SCOTTS LIQUID GOLD INC
Form 10-Q
November 14, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-13458

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	80239

(Address of principal executive offices) (Zip Code)

303-373-4860

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

As of November 11, 2016, the Registrant had 11,748,329 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,” “esti “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.
Consolidated Statements of Operations (Unaudited)

Scott's Liquid Gold-Inc. & Subsidiaries

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	$9,936,900	$7,548,100	$24,274,800	$21,755,700
Operating costs and expenses:				
Cost of sales	5,830,600	4,284,600	13,454,600	12,042,600
Advertising	91,700	528,600	1,426,600	1,087,900
Selling	1,717,300	1,336,600	4,184,300	4,043,600
General and administrative	1,218,800	733,200	3,433,000	2,433,900
Total operating costs and expenses	8,858,400	6,883,000	22,498,500	19,608,000
Income from operations	1,078,500	665,100	1,776,300	2,147,700
Other income	1,000	6,800	12,600	16,100
Interest expense	(60,400)	(7,400)	(77,500)	(22,000)
Income before income taxes	1,019,100	664,500	1,711,400	2,141,800
Income tax (expense) benefit	(415,500)	(191,500)	(697,900)	2,377,500
Net income	$603,600	$473,000	$1,013,500	$4,519,300
Net income per common share				
Basic	$0.05	$0.04	$0.09	$0.39
Diluted	$0.05	$0.04	$0.08	$0.38
Weighted average shares outstanding:				
Basic	11,747,612	11,665,461	11,730,759	11,617,562
Diluted	12,027,956	11,927,877	11,969,167	11,907,486

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

Consolidated Balance Sheets

Scott’s Liquid Gold-Inc. & Subsidiaries

	September 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 1,872,800	$ 7,165,100
Accounts receivable, net	3,789,400	1,014,700
Inventories, net	5,404,100	4,698,600
Income taxes receivable	8,100	0
Prepaid expenses	281,400	227,200
Total current assets	11,355,800	13,105,600
Property and equipment, net	550,100	430,000
Deferred tax asset	1,906,600	2,556,200
Goodwill	1,520,600	0
Intangible assets, net	6,924,200	0
Other assets	51,000	51,000
Total assets	$ 22,308,300	$ 16,142,800
Liabilities and Shareholders’ Equity		
Current liabilities:		
Accounts payable	2,342,300	1,238,000
Accrued expenses	605,700	803,700
Income taxes payable	0	5,300
Current maturities of long-term debt	800,000	0
Total current liabilities	3,748,000	2,047,000
Line-of-credit	1,900,000	0
Long-term debt, net of current maturities and debt issuance costs	1,331,000	0
Total liabilities	6,979,000	2,047,000
Shareholders’ equity:		
Common stock; $0.10 par value, authorized 50,000,000 shares; issued and outstanding 11,748,329 shares (2016) and 11,710,745 shares (2015)	1,174,800	1,171,100
Capital in excess of par	6,117,400	5,901,100
Retained earnings	8,037,100	7,023,600
Total shareholders’ equity	15,329,300	14,095,800
Total liabilities and shareholders’ equity	$ 22,308,300	$ 16,142,800

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

Consolidated Statements of Cash Flows (Unaudited)

Scott's Liquid Gold-Inc. & Subsidiaries

	Nine Months Ended September 30, 2016	2015
Cash flows from operating activities:		
Net income	$1,013,500	$4,519,300
Adjustment to reconcile net income to net cash (used) provided by operating activities:		
Depreciation and amortization	264,900	118,800
Stock-based compensation	189,500	96,900
Deferred income taxes	649,600	(2,419,300)
Change in operating assets and liabilities:		
Accounts receivables	(2,774,700)	(594,500)
Inventories	(305,500)	(1,922,600)
Prepaid expenses and other assets	(54,200)	155,900
Income taxes payable (receivable)	(13,400)	2,200
Accounts payable and accrued expenses	906,300	1,379,700
Total adjustments to net income	(1,137,500)	(3,182,900)
Net Cash (Used) Provided by Operating Activities	(124,000)	1,336,400
Cash flow from investing activities:		
Cash paid for Acquisition	(9,000,000)	0
Purchase of property and equipment	(223,600)	(143,100)
Net Cash Used by Investing Activities	(9,223,600)	(143,100)
Cash flow from financing activities:		
Borrowing under line-of-credit	3,694,100	0
Repayments under line-of-credit	(1,794,100)	0
Proceeds from issuance of long-term debt	2,400,000	0
Repayments of long-term debt	(200,000)	0
Debt issuance costs	(75,200)	0
Proceeds from exercise of stock options	30,500	32,400
Net Cash Provided by Financing Activities	4,055,300	32,400
Net (Decrease) Increase in Cash and Cash Equivalents	(5,292,300)	1,225,700
Cash and Cash Equivalents, beginning of period	7,165,100	5,896,600
Cash and Cash Equivalents, end of period	$1,872,800	$7,122,300
Supplemental disclosures:		
Cash paid during the period for interest	$77,500	$22,000

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

Supplemental disclosure of non-cash activity:

In connection with the Company's Acquisition (defined in Note 4) during the nine months ended September 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.

