Oil-Dri Corp of America
Form 10-Q
March 11, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q
(Mark One)

x	Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Quarterly Period Ended January 31, 2019
or	
o	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 001-12622

OIL-DRI CORPORATION OF AMERICA
(Exact name of the registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	36-2048898 (I.R.S. Employer Identification No.)
410 North Michigan Avenue, Suite 400 Chicago, Illinois (Address of principal executive offices)	60611-4213 (Zip Code)

The registrant's telephone number, including area code: (312) 321-1515

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 at least the past 90 days. Yes x No o

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

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

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o	Smaller reporting company x	Emerging growth company o

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of January 31, 2019.
Common Stock – 5,311,462 Shares and Class B Stock – 2,251,738 Shares

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FORWARD-LOOKING STATEMENTS

Certain statements in this report, including, but not limited to, those under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" and those statements elsewhere in this report and other documents that we file with the Securities and Exchange Commission ("SEC"), contain forward-looking statements that are based on current expectations, estimates, forecasts and projections about our future performance, our business, our beliefs and our management's assumptions. In addition, we, or others on our behalf, may make forward-looking statements in press releases or written statements, or in our communications and discussions with investors and analysts in the normal course of business through meetings, webcasts, phone calls and conference calls. Words such as "expect," "outlook," "forecast," "would," "could," "should," "project," "intend," "plan," "continue," "believe," "seek," "estima "assume," and variations of such words and similar expressions are intended to identify such forward-looking statements, which are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Such statements are subject to certain risks, uncertainties and assumptions that could cause actual results to differ materially, including, but not limited to, those described in Item 1A, Risk Factors, of our Annual Report on Form 10-K for the fiscal year ended July 31, 2018, which contains, among other risk factors, a description of the issues that may arise with the implementation of our new enterprise resource planning system which became operational on August 1, 2018. Should one or more of these or other risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, intended, expected, believed, estimated, projected or planned. Investors are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. Except to the extent required by law, we do not have any intention or obligation to update publicly any forward-looking statements after the distribution of this report, whether as a result of new information, future events, changes in assumptions or otherwise.

TRADEMARK NOTICE

Oil-Dri is a registered trademark of Oil-Dri Corporation of America.

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PART I - FINANCIAL INFORMATION

ITEM 1. Financial Statements

OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Balance Sheet
(in thousands, except share and per share amounts)

ASSETS	(unaudited) January 31, 2019		July 31, 2018	
Current Assets				
Cash and cash equivalents	$ 9,375		$ 12,757	
Short-term investments	480		7,124	
Accounts receivable, less allowance of $690 and $817 at January 31, 2019 and July 31, 2018, respectively	38,282		33,602	
Inventories	28,123		22,521	
Prepaid repairs expense	4,116		4,111	
Prepaid expenses and other assets	1,924		2,899	
Total Current Assets	82,300		83,014	
Property, Plant and Equipment				
Cost	241,425		236,091	
Less accumulated depreciation and amortization	(155,232	)	(149,385	)
Total Property, Plant and Equipment, Net	86,193		86,706	
Other Assets				
Goodwill	9,262		9,262	
Trademarks and patents, net of accumulated amortization of $283 and $267 at January 31, 2019 and July 31, 2018, respectively	1,298		1,220	
	1,867		2,245	

Customer list, net of accumulated amortization of $5,918 and $5,540 at January 31, 2019 and July 31, 2018, respectively				
Deferred income taxes	7,013		7,349	
Other	5,204		4,886	
Total Other Assets	24,644		24,962	
Total Assets	$	193,137	$	194,682

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

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OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Balance Sheet (continued)
(in thousands, except share and per share amounts)

LIABILITIES & STOCKHOLDERS' EQUITY	(unaudited) January 31, 2019	July 31, 2018
Current Liabilities		
Current maturities of notes payable	$ 3,083	$ 3,083
Accounts payable	7,882	6,543
Dividends payable	1,680	1,627
Accrued expenses:		
Salaries, wages and commissions	4,518	8,974
Trade promotions and advertising	1,132	1,280
Freight	5,302	1,767
Other	7,492	7,675
Total Current Liabilities	31,089	30,949
Noncurrent Liabilities		
Notes payable, net of unamortized debt issuance costs of $46 and $60 at January 31, 2019 and July 31, 2018, respectively	3,038	6,107
Deferred compensation	5,664	6,100
Pension and postretirement benefits	16,474	15,906
Other	4,108	3,735
Total Noncurrent Liabilities	29,284	31,848
Total Liabilities	60,373	62,797
Stockholders' Equity		
Common Stock, par value $.10 per share, issued 8,236,449 shares at January 31, 2019 and 8,086,849 shares at July 31, 2018	823	809
Class B Stock, par value $.10 per share, issued 2,576,479 shares at January 31, 2019 and 2,468,979 shares at July 31, 2018	258	247
Additional paid-in capital	39,730	38,473
Retained earnings	158,788	158,935
Noncontrolling interest	5	(18)
Accumulated Other Comprehensive Loss:		
Pension and postretirement benefits	(10,093)	(10,384)
Cumulative translation adjustment	(267)	(231)
Total Accumulated Other Comprehensive Loss	(10,360)	(10,615)
Less Treasury Stock, at cost (2,924,987 Common and 324,741 Class B shares at January 31, 2019 and 2,914,092 Common and 324,741 Class B shares at July 31, 2018)	(56,480)	(55,946)
Total Stockholders' Equity	132,764	131,885
Total Liabilities & Stockholders' Equity	$ 193,137	$ 194,682

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Statements of Income and Retained Earnings
(in thousands, except for per share amounts)

	(unaudited) For the Six Months Ended January 31, 2019	2018
Net Sales	$136,023	$135,540
Cost of Sales (1)	(104,609)	(96,908)
Gross Profit	31,414	38,632
Selling, General and Administrative Expenses (1)	(27,584)	(29,234)
Income from Operations	3,830	9,398
Other Income (Expense)		
Interest expense	(293)	(400)
Interest income	96	119
Other, net (1)	39	(207)
Total Other Expense, Net	(158)	(488)
Income Before Income Taxes	3,672	8,910
Income Tax Expense	(456)	(6,956)
Net Income	3,216	1,954
Net Income Attributable to Noncontrolling Interest	23	—
Net Income Attributable to Oil-Dri	3,193	1,954
Retained Earnings:		
Balance at beginning of period	158,935	154,735
Cash dividends declared	(3,340)	(3,118)
Balance at End of Period	$158,788	$153,571
Net Income Per Share		
Basic Common	$0.46	$0.29
Basic Class B Common	$0.34	$0.22
Diluted Common	$0.42	$0.26
Average Shares Outstanding		
Basic Common	5,099	5,030
Basic Class B Common	2,069	2,097
Diluted Common	7,242	7,215
Dividends Declared Per Share		
Basic Common	$0.4800	$0.4600
Basic Class B Common	$0.3600	$0.3450

(1) Prior year amounts have been retrospectively adjusted to conform to the current year presentation of the non-service cost components of net periodic benefit cost required by new guidance under Accounting Standards Codification (“ASC”) 715, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. See Note 2 of the Notes to unaudited Condensed Consolidated Financial Statements for details.

