So from just a pure operation standpoint, we still have some integration, consolidation in Europe where we have been moving some of our production from Milan to both Riddings in the UK and to St. Fromond in France. We're getting close to completing that, we still have some further to go.

In the US we've done the majority of it, the one remain piece right now is the realignment on the hydro forecast of production in bay point.

So we're still working, we've seized production there, but we're still working through the inventory, we expect to have that completed at/or close to the end of our fiscal year. So we're getting close to the end, we're not completely at a full run rate yet, we still got some opportunities to play out in the fourth quarter and then some into the beginning of 2016.

Operator

Our next question comes from the line of Rosemarie Morbelli with Gabelli & Company. Your line is open. Please go ahead.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Thank you. Congratulations on the great quarter.

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Thanks, Rosemarie.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Were you surprised by the strengths of all of your operations, was that a lot more than you anticipated?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

No, I wouldn't say surprised, I mean I think as we talked about last quarter North America continues to be very strong and we're watching that to see if we continue and it has continued, we see it continuing even further.

So we're not surprised but we feel good about where we are and as I said we've been setting production records both our facilities Hollister and Pueblo have been running at very good rates.

We're getting the benefits of the consolidation and we're seeing that play out. And so, I wouldn't say we were surprised there, we're just continuing on the past that we had in the last couple of quarters.

In Europe, we're starting to see a small upturn in volume as I said, if you impacted and effected out, took out the currency, we would see a slight increase which is encouraging, but still Europe is sluggish both the economy and the area that we -- the market that we serve.

We're encouraged that that might be picking up, but it's been sluggish since the summer of last year and then the currency just has a further impact. So in Penta as I said, we benefitted from the lower raw material. So there are a lot of things lined up for us and so this quarter was very similar to last quarter on a results basis.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

And when we look at, I mean, when I went back to my notes from last quarter you thought that, that 36% well 35.9% I think it was gross margin, was good but was high because everything was working in all cylinders and you somehow did not expect it to continue and now we're 36.3%.

So the question is the same, is that 36% let's call it that kind of something we can look at on an ongoing basis or do you think that on the Penta side for example because your raw material costs are coming down or are lower you're going to be have to give that some price and maybe the margin won't stay at 34% for that particular business and then of course similar questions for the Electronic Chemicals?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Yes, so I mean, we were -- 36% margin is obviously a good margin from a historical standpoint and we're -- as I said before we're realizing some of the benefits of the consolidation that we've been working on for several years.

And we did benefit on Penta, so if a going forward basis, I think you're going to see the margins on Penta come down off the level that it is today because of the raw material subject that I've talked about. On the EC side, a lot of it is volume driven.

If we can continue to run our facilities at high volume obviously it improves the margins, but we're never satisfied -- so we're constantly looking for ways to improve it, so I don't want to say that margins are definitely going to go down, but I would say that we're continually striving to be more efficient.

We're going to continue look for ways and where there is opportunities price improvement, we'll pursue those. The Val-Tex business also has a very good margin so that will be starting to be blended in as well as our overall margin.

In Asia, as I mentioned earlier, pricing is -- it's a very competitive market, high growth but very competitive, so depending on the mix of our business between North America, Asia and Europe that will affect our overall EC margins, our highest margins are in North America.

So with the increased volume we see in North America at a higher level than in Europe and in Asia, it's obviously creating a mixed impact on the margins. So there is a lot of moving pieces that will affect that margin but least to say we're going to continue try and drive the margin improvement every day.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay and if I can follow up on Penta, when you, I am talking about the margin kind of declining is this because of seasonality or is it because going back to my multitude of comments before, is it because you're going to have to give some price?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

So, so the margin reduction would be because of raw material cost increase, we don't see any price erosion. We're comfortable with the pricing level that we're at right now and to the extent we see phenol and chlorine prices going up which we anticipate, it will decrease the margin.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay. And if I may on Europe you said that it improved sequentially so that is a positive, have you seen some European business from your customers' standpoint moving from one of their fabs in Europe to a fab in Asia, and if that particular migration continues, is it affecting the margin or are European margin and Asian margin similar?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

So we have seen some of that in the past and I think as the industry continues to consolidate there will be continual movement from one fab to the other and one customer particular we've seen some movement out of the European fabs into Asia.

Our relative margins between Asia and Europe, currently Asia is slightly below Europe but they're very similar, so I wouldn't see if there was a significant move from one direction to other, I don't see it as a major impact on our overall margin.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay and one last question for this round if I may, what kind of top line growth has Val-Tex experienced?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

So I really can't comment on their past top line growth, so I would say that we expect some top line growth as the business continuous to grow and expand geographically both as well as in North America. So I can't really give you a historical perspective on what their growth has been Rosemarie.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

What about the growth of that industry then? Is that a GDP that's less than GDP?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Yes, it's primarily a GDP driven as a lot of their products go to maintenance, so the some growth as -- there is pipeline growth have more drilling will increase their overall opportunities in the marketplace. So yes, I would look at GDP growth as a type of number.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay, thank you.

Operator

Thank you. Our next question comes from the line of Richard O'Reilly with Sidoti & Company. Your line is open. Please go ahead.

Richard O'Reilly - *Sidoti & Company - Analyst*

Okay, thank you. Good afternoon everyone.