Notes to 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 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 Consolidated Statements of Operations, Consolidated Balance Sheets, and the 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 September 30, 2016 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 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, 2015. The results of operations for the period ended September 30, 2016 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 November 3, 2008, effective as of October 31, 2008, we entered into a financing agreement with Summit Financial Resources, L.P. (“Summit”) for the purpose of providing working capital. The financing agreement with Summit was amended on March 12, 2009, March 16, 2011 (effective March 1, 2011) and June 29, 2012 (effective July 1, 2012) and terminated on June 30, 2016.

The agreement provided for a factoring line up to $1.5 million and was secured primarily by accounts receivable, inventory, any lease in which we are a lessor and all investment property and guarantees by our active subsidiaries. Under the agreement, Summit will make loans at our request and in its discretion based on: (i) its purchases of our receivables, with recourse against us, at an advance rate of 85% (or such other percentage determined by Summit in its discretion) and (ii) our inventory not to exceed certain amounts, including an aggregate maximum of $500,000. Advances under the agreement had an interest rate of 1.0% over the prime rate (as published in The Wall Street Journal) for the accounts receivable portion of the advances and 2.5% over the prime rate for the inventory portion of the borrowings. At June 30, 2016, the prime rate was 3.5%.

There was also an administrative fee of 0.85% per month on the average monthly outstanding loan on the receivable portion of any advance if the average quarterly loan in the prior quarter was less than or equal to $1,000,000, and 0.75% per month if the average quarterly loan in the prior quarter was greater than $1,000,000 and of 1.0% per month on the average monthly outstanding loan on the inventory portion of any advance.

In 2016 and 2015, we did not sell any of our accounts receivable to Summit.

On March 16, 2011, with the consent of Summit, we entered into a financing agreement with Wells Fargo Bank, National Association (“Wells Fargo”) for the purpose of further lowering the cost of borrowing associated with the financing of our accounts receivable and on January 29, 2016 we terminated our agreement with Wells Fargo due to Wal-Mart Stores, Inc. (“Wal-Mart”) changing its accounts payable policy. Pursuant to this agreement, we were able to sell accounts receivable from Wal-Mart at a discount to Wells Fargo; provided, however, that Wells Fargo could reject offers to purchase such receivables in its discretion. These receivables could be purchased by Wells Fargo at a cost to us equal to LIBOR plus 1.15% per annum. The LIBOR rate used depends on the days to maturity of the receivable sold, typically ranging from 102 to 105 days. At January 29, 2016, Wells Fargo used the 105-day LIBOR rate of 0.7%.

During the nine months ended September 30, 2016 and 2015, we sold approximately $306,800 and $3,219,600, respectively, of our relevant accounts receivable to Wells Fargo for approximately $305,200 and $3,205,900, 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.

(g) Inventories
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:

	September 30, 2016	December 31, 2015
Finished goods	$ 3,509,500	$ 2,101,300
Raw materials	2,014,600	2,717,300
Inventory reserve for obsolescence	(120,000)	(120,000)
	$ 5,404,100	$ 4,698,600

(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.

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(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 Note 4. 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 nine months ended September 30, 2016, 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 and accrued expenses approximate fair value due to the short-term nature of these financial instruments. At December 31, 2015 we had no long-term debt or outstanding balance on a line-of-credit. At September 30, 2016 we had long-term debt of $2,131,000 and a $1,900,000 outstanding balance on our line-of-credit.

(l) Income Taxes
Deferred income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying amounts of 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 statement of operations or accrued on the balance sheet.

The effective tax rate for the nine months ended September 30, 2016 and 2015 was 40.8% and (111.0%) respectively, which differs from the statutory income tax rate due to permanent book to tax differences and the release of the valuation allowance in 2015.

As of December 31, 2014, the Company had a deferred tax asset of $0, net of a valuation allowance of $3,379,100. As of that date and until the second quarter of 2015, a full valuation allowance had been provided against deferred tax assets, as it was more-likely-than-not that the Company's net deferred tax asset would not be realized in the foreseeable future due to the Company's cumulative book loss. Consequently, the Company was unable to recognize any income tax benefit in such prior periods. However, the Company had, as of June 30, 2015, reported positive income for nine consecutive quarters and the 36 month cumulative income before income taxes was approximately $3.4 million. Accordingly, the Company as of June 30, 2015 released a portion of the valuation allowance related to the deferred tax asset of approximately $3.1 million as well as an additional $70,200 in the third quarter which ended September

30, 2015. The analysis of the partial valuation allowance release was in accordance with accounting standards for interim period reporting. The remaining $169,200 in valuation allowance was released during the fourth quarter of 2015.