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Statements of Comprehensive Income
(in thousands of dollars)

	(unaudited) For the Six Months Ended January 31,	
	2019	2018
Net Income Attributable to Oil-Dri	$3,193	$1,954
Other Comprehensive Income:		
Pension and postretirement benefits (net of tax)	291	418
Cumulative translation adjustment	(36)	70
Other Comprehensive Income	255	488
Total Comprehensive Income	$3,448	$2,442

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Statements of Income and Retained Earnings
(in thousands, except for per share amounts)

	(unaudited) For the Three Months Ended January 31, 2019	2018
Net Sales	$69,880	$68,894
Cost of Sales (1)	(54,476)	(49,237)
Gross Profit	15,404	19,657
Selling, General and Administrative Expenses (1)	(12,577)	(14,474)
Income from Operations	2,827	5,183
Other Income (Expense)		
Interest expense	(142)	(199)
Interest income	47	65
Other, net (1)	56	22
Total Other Expense, Net	(39)	(112)
Income Before Income Taxes	2,788	5,071
Income Tax Expense	(506)	(6,167)
Net Income (Loss)	2,282	(1,096)
Net Loss Attributable to Noncontrolling Interest	(5)	—
Net Income (Loss) Attributable to Oil-Dri	2,287	(1,096)
Net Income (Loss) Per Share		
Basic Common	$0.33	$(0.17)
Basic Class B	$0.25	$(0.12)
Diluted Common	$0.30	$(0.15)
Average Shares Outstanding		
Basic Common	5,121	5,035
Basic Class B	2,068	2,104
Diluted Common	7,229	7,139
Dividends Declared Per Share		
Basic Common	$0.2400	$0.2300
Basic Class B	$0.1800	$0.1725

(1) Prior year amounts have been retrospectively adjusted to conform to the current year presentation of the non-service cost components of net periodic benefit cost required by new guidance under Accounting Standards Codification (“ASC”) 715, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. See Note 2 of the Notes to unaudited Condensed Consolidated Financial Statements for details.

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Statements of Comprehensive Income
(in thousands of dollars)

	(unaudited) For the Three Months Ended January 31,	
	2019	2018
Net Income (Loss) Attributable to Oil-Dri	$2,287	$(1,096)
Other Comprehensive Income:		
Pension and postretirement benefits (net of tax)	124	237
Cumulative translation adjustment	28	144
Other Comprehensive Income	152	381
Total Comprehensive Income (Loss)	$2,439	$(715)

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Statements of Cash Flows
(in thousands)

	(unaudited) For the Six Months Ended January 31,	
CASH FLOWS FROM OPERATING ACTIVITIES	2019	2018
Net Income	$3,216	$1,954
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,539	6,413
Amortization of investment net discount	(10)	(57)
Stock-based compensation	898	770
Deferred income taxes	106	5,312
Provision for bad debts and cash discounts	(168)	155
Loss on the sale of fixed assets	1	31
Life insurance benefits	—	(334)
(Increase) Decrease in assets:		
Accounts receivable	(4,529)	362
Inventories	(5,607)	75
Prepaid expenses	970	(51)
Other assets	(422)	55
Increase (Decrease) in liabilities:		
Accounts payable	2,295	(743)
Accrued expenses	(1,390)	(3,637)
Deferred compensation	(436)	268
Pension and postretirement benefits	859	649
Other liabilities	370	407
Total Adjustments	(524)	9,675
Net Cash Provided by Operating Activities	2,692	11,629
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(6,199)	(6,850)
Proceeds from sale of property, plant and equipment	—	11
Purchases of short-term investments	(3,948)	(24,101)
Dispositions of short-term investments	10,602	25,840
Net Cash Provided by (Used in) Investing Activities	455	(5,100)
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal payments on notes payable	(3,083)	(3,083)
Dividends paid	(3,287)	(3,112)
Purchase of treasury stock	(135)	(27)
Net Cash Used in Financing Activities	(6,505)	(6,222)
Effect of exchange rate changes on Cash and Cash Equivalents	(24)	(21)
Net (Decrease) Increase in Cash and Cash Equivalents	(3,382)	286
Cash and Cash Equivalents, Beginning of Period	12,757	9,095
Cash and Cash Equivalents, End of Period	$9,375	$9,381

OIL-DRI CORPORATION OF AMERICA
Condensed Consolidated Statements of Cash Flows - Continued
(in thousands)

	(unaudited) For the Six Months Ended January 31,	
	2019	2018
Supplemental disclosure of non-cash investing and financing activities:		
Capital expenditures accrued, but not paid	$416	$890
Cash dividends declared and accrued, but not paid	$1,680	$1,559

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

OIL-DRI CORPORATION OF AMERICA
Notes To Condensed Consolidated Financial Statements
(Unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and in compliance with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The financial statements and the related notes are condensed and should be read in conjunction with the Consolidated Financial Statements and related notes for the fiscal year ended July 31, 2018 included in our Annual Report on Form 10-K filed with the SEC.

The unaudited Condensed Consolidated Financial Statements include the accounts of Oil-Dri Corporation of America and its subsidiaries. All significant intercompany transactions are eliminated. Except as otherwise indicated herein or as the context otherwise requires, references to "Oil-Dri," the "Company," "we," "us" or "our" refer to Oil-Dri Corporation of America and its subsidiaries.

The unaudited Condensed Consolidated Financial Statements reflect all adjustments, consisting of normal recurring accruals and reclassifications which are, in the opinion of management, necessary for a fair presentation of the statements contained herein. In addition, certain prior year reclassifications were made to conform to the current year presentation. Operating results for the three and six months ended January 31, 2019 are not necessarily an indication of the results that may be expected for the fiscal year ending July 31, 2019.

Management Use of Estimates

The preparation of the unaudited Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires the use of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses during the reporting period, as well as the related disclosures. All of our estimates and assumptions are revised periodically. Actual results could differ from these estimates.

Summary of Significant Accounting Policies

Except as described herein, our significant accounting policies, which are detailed in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018 have not materially changed. However, the unaudited Condensed Consolidated Financial Statements reflect changes required upon adoption of new accounting guidance, as described in Note 2 of the Notes to unaudited Condensed Consolidated Financial Statements. The following is a description of certain of our significant accounting policies.

Revenue Recognition. We recognize revenue when performance obligations under the terms of the contracts with customers are satisfied. Our performance obligation generally consists of the promise to sell finished products to wholesalers, distributors and retailers or consumers and our obligations have an original duration of one year or less. Control of the finished products are transferred upon shipment to, or receipt at, customers' locations, as determined by the specific terms of the contract. We have completed our performance obligation when control is transferred and we recognize revenue accordingly.

We have an unconditional right to consideration under the payment terms specified in the contract upon completion of the performance obligation. We may require certain customers to provide payment in advance of product shipment. We recorded a liability for these advance payments of $96,000 and $390,000 as of January 31, 2019 and July 31, 2018, respectively. This liability is reported in Other Accrued Expenses on the Condensed Consolidated Balance Sheet. Revenue recognized during the second quarter ended January 31, 2019 that was included in the liability for advance payments at the beginning of the period was $84,000.

We routinely commit to one-time or ongoing trade promotion programs directly with consumers, such as coupon programs, and with customers, such as volume discounts, cooperative marketing and other arrangements. We estimate and accrue the expected costs of these programs. These costs are considered variable consideration under ASC 606, Revenue from Contracts with Customers, and are netted against sales when revenue is recorded. The accruals are based on our best estimate of the amounts necessary to settle future and existing obligations on products sold as of the balance sheet date. To estimate these accruals, we rely on our historical experience of trade spending patterns and that of the industry, current trends and forecasted data.

Selling, General and Administrative Expenses. Selling, general and administrative expenses (“SG&A”) include salaries, wages and benefits associated with staff outside the manufacturing and distribution functions, all marketing related costs, any miscellaneous trade spending expenses not required to be included in net sales, research and development costs, depreciation and amortization related to assets outside the manufacturing and distribution process and all other non-manufacturing and non-distribution expenses.