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Good afternoon, Richard.

Richard O'Reilly - *Sidoti & Company - Analyst*

I have got a couple of questions on the Val-Tex. Can you explain on the transaction the 600,000 shares, how they initially acquired the KMG shares?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Yes. So Val-Tex and their principal owner, majority owner is a board member of KMG and overtime acquired KMG stock. So overtime many years accumulated that via Val-Tex and accumulated 606,000 shares. So they had opportunity to buy stock but also opportunity via Fred Leonard as a director.

Richard O'Reilly - *Sidoti & Company - Analyst*

And is that a current director or a former director?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

He is a current director.

Richard O'Reilly - *Sidoti & Company - Analyst*

Okay fine, okay fine. Second question is they have nice margins there from the numbers you've given us I think 28%.

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Yes.

Richard O'Reilly - *Sidoti & Company - Analyst*

And is, is that an indication of what they've done recently more than in just the last 12 months or whatever the time period that you've given us because you've got two businesses now that have fairly good margins and the electronics looks like the [laggard]. So is Val-Tex, is that 28% sustainable?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Well we are really not giving guidance on where Val-Tex is going to be but Val-Tex has got a history that we showed, they've got good margins with one of our interest in the business, it is a good margin business and we look to continue that.

And as you commented on Wood Treating with Penta, it's a reasonable return business with good margins and we look to continue to have that continue as well. I don't see EC as a laggard I guess just compared on relative speaking but it's a business that we have improved the margins on and it's a business that we continue to drive to be more efficient and our consolidation efforts will continue to improve the margins there as well.

So I am happy about margins on all the businesses and that's our role is to continue to find margin improvements as well as total profits across all of our businesses.

Richard O'Reilly - *Sidoti & Company - Analyst*

Right, of course you didn't see when I made that comment I had a tongue in cheek, you couldn't see that. My third question is on the Penta business, there is very little D&A, is that just because the business is so, I don't want to say old, but really the book value has been written down over the years?

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Mindy you want to handle that?

Mindy Passmore - *KMG Chemicals - CFO*

Yes, sure. Yes, I mean consistent with KMG's model Penta is at the position now where after consolidation that it's the sole player in the market that occurs in US and there is very little additional CapEx investment required. So it's just kind of a steady kind of keeps moving along type of a business without a lot of CapEx needs.

Richard O'Reilly - *Sidoti & Company - Analyst*

Okay. And the book value must be relatively low now. Okay. That's all from me. Thank you.

Operator

(Operator Instructions).

We do have a follow up question from Rosemarie Morbelli with Gabelli & Company, your line is open. Please go ahead.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Thank you. Looking at your CapEx which is at this stage about [$50 million] if I remember properly a normalized number is going to be between $10 million and $12 million once you are done with ERP and consolidation. Is Val-Tex making a bit difference I mean you did say that they have little CapEx but is that $10 million to $12 million of, is that something we can look at going forward?

Mindy Passmore - *KMG Chemicals - CFO*

Yes, the Val-Tex is a very minimal CapEx requirement, I think historically less than a $100,000 per year type of a deal. If we expand obviously into a different geography or something like that there would be some CapEx but we don't anticipate for Val-Tex it will be significant.

The difference between the normalized run rate and the $16 million this year is really due to three things. First, we have the ERP investment that we've made a significant investment this year for the global ERP system.

Secondly, we had some carryover CapEx related to the integration and the restructuring in Europe.

And third, we also anticipate some incremental CapEx in Q4 for business growth in North America, EC North America.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Okay, thanks. I was wondering Mindy if you could give us a little more details on that Superfund? Which products were there, is it linked to creosote? What is it linked to?

Mindy Passmore - *KMG Chemicals - CFO*

Sure. First of all, I think we have one this in a much more detail in our 10-Q and we did mention it last year -- last month -- last quarter. But we have now finally got an estimate for it for the first time this quarter. It is related to Penta, a predecessor company I believe a predecessor company prior to KMG and somewhat indirectly linked to the side.

So, we're still in the process of discussing with other potentially responsible parties around that clean up. But this quarter we thought it's prudent to go ahead and include an estimate since we've gotten to that point where we can actually make a reasonable estimate.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

Sure I appreciate it. And then lastly are you going to report to Val-Tex as a new segment, I know it is small but you are planning to add to it. So are we going to have an industrial [sealants] so we can actually keep track of the progress?

Mindy Passmore - *KMG Chemicals - CFO*

Well from the operating segment perspective it's a separate segment. Now the question is materiality, we'll have to look at it in accordance with GAAP based on materiality.

Right now it's very small in terms of the GAAP rules and is not material. So it may be included as other chemicals with Penta, but we'll have to evaluate Q4 and see what we invest for those businesses.

Rosemarie Morbelli - *Gabelli & Company - Analyst*

You're not going to make me adjust my tables a thousand times are you, first out and then separate it? Thank you very much, I appreciate your help.

Operator

And I am showing no further questions. I would now like to turn the call back to Chris Fraser for any further remarks.

Chris Fraser - *KMG Chemicals - Chairman, CEO*

Thank you everyone for joining the call and we look forward to speaking you about fourth quarter and full year fiscal 2015 conference call in October. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a great day.