(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 we have an arrangement to sell a product, we have delivered the product in accordance with that arrangement, the sales price of the product is determinable and 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 September 30, 2016 and December 31, 2015 approximately $1,030,400 and $1,179,700, 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 $1,584,500 and $1,661,100 for the nine months ended September 30, 2016 and 2015, respectively.

(n) Advertising Costs
Advertising costs are expensed as incurred.

(o) Stock-based Compensation
During the nine months ended September 30, 2016, we granted options to acquire 3,000 shares of our common stock to one of our production personnel at a price of $1.20 per share, which vest ratably over 48 months, or upon a change in control under certain circumstances, and which expire after 10 years.

During the nine months ended September 30, 2015, we granted options to acquire: (1) 326,500 shares of our common stock to 40 of our management and administrative personnel at a price of $1.25 per share, which vest ratably over 48 months, or upon a change in control under certain circumstances, and which expire after 10 years; (2) 200,000 shares of our common stock to one of our executive officers at a price of $1.25 per share, which vest ratably over 60 months, or upon a change in control under certain circumstances, and which expire after 10 years; and (3) 90,000 shares of our common stock to our three non-employee board members at a price of $1.25 per share, half of which vested on the date of grant and the other half of which will vest on the first anniversary of the date of grant, or upon a change in control under certain circumstances, and which expire after five years. All of the foregoing options were granted at the market value as of the date of grant. We also granted options to acquire 100,000 shares of our common stock to one of our executive officers at a price of $1.375 per share, which vest ratably over 48 months, or upon a change in control under certain circumstances, and which expire after five years. Such options were granted at 110% of the market value as of the date of grant.

The weighted average fair market value of the options granted in the first nine months of 2016 and 2015 was estimated on the date of grant, using a Black-Scholes option pricing model with the following assumptions:

	September 30, 2016	September 30, 2015
Expected life of options (using the “simplified” method)	7 years	5.3 years
Average risk-free interest rate	1.5%	1.4%
Average expected volatility of stock	134%	133%
Expected dividend rate	None	None
Fair value of options granted	$3,488	$755,105

Compensation cost related to stock options recognized in operating results (included in general and administrative expenses) was $189,500 and $96,900 in the nine months ended September 30, 2016 and 2015, respectively. Approximately $649,300 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. With respect to the non-cash expense associated with options granted to the non-employee directors, no tax benefit is recognized for the excess of the tax deduction over the book expense previously recognized due to the existence of as yet unutilized net operating losses. At such time as these operating losses have been utilized and a tax benefit is realized from the issuance of non-qualified stock options, a corresponding tax benefit may be recognized.

(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 $1,149,600 and $1,081,400 for the nine months ended September 30, 2016 and 2015, 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 FASB issued 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 are currently assessing the impact, if any, that the adoption of ASU 2016-02 will have on our financial statements.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation-Stock Compensation- Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”), which involves several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Under the new standard, income tax benefits and deficiencies are to be recognized as income tax expense or benefit in the income statement and the tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. An entity should also recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. Excess tax benefits should be classified along with other income tax cash flows as an operating activity. In regards to forfeitures, the entity may make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. This ASU is effective for fiscal years beginning after December 15, 2016 including interim periods within that reporting period, however early adoption is permitted. We are currently assessing the impact, if any, that the adoption of ASU 2016-09 will have on our financial statements.

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. We are currently assessing the impact, if any, that the adoption of ASU 2014-09 will have on our financial statements.

In April 2015, the FASB issued ASU No. 2015-03, "Interest — Imputation of Interest (Subtopic 835-30) — Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"), which provides guidance on simplifying the presentation of debt issuance costs, requiring that debt issuance costs related to a recognized debt liability be presented in the consolidated balance sheets as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. In August 2015, the FASB issued ASU No, 2015-15, "Interest – Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements — Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting" ("ASU 2015-15"), which further clarifies ASU 2015-03 as it relates to presentation and subsequent measurement of debt issuance costs related to line-of-credit arrangements. ASU 2015-15 allows an entity deferring and presenting debt issuance costs related to line-of-credit arrangements as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. Both ASU 2015-03 and ASU 2015-15 require retrospective adoption and are effective for financial statement periods beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. The Company adopted ASU 2015-03 and ASU 2015-15 as of January 1, 2016. The adoption did not have a material effect on our consolidated financial statements.

In September 2015, FASB issued ASU No. 2015-16, "Business Combinations (Topic 805) – Simplifying the Accounting for Measurement-Period Adjustments" (ASU 2015-16"), which requires that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The standard will be effective for us in the first quarter of our fiscal year 2017, although early adoption is permitted. The Company adopted ASU 2015-16 as of June 30, 2016, and the adoption of this standard did not have a material effect on our consolidated financial statements.