Trade Receivables. We record an allowance for doubtful accounts based on our historical experience and a periodic review of our accounts receivable, including a review of the overall aging of accounts, consideration of customer credit risk and analysis of facts and circumstances about specific customer accounts. A customer account is determined to be uncollectible when it is probable that a loss will be incurred after we have completed our internal collection procedures, including termination of shipments, direct customer contact and formal demand of payment.

Overburden Removal and Mining Costs. We mine sorbent materials on property that we either own or lease as part of our overall operations. A significant part of our overall mining cost is incurred during the process of removing the overburden (non-usable material) from the mine site, thus exposing the sorbent material used in a majority of our production processes. These stripping costs are treated as a variable inventory production cost and are included in cost of sales in the period they are incurred. We defer and amortize the pre-production overburden removal costs associated with opening a new mine.

Additionally, it is our policy to capitalize the purchase cost of land and mineral rights, including associated legal fees, survey fees and real estate fees. The costs of obtaining mineral patents, including legal fees and drilling expenses, are also capitalized. Pre-production development costs on new mines and any prepaid royalties that may be offset against future royalties due upon extraction of the minerals are also capitalized. All exploration related costs are expensed as incurred.

We perform ongoing reclamation activities during the normal course of our overburden removal. As overburden is removed from a mine site, it is hauled to previously mined sites and is used to refill older sites. This process allows us to continuously reclaim older mine sites and dispose of overburden simultaneously, therefore minimizing the costs associated with the reclamation process.

2. NEW ACCOUNTING PRONOUNCEMENTS AND REGULATIONS

Recently Issued Pronouncements

In February 2016, the Financial Accounting Standards Board (“FASB”) issued guidance under ASC 842, Leases, which provides that, for leases with a term greater than 12 months, a lessee must recognize in the statement of financial position both a liability to make lease payments and an asset representing its right to use the underlying asset. Other requirements describe expense recognition, as well as financial statement presentation and disclosure. This guidance is effective for our first quarter of fiscal year 2020 using a modified retrospective approach, which includes a number of optional practical expedients. Early adoption is permitted. We are currently evaluating the impact of the adoption of this requirement on our Consolidated Financial Statements.
In June 2016, the FASB issued guidance under ASC 326, Financial Instruments-Credit Losses, which requires companies to utilize an impairment model for most financial assets measured at amortized cost and certain other financial instruments, which include trade and other receivables, loans and held-to-maturity debt securities, to record an allowance for credit risk based on expected losses rather than incurred losses. In addition, this new guidance changes the recognition method for credit losses on available-for-sale debt securities, which can occur as a result of market and credit risk, as well as additional disclosures. In general, this guidance will require modified retrospective adoption for all outstanding instruments that fall under this guidance. This guidance is effective for our first quarter of fiscal year 2021. We are currently evaluating the impact of the adoption of this requirement on our Consolidated

Financial Statements.
There have been no other accounting pronouncements issued but not yet adopted by us which are expected to have a material impact on our Consolidated Financial Statements.

Recently Adopted Pronouncements

In May 2014, the FASB issued guidance under ASC 606, Revenue from Contracts with Customers, and subsequently issued several amendments to further clarify the principles for recognizing revenue. This guidance establishes a single comprehensive revenue recognition model for all contracts with customers and will supersede most existing revenue guidance. The core principle of ASC 606 is that entities should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to receive in exchange.

Oil-Dri adopted the new guidance on a modified retrospective basis effective August 1, 2018. We applied the practical expedient available under ASC 606 to disregard determining significant financing components if the good is transferred and payment is received within one year. We also adopted the policy election to exclude from the transaction price all amounts collected from customers for sales and other taxes. We do not expect a material impact on our annual Consolidated Financial Statements from the adoption of this guidance. Results for periods beginning on or after August 1, 2018 are recognized and presented in accordance with ASC 606, while prior period amounts have not been adjusted and continue to be reported in accordance with the prior account guidance under ASC 605, Revenue Recognition.

In January 2016, the FASB issued guidance under ASC 825, Recognition and Measurement of Financial Assets and Financial Liabilities. This guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. This guidance was effective for our first quarter of fiscal year 2019. The provisions relevant to us relate to fair value disclosures for our notes payable, which are measured at amortized cost on the balance sheet. These provisions require the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes, as well as eliminate the requirement to disclose the method and significant assumptions used to estimate the fair value in such disclosure. This guidance impacted our disclosures only on a prospective basis and did not have a material impact on our unaudited Condensed Consolidated Financial Statements. See Note 4 of the Notes to unaudited Condensed Consolidated Financial Statements for further information about Fair Value Measurements.
In March 2017, the FASB issued guidance under ASC 715, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires presenting the service cost component of net periodic benefit cost in the same income statement line item(s) as other employee compensation costs arising from services rendered during the period. This standard also requires that other components of the net periodic benefit cost be presented separately from the line items that includes service costs and outside of any subtotal of operating income, if one is presented, on a retrospective basis. We adopted this new guidance in the first quarter of fiscal 2019 and accordingly recorded the non-service cost components of net periodic benefit cost in Other Income (Expense) in the line item Other, net on the unaudited Condensed Consolidated Statements of Income and Retained Earnings. As such, the adoption did not have a material impact on our Consolidated Financial Statements. See Note 6 of the Notes to unaudited Condensed Consolidated Financial Statements for further information about our pension and postretirement health plans.

3. INVENTORIES

The composition of inventories is as follows (in thousands):

	January 31, 2019	July 31, 2018
Finished goods	$ 17,747	$14,223
Packaging	6,177	5,349
Other	4,199	2,949
Total Inventories	$ 28,123	$22,521

Inventories are valued at the lower of cost (first-in, first-out) or net realizable value. Inventory costs include the cost of raw materials, packaging supplies, labor and other overhead costs. We performed a detailed review of our inventory items to determine if an obsolescence reserve adjustment was necessary. The review surveyed all of our operating facilities and sales groups to ensure that both historical issues and new market trends were considered. The obsolescence reserve not only considered specific items, but also took into consideration the overall value of the inventory as of the balance sheet date. The inventory obsolescence reserve values at January 31, 2019 and July 31, 2018 were $1,028,000 and $1,136,000, respectively.

4. FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The inputs used to measure fair value are prioritized into categories based on the lowest level of input that is significant to the fair value measurement. The categories in the fair value hierarchy are as follows:

Level 1: Quoted market prices in active markets for identical assets or liabilities.
Level 2: Observable market-based inputs for similar assets or liabilities or valuation models whose inputs are observable, directly or indirectly.
Level 3: Unobservable inputs.

Cash equivalents of $7,163,000 and $9,920,000 as of January 31, 2019 and July 31, 2018, respectively, were classified as Level 1. These cash instruments are primarily money market mutual funds and are included in cash and cash equivalents on the unaudited Condensed Consolidated Balance Sheet.

Short-term investments included U.S. Treasury securities and certificates of deposit. We intend and have the ability to hold our short-term investments to maturity; therefore, these investments were reported at amortized cost, which approximated fair value as of January 31, 2019 and July 31, 2018.

Balances of accounts receivable and accounts payable approximated their fair values at January 31, 2019 and July 31, 2018 due to the short maturity and nature of those balances.

Notes payable are reported at the face amount of future maturities. The estimated fair value of notes payable, including current maturities, was $6,384,000 and $9,553,000 as of January 31, 2019 and July 31, 2018, respectively, and are classified as Level 2. The fair value as of January 31, 2019, was determined using the exit price notion of fair value required by the adoption of new accounting guidance for fiscal year 2019, as discussed in Note 2 of the Notes to unaudited Condensed Consolidated Financial Statements.