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). We are currently assessing the impact, if any, that the adoption of ASU 2016-13 will have on our financial statements.

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory" ("ASU 2015-11"), which is intended to simplify the subsequent measurement of inventories by replacing the current lower of cost or market test with a lower of cost and net realizable value test. The guidance applies only to inventories for which cost is determined by methods other than last-in first-out and the retail inventory method. Application of the standard, which should be applied prospectively, is required for the annual and interim periods beginning after December 15, 2016. Early adoption is permitted. We are currently assessing the impact, if any, that the adoption of ASU 2015-11 will have 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. We are currently assessing the impact, if any, that the adoption of ASU 2016-15 will have on our financial statements.

Note 2. 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. There were common stock equivalents of 579,500 and 1,114,000 shares outstanding at September 30, 2016 and 2015, respectively, consisting of stock options that were not included in the calculation of earnings per share because they would have been anti-dilutive.

A reconciliation of the weighted average number of common shares outstanding for the three and nine months ended September 30, 2016 and 2015 is as follows:

	2016	
	Three Months	Nine Months
Common shares outstanding, beginning of the period	11,742,329	11,710,745
Weighted average common shares issued	5,283	20,014
Weighted average number of common shares outstanding	11,747,612	11,730,759
Dilutive effect of common share equivalents	280,344	238,408
Diluted weighted average number of common shares outstanding	12,027,956	11,969,167

	2015	
	Three Months	Nine Months
Common shares outstanding, beginning of the period	11,665,220	11,549,789
Weighted average common shares issued	241	67,773
Weighted average number of common shares outstanding	11,665,461	11,617,562
Dilutive effect of common share equivalents	262,416	289,924
Diluted weighted average number of common shares outstanding	11,927,877	11,907,486

We have authorized 20,000,000 shares of preferred stock issuable in one or more series, none of which is issued or outstanding as of September 30, 2016.

Note 3. 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 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.

Information on our segments for the three and nine months ended September 30, 2016 and 2015 is set forth on the next page:

	Three Months Ended September 30, 2016		2015	
	Household Products	Skin and Hair Care Products	Household Products	Skin and Hair Care Products
Net sales	$1,453,400	$8,483,500	$1,485,300	6,062,800
Cost of sales	690,000	5,140,600	679,400	3,605,200
Advertising expenses	10,300	81,400	401,000	127,600
Selling expenses	276,800	1,440,500	412,700	923,900
General and administrative expenses	328,900	889,900	318,200	415,000
Total operating costs and expenses	1,306,000	7,552,400	1,811,300	5,071,700
Income (loss) from operations	147,400	932,100	(326,000)	991,100
Other (expense) income	(1,100)	2,100	1,700	5,100
Interest expense	0	(60,400)	(1,700)	(5,700)
Income (loss) before income taxes	$146,300	$872,800	$(326,000)	$990,500

	Nine Months Ended September 30, 2016		2015	
	Household Products	Skin and Hair Care Products	Household Products	Skin and Hair Care Products
Net sales	$4,490,300	19,784,500	$4,661,700	17,094,000
Cost of sales	2,148,500	11,306,100	2,196,300	9,846,300
Advertising expenses	889,100	537,500	661,000	426,900
Selling expenses	1,118,400	3,065,900	1,261,800	2,781,800
General and administrative expenses	1,136,900	2,296,100	1,083,500	1,350,400
Total operating costs and expenses	5,292,900	17,205,600	5,202,600	14,405,400
(Loss) income from operations	(802,600)	2,578,900	(540,900)	2,688,600
Other income	2,300	10,300	3,900	12,200
Interest expense	(3,500)	(74,000)	(5,100)	(16,900)
(Loss) income before income taxes	$(803,800)	$2,515,200	$(542,100)	$2,683,900

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

	Three Months Ended September 30, 2016	2015	Nine Months Ended September 30, 2016	2015
Net sales	$9,936,900	$7,548,100	$24,274,800	$21,755,700
Consolidated income before income taxes	$1,019,100	$664,500	$1,711,400	$2,141,800

September 30, 2016	December 31, 2015

Assets:		
Household Products	$1,759,100	$7,585,800
Skin and Haircare Products	18,444,900	5,073,200
Corporate	2,104,300	3,483,800
Consolidated	$22,308,300	$16,142,800

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

Note 4. 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 (the “Brands”). The total consideration Neoteric paid for the Brands was approximately $9.1 million, plus or minus any inventory adjustment based on the value of the inventory of finished goods as of the closing compared to the target inventory of $493,034, 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”). Subsequently, the inventory adjustment of $93,000 reduced the total consideration paid by Neoteric to approximately $9.0 million.