We apply fair value techniques on at least an annual basis associated with: (1) valuing potential impairment loss related to goodwill, trademarks and other indefinite-lived intangible assets and (2) valuing potential impairment loss related to long-lived assets. See Note 5 of the Notes to unaudited Condensed Consolidated Financial Statements for further information about goodwill and other intangible assets.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

Intangible amortization expense was $209,000 and $253,000 in the second quarter of fiscal years 2019 and 2018, respectively. Intangible amortization expense was $419,000 and $507,000 in the first six months of fiscal years 2019 and 2018, respectively. Estimated intangible amortization for the remainder of fiscal year 2019 is $417,000. Estimated intangible amortization for the next five fiscal years is as follows (in thousands):

2020	$667
2021	$483
2022	$333
2023	$201
2024	$68

We have one acquired trademark recorded at a cost of $376,000 that was determined to have an indefinite life and is not amortized.

We performed our annual goodwill impairment analysis in the fourth quarter of fiscal year 2018 and no impairment was identified. There have been no triggering events that would indicate a new impairment analysis is needed.

6. PENSION AND OTHER POSTRETIREMENT BENEFITS

The components of net periodic pension and postretirement health benefit costs were as follows:

	Pension Benefits (in thousands)			
	For the Three Months Ended January 31,		For the Six Months Ended January 31,	
	2019	2018	2019	2018
Service cost	$391	$438	$813	$862
Interest cost	517	517	1,057	1,014
Expected return on plan assets	(703)	(485)	(1,405)	(971)
Amortization of:				
Prior service costs	1	—	1	1
Other actuarial loss	165	354	386	641
Net periodic benefit cost	$371	$824	$852	$1,547

	Postretirement Health Benefits (in thousands)			
	For the Three Months Ended January 31,		For the Six Months Ended January 31,	
	2019	2018	2019	2018
Service cost	$25	$25	$52	$54
Interest cost	24	19	49	43
Amortization of:				
Prior service costs	(2)	(1)	(3)	(3)
Other actuarial loss	—	(5)	—	—
Net periodic benefit cost	$47	$38	$98	$94

The non-service cost components of net periodic benefit cost are included in Other Income (Expense) in the line item Other, net on the unaudited Condensed Consolidated Statements of Income and Retained Earnings.

The pension plan is funded based upon actuarially determined contributions that take into account the amount deductible for income tax purposes, the normal cost and the minimum contribution required and the maximum contribution allowed under applicable regulations. We were not required to make, and did not make, a contribution to the pension plan during the first six months of fiscal year 2019. We have no minimum funding requirements for the remainder of fiscal year 2019.

We made a significant voluntary contribution to the pension plan in excess of the minimum required contribution in the third quarter of fiscal year 2018. This voluntary contribution improved the plan's funded status and contributed to a lower net periodic benefit expense for the second quarter and the first six months of fiscal year 2019 compared to the same period in the prior year. The postretirement health plan is an unfunded plan. We pay insurance premiums and claims from our assets.

Assumptions used in the previous calculations were as follows:

	Pension Benefits		Postretirement Health Benefits	
	For the Three and Six Months Ended January 31,			
	2019	2018	2019	2018
Discount rate for net periodic benefit cost	4.04%	3.75%	3.81%	3.26%
Rate of increase in compensation levels	3.50%	3.50%	—	—
Long-term expected rate of return on assets	7.00%	7.00%	—	—

The medical cost trend assumption for postretirement health benefits was 7.50%. The graded trend rate is expected to decrease to an ultimate rate of 4.50% in fiscal year 2038.

7. OPERATING SEGMENTS

We have two operating segments: (1) Business to Business Products Group and (2) Retail and Wholesale Products Group. These operating segments are managed separately and each segment's major customers have different characteristics. The Retail and Wholesale Products Group customers include: mass merchandisers; wholesale clubs; drugstore chains; pet specialty retail outlets; dollar stores; retail grocery stores; distributors of industrial cleanup and automotive products; environmental service companies; and sports field product users. The Business to Business Products Group customers include: processors and refiners of edible oils, petroleum-based oils and biodiesel fuel; manufacturers of animal feed and agricultural chemicals; distributors of animal health and nutrition products; and marketers of consumer products. Our operating segments are also our reportable segments. The accounting policies of the segments are the same as those described in Note 1 of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018.

Net sales for our principal products by segment are as follows (in thousands):

	Business to Business Products Group		Retail and Wholesale Products Group	
	For the Six Months Ended January 31,			
Product	2019	2018	2019	2018
Cat Litter	$6,502	$7,073	$67,613	$64,286
Industrial and Sports	—	—	15,429	15,686
Agricultural and Horticultural	12,698	12,979	—	—
Bleaching Clay and Fluids Purification	24,454	25,545	1,197	1,126
Animal Health and Nutrition	8,130	8,845	—	—
Net Sales	$51,784	$54,442	$84,239	$81,098

	Business to Business Products Group		Retail and Wholesale Products Group	
	For the Three Months Ended January 31,			
Product	2019	2018	2019	2018
Cat Litter	$3,287	$3,273	$35,218	$33,464
Industrial and Sports	—	—	7,652	7,569
Agricultural and Horticultural	6,646	6,936	—	—
Bleaching Clay and Fluids Purification	12,559	12,928	552	506
Animal Health and Nutrition	3,966	4,218	—	—
Net Sales	$26,458	$27,355	$43,422	$41,539

We do not rely on any segment asset allocations and we do not consider them meaningful because of the shared nature of our production facilities; however, we have estimated the segment asset allocations below for those assets for which we can reasonably determine. The unallocated asset category is the remainder of our total assets. The asset allocation is estimated and is not a measure used by our chief operating decision maker about allocating resources to the operating segments or in assessing their performance.

Assets

	January 31, 2019	July 31, 2018
	(in thousands)	
Business to Business Products Group	$60,283	$65,143
Retail and Wholesale Products Group	93,950	89,623
Unallocated Assets	38,904	39,916
Total Assets	$193,137	$194,682

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Net sales and operating income for each segment are provided below. The corporate expenses line includes certain unallocated expenses, including primarily salaries, wages and benefits, purchased services, rent, utilities and depreciation and amortization associated with corporate functions such as research and development, information systems, finance, legal, human resources and customer service. Corporate expenses also include the estimated annual incentive plan bonus accrual.

	For the Six Months Ended January 31,			
	Net Sales		Income (Loss)	
	2019	2018	2019	2018
	(in thousands)			
Business to Business Products Group	$51,784	$54,442	$14,304	$18,635
Retail and Wholesale Products Group	84,239	81,098	2,662	4,787
Net Sales	$136,023	$135,540		
Corporate Expenses			(13,136)	(14,024)
Income from Operations			3,830	9,398
Total Other Expense, Net			(158)	(488)
Income before Income Taxes			3,672	8,910
Income Tax Expense			(456)	(6,956)
Net Income			3,216	1,954
Net Income Attributable to Noncontrolling Interest			23	—
Net Income Attributable to Oil-Dri			$3,193	$1,954

	For the Three Months Ended January 31,			
	Net Sales		Income (Loss)	
	2019	2018	2019	2018
	(in thousands)			
Business to Business Products Group	$26,458	$27,355	$7,272	$9,759
Retail and Wholesale Products Group	43,422	41,539	2,653	2,422
Net Sales	$69,880	$68,894		
Corporate Expenses			(7,098)	(6,998)
Income from Operations			2,827	5,183
Total Other Expense, Net			(39)	(112)
Income before Income Taxes			2,788	5,071
Income Tax Expense			(506)	(6,167)
Net Income (Loss)			2,282	(1,096)
Net Loss Attributable to Noncontrolling Interest			(5)	—
Net Income (Loss) Attributable to Oil-Dri			$2,287	$(1,096)

8. STOCK-BASED COMPENSATION

The Oil-Dri Corporation of America 2006 Long Term Incentive Plan (the “2006 Plan”) permits the grant of stock options, stock appreciation rights, restricted stock, restricted stock units, performance awards and other stock-based and cash-based awards. Our employees and outside directors are eligible to receive grants under the 2006 Plan. The total number of shares of stock subject to grants under the 2006 Plan may not exceed 937,500.