The Company incurred $721,600 of transaction costs related to the Acquisition for the nine months ended September 30, 2016. These expenses were recorded in general and administrative expense in the consolidated statement of operations.

(a) Purchase Price Allocation

The purchase price allocations for the Acquisition are preliminary and subject to further adjustment. The following summarizes the aggregate fair values of the assets acquired during 2016 as of the acquisition date:

Inventories	$ 400,000
Intangible assets	7,079,400
Goodwill	1,520,600
Total assets acquired	$ 9,000,000

Intangible assets in the table above consist of customer relationships of $4,022,100, trade names of $2,362,400, formulas and batching processes of $668,600, and a non-compete agreement of $26,300, and will be amortized over their estimated useful lives of approximately 10 years, 15 years, 12 years and five years, respectively.

Goodwill recorded in connection with the Acquisition represents, among other things, future economic benefits expected to be recognized from the Company’s expansion of the products it offers to the skin and haircare segment, as well as expected future synergies and operating efficiencies from combining the acquired products to the brands we manufacture and distribute. All of the recorded goodwill is tax-deductible. At the time the financial statements were issued, initial accounting for the business combination related to tax matters were preliminary and may be adjusted during the measurement period.

(b) Pro Forma Results of Operations (Unaudited)

The following table summarizes selected unaudited pro forma condensed consolidated statements of operations data for the three and nine months ended September 30, 2016 and 2015 as if the Acquisition had been completed on January 1, 2015.

	Pro Forma for the Three Months Ended		Pro Forma for the Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	$9,936,900	$9,386,800	$27,678,900	$27,027,400
Net income	$603,600	$373,300	$1,026,800	$4,289,600

This selected unaudited pro forma condensed consolidated financial data is included only for the purpose of illustration and does not necessarily indicate what the operating results would have been if the Acquisition had been completed on that date. Moreover, this information does not indicate what our future operating results will be. The information for 2015 and 2016 prior to the Acquisition from Ultimark is included based on prior accounting records maintained by Ultimark. In some cases, Ultimark's accounting policies may differ materially from accounting policies adopted by the Company following the Acquisition. For 2016, this information includes actual operating results recorded in the financial statements for the period subsequent to the date of the Acquisition on June

30, 2016. The Company's consolidated statements of operations for the nine months ended September 30, 2016 includes net sales and net income of $1,780,100 and $781,600, respectively, attributable to the Acquisition.

The pro forma amounts included in the table above reflect the application of accounting policies and adjustment of the results of the Acquisition to reflect: (1) the additional amortization that would have been charged to the acquired intangible assets; (2) additional interest expense relating to the borrowings on the term loan and line-of credit, including amortization of debt issuance costs; and (3) the tax impacts.

Note 5. Goodwill and Intangible Assets
Intangible assets consisted of the following:

	As of September 30, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Intangible assets:			
Customer relationships	$4,022,100	$ 100,600	$3,921,500
Trade names	2,362,400	39,400	2,323,000
Formulas and batching processes	668,600	13,900	654,700
Non-compete agreement	26,300	1,300	25,000
	7,079,400	155,200	6,924,200
Goodwill			1,520,600
Total intangible assets			$8,444,800

The amortization expense for the three and nine months ended September 30, 2016 was $155,200. There was no amortization expense for the three and nine months ended September 30, 2015.

Estimated amortization expense for 2016 and subsequent years is as follows:

2016	$ 155,100
2017	620,700
2018	620,700
2019	620,700
2020	620,700
Thereafter	4,286,300
Total	$6,924,200

Note 6. 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 September 30, 2016, our rate was 4.28%. 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 September 30, 2016, our rate was 3.53%. 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, 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 our 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 its corporate structure or business; make investments or asset sales; or engage in certain other activities as set forth in the Credit Agreement. Capitalized terms used but not defined shall have the meanings provided in the Credit Agreement.

Maturities of long-term debt and line-of-credit are as follows as of September 30, 2016:

2016	$ 200,000
2017	800,000
2018	800,000

2019	2,300,000
	4,100,000
Less unamortized debt issuance costs	(69,000)
Total	$4,031,000

We recognized $6,200 as a component of interest expense for the three and nine months ended September 30, 2016. As of September 30, 2016, the Company recognized unamortized debt issuance costs of $69,000. Debt issuance costs are amortized using the effective interest method.

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

Results of Operations

Our consolidated net sales for the first nine months of 2016 were $24,274,800 versus $21,755,700 for the first nine months of 2015, an increase of $2,519,100 or 11.6%. We saw a 7.8% increase in net sales of the skin and hair care products that we distribute for other companies and a 43.4% increase in net sales of our own skin and hair care products. We saw a 3.7% 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 third quarter of 2016 were $9,936,900 versus $7,548,100 for the third quarter of 2015, an increase of $2,388,800 or 31.6%. We saw a 22.4% increase in net sales of the skin and hair care products that we distribute for other companies and a 95.3% increase in net sales of our own skin and hair care products. We saw a 2.1% 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 nine months of 2016 was $1,013,500 versus net income of $4,519,300 in the first nine months of 2015. Our net income for the third quarter of 2016 was $603,600 versus net income of $473,000 in the third quarter of 2015. The decrease in net income for the first nine months of 2016 compared to the net income for the same period in 2015 resulted primarily from: (1) changes in income tax expense; and (2) the incurrence of the transaction costs related to the Acquisition and the amortization of the acquired intangible assets.