Restricted Stock

All of our non-vested restricted stock as of January 31, 2019 was issued under the 2006 Plan with vesting periods generally between two years and five years. We determined the fair value of restricted stock as of the grant date. We recognize the related compensation expense over the period from the date of grant to the date the shares vest.

There were 117,000 restricted shares of Common Stock and 7,000 restricted shares of Class B Stock granted during the second quarter of fiscal year 2019. No restricted stock was granted during the second quarter of fiscal year 2018. Stock-based compensation expense related to non-vested restricted stock was $229,000 and $426,000 for the second quarter of fiscal years 2019 and 2018, respectively. Stock-based compensation expense related to non-vested restricted stock was $889,000 and $928,000 for the first six months of fiscal years 2019 and 2018, respectively.

A summary of restricted stock transactions is shown below:

	Restricted Shares (in thousands)	Weighted Average Grant Date Fair Value
Non-vested restricted stock outstanding at July 31, 2018	178	$ 32.74
Granted	273	$ 33.00
Vested	(60)	$ 31.82
Forfeitures	(22)	$ 30.21
Non-vested restricted stock outstanding at January 31, 2019	369	$ 33.23

9. ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

The following table summarizes the changes in accumulated other comprehensive (loss) income by component as of January 31, 2019 (in thousands):

	Pension and Postretirement Health Benefits	Cumulative Translation Adjustment	Total Accumulated Other Comprehensive (Loss) Income
Balance as of July 31, 2018	$ (10,384)	$ (231)	$ (10,615)
Other comprehensive loss before reclassifications, net of tax	—	(36)	(36)
Amounts reclassified from accumulated other comprehensive income, net of tax	291 (a)	—	291
Net current-period other comprehensive income (loss), net of tax	291	(36)	255
Balance as of January 31, 2019	$ (10,093)	$ (267)	$ (10,360)

(a) Amount is net of tax expense of $93,000. Amount is included in the components of net periodic benefit cost for the pension and postretirement health plans. See Note 6 of the Notes to unaudited Condensed Consolidated Financial Statements for further information.

10. RELATED PARTY TRANSACTIONS

One member of our Board of Directors is the President and Chief Executive Officer of a customer of ours. That customer was a customer of ours before the board member joined that customer and before he became a member of our Board of Directors. Total net sales to that customer, including sales to subsidiaries of that customer, were $105,000 and $77,000 for the second quarters of fiscal years 2019 and 2018, respectively, and were $202,000 and $163,000 for the first six months of fiscal years 2019 and 2018, respectively. Outstanding accounts receivable from that customer, and its subsidiaries, were $45,000 and $14,000 as of January 31, 2019 and July 31, 2018, respectively.

One member of our Board of Directors, and of the Compensation Committee of our Board of Directors, is the President and Chief Executive Officer as well as a director and shareholder of a law firm that regularly provides services to us. Total payments to that vendor for fees and cost reimbursements were $51,000 and $53,000 for the second quarters of fiscal years 2019 and 2018, respectively, and were $97,000 and $116,000 for the first six months of fiscal years 2019 and 2018, respectively. There were no outstanding accounts payable to that vendor as of January 31, 2019 or July 31, 2018.

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

The following discussion and analysis of our financial condition and results of operations should be read together with the financial statements and the related notes included herein and our Consolidated Financial Statements, accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements. Factors that might cause a difference include, but are not limited to, those discussed under "Forward-Looking Statements" and Item 1A, Risk Factors, of our Annual Report on Form 10-K for the fiscal year ended July 31, 2018, which contained, among other risk factors, a description of the issues that may arise with the implementation of our new enterprise resource planning system which became operational on August 1, 2018.

OVERVIEW

We develop, mine, manufacture and market sorbent products principally produced from clay minerals and, to a lesser extent, other clay-like sorbent materials. Our principal products include agricultural and horticultural chemical carriers, animal health and nutrition products, bleaching clay and fluid purification aids, cat litter, industrial and automotive floor absorbents and sports field products. Our products are sold to two primary customer groups, including customers who resell our products as originally produced to the end consumer and those who use our products as part of their production process or use them as an ingredient in their final finished product. We have two reportable operating segments based on the different characteristics of our two primary customer groups: Retail and Wholesale Products Group and Business to Business Products Group, as described in Note 7 of the Notes to unaudited Condensed Consolidated Financial Statements.

RESULTS OF OPERATIONS

SIX MONTHS ENDED JANUARY 31, 2019 COMPARED TO
SIX MONTHS ENDED JANUARY 31, 2018

CONSOLIDATED RESULTS

Consolidated net sales for the six months ended January 31, 2019 were $136,023,000, compared to net sales of $135,540,000 for the six months ended January 31, 2018. Net sales were up for our Retail and Wholesale Products Group and were down for our Business to Business Products Group. Both groups reported lower operating income, as discussed further below.

Consolidated gross profit for the first six months of fiscal year 2019 was $31,414,000, or 23.1% of net sales, compared to $38,632,000, or 28.5% of net sales, for the first six months of fiscal year 2018. Gross profit was negatively impacted by higher freight, packaging and manufacturing costs, including higher natural gas costs. Freight costs per ton were up over 20%, an increase of about $4,000,000 compared to the first six months of fiscal year 2018. A shortage of drivers combined with the impact of government regulations in the trucking industry (new regulations went into effect during the second quarter of our fiscal year 2018) resulted in less truck availability and higher freight rates. The truck shortage has shifted transportation demand to railroads, which are also facing capacity constraints. Furthermore, we incurred additional freight costs for an increased number of product transfers between our plants and warehouses to support customer service during the implementation of our new enterprise resource planning ("ERP") system on August 1, 2018, and during disruptions due to Hurricane Michael in the first quarter of fiscal year 2019. Packaging costs per ton were approximately 12% higher, an increase of about $1,700,000 compared to the first six months of the prior fiscal year. Significant amounts of our packaging purchases are subject to contractual price adjustments throughout the year based on underlying commodity prices. Higher costs for both our resin and paper-based packaging reflected changes in their respective commodity prices. Non-fuel manufacturing costs per ton produced were up approximately 7% compared to the same period in the prior fiscal year. An increase in tons produced contributed to higher costs for labor, warehouse rental, product transfers and waste disposal. Repairs expense also increased for mining equipment and preventative maintenance. In addition, during the first quarter of fiscal 2019 some processing interruptions occurred at our plants due to the ERP system implementation and one plant lost electricity for three days after Hurricane Michael. Finally, the cost of natural gas used to operate kilns that dry our clay was approximately 11% higher per manufactured ton in the first six months of fiscal year 2019 compared to the first six months of fiscal year 2018.

Total SG&A expenses were 6% lower for the first six months of fiscal year 2019 compared to the first six months of fiscal year 2018. The discussion of the segments' operating incomes below describes the changes in SG&A expenses that were allocated to the operating segments. The remaining unallocated corporate expenses included a lower estimated annual incentive bonus accrual and lower actuarially determined costs for our pension and postretirement health plans. The incentive bonus accruals were based on performance targets established for each fiscal year. Pension and postretirement health plan costs are discussed further in Note 6 of the Notes to unaudited Condensed Consolidated Financial Statements. These lower costs were partially offset by additional expenses of approximately $1,200,000 related to the new ERP system implementation.