Our income tax expense for the first nine months of 2016 was $697,900 versus income tax benefit of $2,377,500 in the first nine months of 2015. During the first nine months of 2015, we released our valuation allowance related to a deferred tax asset. See Note 1(l), "Income Taxes," to our Consolidated Financial Statements (Unaudited) in Item 1.

Summary of Results as a Percentage of Net Sales

	Year Ended December 31, 2015	Nine Months Ended September 30, 2016	2015
Net sales			
Household products	21.8 %	18.5 %	21.4 %
Skin and hair care products	78.2 %	81.5 %	78.6 %
Total net sales	100.0 %	100.0 %	100.0 %
Cost of sales	57.6 %	55.4 %	55.4 %
Gross profit	42.4 %	44.6 %	44.6 %
Other revenue	0.1 %	0.1 %	0.1 %
	42.5 %	44.7 %	44.7 %
Operating expenses	34.6 %	37.3 %	34.8 %
Interest expense	0.1 %	0.3 %	0.1 %
	34.7 %	37.6 %	34.9 %
Income before income taxes	7.8 %	7.1 %	9.8 %

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 Consolidated Financial Statements (Unaudited) in Item 1.

Nine Months Ended September 30, 2016 Compared to Nine Months Ended September 30, 2015

Comparative Net Sales

	Nine Months Ended September 30, 2016	2015	Percentage Increase (Decrease)	
Total household products	$4,490,300	$4,661,700	(3.7	%)
Total skin and hair care products	19,784,500	17,094,000	15.7	%
Total net sales	$24,274,800	$21,755,700	11.6	%

Sales of household products for the first nine months of 2016 accounted for 18.5% of consolidated net sales compared to 21.4% for the same period in 2015. During the first nine months of 2016, the sales of our household products were $4,490,300 as compared to $4,661,700 for the same period in 2015, a decrease of $171,400 or 3.7%. This decrease is attributable primarily to: (1) lower sales of our Scott's Liquid Gold® Floor Restore product during the second and third quarters of 2016 due to it being discontinued at one of our customers during the second quarter of 2016 and (2) lower sales of our Scott's Liquid Gold® Wood Wash and Touch of Scent® Air Freshener products, which were discontinued at one of our customers. Our Scott's Liquid Gold® Wood Wash and Touch of Scent® Air Freshener products account for a small percentage of the sales of our total household products.

Sales of skin and hair care products for the first nine months of 2016 accounted for 81.5% of consolidated net sales compared to 78.6% for the same period in 2015. The net sales of these products for that period were $19,784,500 in 2016 compared to $17,094,000 for the same period in 2015, an increase of $2,690,500 or 15.7%, 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 an increase in net sales of the Montagne Jeunesse face masque sachets.

The net sales of our own skin and hair products were $5,492,800 in the first nine months of 2016 compared to $3,830,500 for the same period in 2015, an increase of $1,662,300 or 43.4%. This increase is primarily attributable to the addition of the net sales of Prell®, Denorex®, and Zincon® offset by a small decrease in the sales of our manufactured skin care products. The net sales of Prell®, Denorex®, and Zincon® were $1,780,100 in the third quarter of 2016.

The net sales of Montagne Jeunesse and Batiste Dry Shampoo were $14,291,700 in the first nine months of 2016 compared to $13,263,500 for the same period in 2015, an increase of $1,028,200 or 7.8%. This increase is primarily attributable to increased sales of Montagne Jeunesse.

We paid our customers a total of $1,584,500 in the first nine months of 2016 for trade promotions to support price features, displays, slotting fees and other merchandising of our products compared to $1,661,100 for the same period in 2015, a decrease of $76,600 or 4.6%. This decrease is primarily attributable to lower cost and more efficient trade promotion programs for our skin and hair care products.

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 0.1% percent for first nine months of 2016 compared to 0.4% for the same period in 2015. This decrease is primarily attributable to a few of our customers in the first quarter of 2015 returning various products to us that they no longer carry in certain stores.

On a consolidated basis, cost of sales was $13,454,600 during the first nine months of 2016 compared to $12,042,600 for the same period in 2015, an increase of $1,412,000 or 11.7%, on a net sales increase of 11.6%. As a percentage of consolidated net sales, cost of sales was 55.4% in both the first nine months of 2016 and 2015.