Tax expense for the first six months of fiscal year 2019 was $456,000, compared to $6,956,000 for the first six months of fiscal year 2018. Tax expense for the first six months of fiscal year 2018 included a one-time adjustment of $5,091,000 for the impact on deferred income tax assets under the Tax Cuts and Jobs Act (the "2017 Tax Act"), which was enacted in December 2017. Excluding this adjustment, the effective tax rate for the first six months of fiscal year 2018 would have been 21%. The 2017 Tax Act also lowered the U.S. federal corporate tax rate, as reflected in our effective tax rate of 12% for the first six months of fiscal year 2019. We used an estimated annual effective tax rate in determining our quarterly provision for income taxes, which is based on expected annual taxable income and the assessment of various tax deductions, including depletion.

Consolidated net income for the first six months of fiscal year 2019 was $3,193,000, a 63% increase from net income of $1,954,000 for the first six months of fiscal year 2018. Net income for the first six months of fiscal year 2019 was significantly impacted by higher freight, packaging and non-fuel manufacturing costs, which more than offset the lower SG&A expenses. Net income for the first six months of fiscal year 2018 included the one-time $5,091,000 tax expense adjustment for the impact of the 2017 Tax Act discussed above.

Diluted net income per share was $0.42 for the first six months of fiscal year 2019, compared to $0.26 for the first six months of fiscal year 2018. The tax expense adjustment discussed above effectively reduced diluted net income per share by $0.69 for the first six months of fiscal year 2018.

BUSINESS TO BUSINESS PRODUCTS GROUP

Net sales of the Business to Business Products Group for the first six months of fiscal year 2019 were $51,784,000, a decrease of $2,658,000, or 5%, from net sales of $54,442,000 for the first six months of fiscal year 2018. Net sales of fluids purification products were down approximately 4% compared to the first six months of the prior year. Price competition due to the strength of the U.S. Dollar resulted in a loss of international sales to local suppliers, particularly in Brazil. New competitors in other foreign markets also negatively impacted sales. This decline was partially offset by higher domestic sales of fluids purification products due to increased customer requirements as a result of the characteristics of recent crops that are processed to create edible oils. Net sales of our animal health and nutrition products decreased approximately 8% compared to the first six months of the prior year. A swine virus outbreak in China in August of 2018 impacted the pork market and weakened sales of our products in Asia, including for our subsidiary in China discussed in “Foreign Operations” below. In contrast, sales of animal health products improved in Latin America to new and existing distributors. Net sales of our co-packaged coarse cat litter were down approximately 8% compared to the first six months of the prior year. Net sales of agricultural and horticultural chemical carrier products decreased approximately 2%. Reduced sales of our traditional carrier granules were partially offset by increased sales of our engineered granules.

SG&A expenses for the Business to Business Products Group were approximately 2% lower for the first six months of fiscal year 2019 compared to the same period of the prior year, including lower net compensation-related costs that resulted from employee turnover.

The Business to Business Products Group’s operating income for the first six months of fiscal year 2019 was $14,304,000, a decrease of $4,331,000, or 23%, from operating income of $18,635,000 for the first six months of fiscal year 2018. The operating income decline was driven by the lower sales, discussed above, combined with higher freight, packaging and non-fuel manufacturing costs. See “Consolidated Results” above for further discussion of these costs.

RETAIL AND WHOLESALE PRODUCTS GROUP

Net sales of the Retail and Wholesale Products Group for the first six months of fiscal year 2019 of $84,239,000, an increase of $3,141,000, or 4%, from net sales of $81,098,000 for the first six months of fiscal year 2018. Total cat litter net sales were 5% higher compared to the first six months of the prior year, driven by increased sales of private label lightweight and traditional scoopable litters. Sales of private label scoopable litters increased to existing customers and sales of private label coarse litter to our largest customer were higher compared to the first six months of the prior year. Our branded scoopable and coarse litter sales were essentially even with the same period in the prior year.

Net sales of industrial and automotive absorbent products decreased approximately 2% compared to the first six months of fiscal year 2018. Six month sales for our subsidiary in the United Kingdom were slightly higher, while sales for our subsidiary in Canada were slightly lower than the prior year. See “Foreign Operations” below for further discussion about the sales and types of products sold by our foreign subsidiaries.

SG&A expenses for the Retail and Wholesale Products Group were 5% lower compared to the first six months of fiscal year 2018. The decrease was driven by about $1,000,000 lower advertising expense. We have refocused much of our advertising to digital promotions and we expect advertising expense for the full year of fiscal 2019 to be lower than in fiscal 2018. Partially offsetting the lower advertising costs were approximately $700,000 increased customer compliance fees for shipping and data communication problems during the implementation of the ERP system.

The Retail and Wholesale Products Group's operating income for the first six months of fiscal year 2019 was $2,662,000, a decrease of $2,125,000, or 44%, from operating income of $4,787,000 for the first six months of fiscal year 2018. Higher freight, packaging and non-fuel manufacturing costs more than offset the benefits of increased sales and lower SG&A expenses. See “Consolidated Results” above for further discussion of freight, packaging and manufacturing costs.

FOREIGN OPERATIONS

Foreign operations included our subsidiaries in Canada and the United Kingdom, which are reported in the Retail and Wholesale Products Group, and our subsidiaries in China and Mexico, which are reported in the Business to Business Products Group. Net sales by our foreign subsidiaries during the first six months of fiscal year 2019 were $6,482,000, a 7% increase compared to net sales of $6,047,000 during the first six months of fiscal year 2018. Our subsidiary in Mexico was acquired in the fourth quarter of fiscal year 2018 and provided incremental sales in the first six months of fiscal year 2019. Net sales were up slightly for fluids purification products sold by our United Kingdom subsidiary and for cat litter sold by our Canada subsidiary. Weaker exchange rates for the British Pound and Canadian Dollar moderated the positive impact of these sales increases when translated to the reported U.S. Dollar results. In addition, the outbreak of swine fever in Asia contributed to decline in sales of animal health and nutrition products by our subsidiary in China. Net sales by our foreign subsidiaries represented 5% and 4% of our consolidated net sales during the first six months of fiscal years 2019 and 2018, respectively.

Our foreign subsidiaries reported net income of $315,000 for the first six months of fiscal 2019, compared to net income of $635,000 for the first six months of fiscal 2018. The lower reported net income was due primarily to negative changes in foreign currency exchange rates and a reported loss by our subsidiary in Mexico.

Identifiable assets of our foreign subsidiaries as of January 31, 2019 were $9,643,000, compared to $8,343,000 as of January 31, 2018. The increase was attributed to the addition of our subsidiary in Mexico.

THREE MONTHS ENDED JANUARY 31, 2019 COMPARED TO
THREE MONTHS ENDED JANUARY 31, 2018

CONSOLIDATED RESULTS

Consolidated net sales for the three months ended January 31, 2019 were $69,880,000, compared to $68,894,000 for the three months ended January 31, 2018. Net sales were up for the Retail and Wholesale Products Group and were down for the Business to Business Products Group.