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 57.1% in the first nine months of 2016 compared to 57.6% for the same period in 2015. This decrease is primarily attributable to a higher percentage of net sales of our own skin and hair products, which have a lower cost than the skin and hair care products that we distribute for other companies.

As a percentage of net sales of our household products, the costs of sales for our household products increased to 47.8% in the first nine months of 2016 compared to 47.1% for the same period in 2015. This increase is primarily attributable to an increase in our costs for certain raw materials.

Operating Expenses, Interest Expense and Other Income

	Nine Months Ended September 30, 2016	2015	Percentage Increase (Decrease)
Operating Expenses			
Advertising	$1,426,600	$1,087,900	31.1 %
Selling	4,184,300	4,043,600	3.5 %
General and administrative	3,433,000	2,433,900	41.0 %
Total operating expenses	$9,043,900	$7,565,400	19.5 %
Other Income	$12,600	$16,100	(21.7 %)
Interest Expense	$77,500	$22,000	252.3 %

Our operating expenses for the first nine months of 2016 were $9,043,900 compared to $7,565,400 for the same period in 2015, an increase of $1,478,500 or 19.5%. These expenses consist primarily of advertising, selling, and general and administrative expenses.

Advertising expenses for the first nine months of 2016 were $1,426,600 compared to $1,087,900 for the same period in 2015, an increase of $338,700 or 31.1%. This increase is primarily due to a national television campaign during the second quarter of 2016 for our Scott’s Liquid Gold® Wood Care product and the investments we are making to reposition and grow our Alpha® Skin Care products and Scott’s Liquid Gold® household products in the marketplace.

Selling expenses for the first nine months of 2016 were $4,184,300 compared to $4,043,600 for the same period in 2015, an increase of $140,700 or 3.5%. This increase is primarily attributable to 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.

General and administrative expenses for the first nine months of 2016 were $3,433,000 compared to $2,433,900 for the same period of 2015, an increase of $999,100 or 41.0%. This increase is due primarily to an increase in professional fees related to the Acquisition and the amortization of the acquired intangible assets.

Other income from interest earned on our cash reserves for the first nine months of 2016 and 2015 was $12,600 and $16,100, respectively.

Interest expense for the first nine months of 2016 and 2015 was $77,500 and $22,000, respectively. The increase is due to borrowings under the Credit Agreement on June 30, 2016.

Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015

Comparative Net Sales

	Three Months Ended September 30,		Percentage Increase
	2016	2015	(Decrease)
Total household products	$1,453,400	$1,485,300	(2.1 %)
Total skin and hair care products	8,483,500	6,062,800	39.9 %
Total net sales	$9,936,900	$7,548,100	31.6 %

Sales of household products for the third quarter of 2016 accounted for 14.6% of consolidated net sales compared to 19.7% for the same period in 2015. During the third quarter of 2016, the sales of our household products were $1,453,400 as compared to $1,485,300 for the same period in 2015, a decrease of $31,900 or 2.1%. This decrease is attributable primarily to lower sales of our Scott's Liquid Gold® Floor Restore product during the third quarter of 2016 due to it being discontinued at one of our customers during the second quarter of 2016.

Sales of skin and hair care products for the third quarter of 2016 accounted for 85.4% of consolidated net sales compared to 80.3% for the same period in 2015. The net sales of these products for that period were $8,483,500 in 2016 compared to $6,062,800 for the same period in 2015, an increase of $2,420,700 or 39.9%, 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, an increase in the sales of Montagne Jeunesse face masque sachets and an increase in the sales of Batiste Dry Shampoo offset by a decrease in sales of our manufactured skin care products.

The net sales of our own skin and hair care products were $2,849,900 in the third quarter of 2016 compared to $1,459,100 for the same period in 2015, an increase of $1,390,800 or 95.3%. This increase is primarily attributable to the addition of the net sales of Prell®, Denorex®, and Zincon® offset by a decrease in the sales of our manufactured skin care products. The net sales of Prell®, Denorex®, and Zincon® were $1,780,100 in the third quarter of 2016.

The net sales of Montagne Jeunesse and Batiste Dry Shampoo were $5,633,600 in the third quarter of 2016 compared to $4,603,700 for the same period in 2015, an increase of $1,029,900 or 22.4%. This increase is primarily attributable to increased sales of both products.

We paid our customers a total of $616,300 in the third quarter of 2016 for trade promotions to support price features, displays, slotting fees and other merchandising of our products compared to $538,200 for the same period in 2015, an increase of $78,100 or 14.5%. This increase is primarily attributable to the addition of the net sales of Prell®, Denorex®, and Zincon®.

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 0.1% percent for the third quarter of 2016 compared to 0.1% for the same period in 2015.