Consolidated gross profit for the three months ended January 31, 2019 was $15,404,000, or 22.0% of net sales, compared to $19,657,000, or 28.5% of net sales, for the second quarter of fiscal year 2018. Gross profit was negatively impacted by higher manufacturing costs, including natural gas, as well as freight and packaging costs. Non-fuel manufacturing costs per ton produced were up approximately 9% compared to the second quarter in the prior fiscal year. An increase in tons produced contributed to higher costs for labor, warehouse rental, product transfers and waste disposal. Repairs expense also increased for mining equipment and preventative maintenance. The cost of natural gas used to operate kilns that dry our clay was approximately 25% higher per manufactured ton. Freight costs per ton were up approximately 20%, an increase of almost $2,000,000 over the same quarter of the prior fiscal year. A shortage of drivers combined with the impact of government regulations in the trucking industry (new regulations went into effect during the second quarter of our fiscal year 2018) resulted in less truck availability and higher freight rates. The truck shortage has shifted transportation demand to railroads, which are also facing capacity constraints. Packaging costs per ton were approximately 11% higher, an increase of about $900,000 compared to the second quarter of the prior fiscal year. Significant amounts of our packaging purchases are subject to contractual price adjustments throughout the year based on underlying commodity prices. Higher costs for both our resin and paper-based packaging reflected changes in their respective commodity prices.

Total SG&A expenses were approximately 13% lower for the second quarter of fiscal year 2019 compared to the second quarter of fiscal year 2018. The discussion below describes the SG&A expenses allocated to the operating segments. The remaining unallocated corporate expenses included a lower estimated annual incentive bonus accrual and lower actuarially determined costs for our pension and postretirement health plans. The incentive bonus accruals were based on performance targets established for each fiscal year. Pension and postretirement health plan costs are discussed further in Note 6 of the Notes to unaudited Condensed Consolidated Financial Statements. These lower costs were partially offset by additional expenses of approximately $250,000 related to the new ERP system implementation, as well as costs associated with executive personnel changes.

Tax expense was $506,000 for the second quarter of fiscal year 2019, compared to tax expense of $6,167,000 for the second quarter of fiscal year 2018. Tax expense for the second quarter of fiscal year 2018 included a one-time adjustment of $5,091,000 for the impact on deferred income tax assets under the 2017 Tax Act, which was enacted in December 2017. Excluding this adjustment, the effective tax rate for the second quarter of fiscal year 2018 would have been 21%. The 2017 Tax Act also lowered the U.S. federal corporate tax rate, as reflected in our effective tax rate of 18% for the second quarter of fiscal year 2019. We used an estimated annual effective tax rate in determining our quarterly provision for income taxes, which is based on expected annual taxable income and the assessment of various tax deductions, including depletion.

Consolidated net income of $2,287,000 was reported for the second quarter of fiscal year 2019, compared to net income of $1,096,000 for the second quarter of fiscal year 2018. Net income for the second quarter of fiscal year 2019 was significantly impacted by higher non-fuel manufacturing, freight and packaging costs, which more than offset the lower SG&A expenses. Net income for the second quarter of fiscal year 2018 included the one-time $5,091,000 tax expense adjustment for the impact of the 2017 Tax Act discussed above.

Diluted net earnings per share of $0.30 was reported for the second quarter of fiscal year 2019, compared to diluted net income per share of $0.15 for the second quarter of fiscal year 2018. The tax expense adjustment discussed above effectively reduced diluted net income per share by $0.69 for the second quarter of fiscal year 2018.

BUSINESS TO BUSINESS PRODUCTS GROUP

Net sales of the Business to Business Products Group for the second quarter of fiscal year 2019 were $26,458,000, a decrease of $897,000, or 3%, from net sales of $27,355,000 for the second quarter of fiscal year 2018. Net sales of fluids purification products were down approximately 3%. Price competition due to the strength of the U.S. Dollar resulted in a loss of international sales to local suppliers, particularly in Brazil. New competitors in other foreign markets also negatively impacted sales. This decline was partially offset by higher domestic sales of fluids purification products due to increased customer requirements as a result of the characteristics of recent crops that are processed to create edible oils. Net sales of our animal health and nutrition products were approximately 6% lower than the second quarter of the prior year. A swine virus outbreak in China in August of 2018 impacted the pork market and weakened sales of our products in Asia, including for our subsidiary in China discussed in “Foreign Operations” below. In contrast, sales of animal health products in Latin America to new and existing distributors improved. Net sales of agricultural and horticultural products were down approximately 4%. Reduced sales of our traditional carrier granules were partially offset by increased sales of our engineered granules. Net sales of our co-packaged coarse cat litter for the second quarter were essentially even with the second quarter of the prior year.

SG&A expenses for the Business to Business Products Group were approximately 10% lower compared to the second quarter of fiscal year 2018, including lower net compensation-related costs that resulted from employee turnover.

The Business to Business Products Group's operating income for the second quarter of fiscal year 2019 was $7,272,000, a decrease of $2,487,000, or 25%, from operating income of $9,759,000 in the second quarter of fiscal year 2018. Lower sales combined with increased non-fuel manufacturing, freight and packaging costs more than offset the lower SG&A expenses. See "Consolidated Results" above for further discussion of manufacturing, freight and packaging costs.

RETAIL AND WHOLESALE PRODUCTS GROUP

Net sales of the Retail and Wholesale Products Group for the second quarter of fiscal year 2019 were $43,422,000, an increase of $1,883,000, or 5%, from net sales of $41,539,000 for the second quarter of fiscal year 2018. Total cat litter net sales were 5% higher compared to the second quarter of fiscal year 2018, driven by increased sales of private label lightweight and traditional scoopable litters. Sales of private label scoopable litters increased to existing customers and sales of private label coarse litter to our largest customer were higher compared to the second quarter of the prior year. Both our branded scoopable and coarse litter sales increased slightly compared to the same period in the prior year. Net sales of industrial and automotive absorbent products were down slightly compared to the second quarter of fiscal year 2018.

SG&A expenses for the Retail and Wholesale Products Group were approximately 33% lower compared to the second quarter of fiscal year 2018. The decrease was driven by about $1,500,000 lower advertising expense. We have refocused much of our advertising to digital promotions and we expect advertising expense for the full year of fiscal 2019 to be lower than in fiscal 2018. Partially offsetting the lower advertising costs were approximately $200,000 increased customer compliance fees for shipping and data communication problems during the implementation of the ERP system.

For the second quarter of fiscal year 2019, the Retail and Wholesale Products Group reported operating income of $2,653,000, an increase of $231,000, compared to operating income of $2,422,000 for the second quarter of fiscal year 2018. The increased sales and lower SG&A expenses, as discussed above, more than offset higher non-fuel manufacturing, freight and packaging costs. See “Consolidated Results” above for further discussion of freight, packaging and manufacturing costs.

FOREIGN OPERATIONS

Foreign operations included our subsidiaries in Canada and the United Kingdom, which are reported in the Retail and Wholesale Products Group, and our subsidiaries in China and Mexico, which are reported in the Business to Business Products Group. Net sales by our foreign subsidiaries during the second quarter of fiscal year 2019 were $3,039,000, a 2% decrease compared to net sales of $3,110,000 in the second quarter of fiscal year 2018. The outbreak of swine fever in Asia drove a decline in sales of animal health and nutrition products by our subsidiary in China. Partially offsetting this decline was incremental sales by our subsidiary in Mexico, which was acquired in the fourth quarter of fiscal year 2018. Net sales were up slightly for fluids purification products sold by our United Kingdom subsidiary and for cat litter sold by our Canada subsidiary. Weaker exchange rates for the British Pound and Canadian Dollar moderated the positive impact of these sales increases when translated to the reported U.S. Dollar results. Our foreign subsidiaries' net sales represented approximately 4% and 5% of consolidated net sales during the second quarters of fiscal years 2019 and 2018, respectively.

Our foreign subsidiaries reported net income attributable to Oil-Dri of $79,000 for the second quarter of fiscal year 2019, compared to net income of $436,000 for the second quarter of fiscal year 2018. The lower reported net income was due primarily to the lower sales discussed above, a reported loss by our subsidiary in Mexico and negative changes in foreign currency exchange rates.