On a consolidated basis, cost of sales was $5,830,600 during the third quarter of 2016 compared to $4,284,600 for the same period in 2015, an increase of $1,546,000 or 36.1%, on a net sales increase of 31.6%. As a percentage of consolidated net sales, cost of sales was 58.7% in the third quarter of 2016 compared to 56.8% for the same period in 2015.

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 60.6% in the third quarter of 2016 compared to 59.5% for the same period in 2015. This increase is primarily attributable to a higher percentage of net sales of the skin and hair care products that we distribute for other companies, which have a higher cost than our own skin and hair care products.

As a percentage of net sales of our household products, the costs of sales for our household products increased to 47.5% in the third quarter of 2016 compared to 45.7% for the same period in 2015. This increase is primarily attributable to an increase in our costs for certain raw materials.

Operating Expenses, Interest Expense and Other Income

	Three Months Ended September 30, 2016	2015	Percentage Increase (Decrease)
Operating Expenses			
Advertising	$91,700	$528,600	(82.7%)
Selling	1,717,300	1,336,600	28.5%
General and administrative	1,218,800	733,200	66.2%
Total operating expenses	$3,027,800	$2,598,400	16.5%
Other Income	$1,000	$6,800	(85.3%)
Interest Expense	$60,400	$7,400	716.2%

Our operating expenses for the third quarter of 2016 were $3,027,800 compared to $2,598,400 for the same period in 2015, an increase of $429,400 or 16.5%. These expenses consist primarily of advertising, selling, and general and administrative expenses.

Advertising expenses for the third quarter of 2016 were $91,700 compared to $528,600 for the same period in 2015, a decrease of $436,900 or 82.7%. This decrease is primarily due to the one-time expense we incurred during the third quarter of 2015 relating to the repositioning of our Alpha® Skin Care products and Scott's Liquid Gold® household products in the marketplace, which was not repeated in 2016.

Selling expenses for the third quarter of 2016 were $1,717,300 compared to $1,336,600 for the same period in 2015, an increase of $380,700 or 28.5%. 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 to customers; and (2) the accrual of potential bonus payments to personnel within our sales and marketing organization compared to the same period in 2015.

General and administrative expenses for the third quarter of 2016 were $1,218,800 compared to $733,200 for the same period of 2015, an increase of $485,600 or 66.2%. This increase is due primarily to (1) an increase in professional fees related to the Acquisition and the amortization of the acquired intangible assets; and (2) the accrual of potential bonus payments to our management and administrative personnel compared to the same period in 2015.

Other income from interest earned on our cash reserves for the third quarter of 2016 and 2015 was $1,000 and $6,800, respectively.

Interest expense for the third quarter of 2016 and 2015 was $60,400 and $7,400, respectively. The increase is due to borrowings under the Credit Agreement on June 30, 2016.

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Liquidity and Capital Resources

Financing Agreements

Please see Note 1(f) to our Consolidated Financial Statements (Unaudited) for information on our financing agreements with Summit and Wells Fargo.

Please see Note 6 to our Consolidated Financial Statements (Unaudited) for information on our financing agreements with Chase.

Liquidity

At September 30, 2016, we had approximately $1.9 million in cash on hand. For the first nine months of 2016, the primary components of working capital (exclusive of cash that was $5,592,300 less at September 30, 2016 compared to December 31, 2015 primarily due to using cash for the Acquisition) that significantly affected operating cash flows are the following: (1) net accounts receivable were $2,774,700 more at September 30, 2016 than at December 31, 2015 due primarily to receivables related to the products acquired in the Acquisition and the timing of receiving payment; (2) inventory at September 30, 2016 was $705,500 more than at December 31, 2015 due primarily to the Acquisition and the timing of receiving certain inventory from our vendors and shipping our products to our customers; and (3) accounts payable and accrued expenses at September 30, 2016 were $906,300 more than at December 31, 2015 due primarily to increased inventory and the timing of payments on our inventory.

We believe that our cash on hand at any time during 2016 could be significantly less than at September 30, 2016 due primarily to the following: (1) the repayment of a portion of our revolving credit facility with Chase; (2) costs related to the integration of the Acquisition; (3) the timing of receiving and paying for the significant amounts of Batiste Dry Shampoo that we purchase every month from Church & Dwight; and (4) making a significant investment in 2016 in the brands and products that we own.

We anticipate that our existing cash and our cash from operations, together with our current financing arrangement with Chase, will be sufficient to meet our cash requirements for the next 12 months. During the first nine months of 2016 we spent $223,600 to purchase production and warehouse equipment to improve our manufacturing capabilities and efficiencies. We expect to spend approximately $175,000 on additional production and warehouse equipment that is primarily related to the Acquisition in 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.
Not applicable.

ITEM 4. CONTROLS AND PROCEDURES.
Disclosure Controls and Procedures

As of September 30, 2016, 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 September 30, 2016.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the nine months ended September 30, 2016 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, 2015 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: November 14, 2016

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