LIQUIDITY AND CAPITAL RESOURCES

Our principal capital requirements include: funding working capital needs; purchasing and upgrading equipment, facilities, information systems and real estate; supporting new product development; investing in infrastructure; repurchasing stock; paying dividends; making pension contributions; and business acquisitions. During the first six months of fiscal year 2019, we principally used cash generated from operations to fund these requirements.

The following table sets forth certain elements of our unaudited Condensed Consolidated Statements of Cash Flows (in thousands):

	For the Six Months Ended January 31,	
	2019	2018
Net cash provided by operating activities	$2,692	$11,629
Net cash provided by (used in) investing activities	455	(5,100)
Net cash used in financing activities	(6,505)	(6,222)
Effect of exchange rate changes on cash and cash equivalents	(24)	(21)

Net decrease (increase) in cash and cash equivalents	$(3,382)	$286

Net cash provided by operating activities

In addition to net income, as adjusted for depreciation and amortization and other non-cash operating activities, the primary sources and uses of operating cash flows for the first six months of fiscal years 2019 and 2018 were as follows:

Accounts receivable, less allowance for doubtful accounts, increased $4,697,000 in the first six months of fiscal year 2019 compared to a decrease of $517,000 in the first six months of fiscal year 2018. The number of days sales outstanding in accounts receivable in fiscal 2019 have remained higher than in the prior fiscal year as we continue to address customer invoicing delays and other issues related to the new ERP system. The variation in accounts receivable balances also reflected differences in the level and timing of collection and sales, particularly higher sales in January 2019, as well as the payment terms provided to various customers.

Inventory increased $5,607,000 in the first six months of fiscal year 2019 compared to a decrease of $75,000 in the first six months of fiscal year 2018. Finished goods, packaging and other raw materials inventories were higher due to anticipated sales requirements in fiscal year 2019. Higher costs also increased the inventory value as of January 31, 2019.

Prepaid expenses decreased $970,000 in the first six months of fiscal year 2019 compared to an increase of $51,000 in the first six months of fiscal year 2018. Prepaid income taxes decreased in the first six months of fiscal year 2019 primarily due to the lower federal income tax rate under the 2017 Tax Act. Conversely, prepaid insurance premiums and computer software licenses increased in the first six months of both fiscal years 2018 and 2019.

Accounts payable increased $2,295,000 in the first six months of fiscal year 2019 compared to a decrease of $743,000 in the first six months of fiscal year 2018. Higher costs for freight, packaging and other operating expenses contributed to the increase in accounts payable at the end of the second quarter of fiscal year 2019. Trade and freight payables varied in both periods due to the timing of payments, fluctuations in the cost of goods and services we purchased, production volume levels and vendor payment terms.

Accrued expenses decreased $1,390,000 in the first six months of fiscal year 2019 compared to a decrease of $3,637,000 in the first six months of fiscal year 2018. The payout of the prior fiscal year's discretionary incentive bonus reduced accrued salaries in both fiscal years. In addition, the bonus accrual at the end of the second quarter of fiscal year 2019 was significantly less than as of the same period in the prior fiscal year. Accrued plant expenses also fluctuated due to timing of payments, changes in the cost of goods and services we purchased, production volume levels and vendor payment terms.

Net cash provided by (used in) investing activities

Cash provided by investing activities was $455,000 in the first six months of fiscal year 2019 compared to cash used in investing activities of $5,100,000 in the first six months of fiscal year 2018. Purchases and dispositions of investment securities in both periods were impacted by variations in the timing of investment maturities, the operating cash needs of the Company and the availability of investment options. Cash used for capital expenditures was $6,199,000 and $6,850,000 in the first six months of fiscal years 2019 and 2018, respectively.

Net cash used in financing activities

Cash used in financing activities of $6,505,000 in the first six months of fiscal year 2019 was higher than cash used in financing activities of $6,222,000 in the first six months of fiscal year 2018 due primarily to a higher dividend rate.

Other

Total cash and investment balances held by our foreign subsidiaries of $2,123,000 as of January 31, 2019 were slightly higher than the January 31, 2018 balances of $2,000,000. See further discussion in “Foreign Operations” above.

On January 31, 2019, we signed a fifth amendment to our credit agreement with BMO Harris Bank N.A. ("BMO Harris"), which was scheduled to expire on December 4, 2019. The new agreement will expire on January 31, 2024 and provides for a $45,000,000 unsecured revolving credit agreement, including a maximum of $10,000,000 for letters of credit. The remaining terms are substantially unchanged from our previous agreement with BMO Harris, including the provision that we may select a variable interest rate based on either the BMO Harris prime rate or a LIBOR-based rate, plus a margin that varies depending on our debt to earnings ratio, or a fixed rate as agreed between us and BMO Harris. As of January 31, 2019, the variable rates would have been 3.99% for the BMO Harris prime-based rate or 5.75% for the LIBOR-based rate. The credit agreement contains restrictive covenants that, among other things and under various conditions, limit our ability to incur additional indebtedness or to dispose of assets. The agreement also requires us to maintain a minimum fixed coverage ratio and a minimum consolidated net worth. As of January 31, 2019 and 2018 we were in compliance with the covenants. There were no borrowings during the first six months of either fiscal years 2019 or 2018.

As of January 31, 2019, we had remaining authority to repurchase 296,277 shares of Common Stock under a repurchase plan approved by our Board of Directors (the “Board”). In addition, on March 21, 2018, the Board authorized the repurchase of 300,000 shares of Class B Stock; however, there have been no repurchases of Class B Stock. Repurchases may be made on the open market (pursuant to Rule 10b5-1 plans or otherwise) or in negotiated transactions. The timing and number of shares repurchased will be determined by our management.

We believe that cash flow from operations, availability under our revolving credit facility, current cash and investment balances and our ability to obtain other financing, if necessary, will provide adequate cash funds for foreseeable working capital needs, capital expenditures at existing facilities, deferred compensation payouts, dividend payments and debt service obligations for at least the next 12 months. We plan to continue promoting our lightweight cat litter products; however, we expect advertising expense in fiscal year 2019 to be lower than in fiscal year 2018. We do not believe that these increased cash outflows will dramatically impact our cash position; however our cash requirements are subject to change as business conditions warrant and opportunities arise.

We continually evaluate our liquidity position and anticipated cash needs, as well as the financing options available to obtain additional cash reserves. Our ability to fund operations, to make planned capital expenditures, to make scheduled debt payments and to remain in compliance with all financial covenants under debt agreements, including, but not limited to, the current credit agreement, depends on our future operating performance, which, in turn, is subject to prevailing economic conditions and to financial, business and other factors. The timing and size of any new business ventures or acquisitions that we complete may also impact our cash requirements.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This discussion and analysis of financial condition and results of operations is based on our unaudited Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP for interim financial information and in compliance with instructions to Form 10-Q and Article 10 of Regulation S-X. The preparation of these financial statements requires the use of estimates and assumptions related to the reporting of assets, liabilities, revenues, expenses and related disclosures. In preparing these financial statements, we have made our best estimates and judgments of certain amounts included in the financial statements. Estimates and assumptions are revised periodically. Actual results could differ from these estimates. See the information concerning our critical accounting policies included under “Management’s Discussion of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended July 31, 2018.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”)) as of the end of the period covered by this Quarterly Report on Form 10-Q. The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”). Based upon the controls evaluation, our CEO and CFO have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC, and that such information is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

The Company is engaged in a multi-year implementation of a new ERP system designed to upgrade our technology and improve our financial and operational information. While the Company believes that this new system and related changes to internal controls will ultimately strengthen its internal control over financial reporting, there are inherent risks in implementing a new ERP system. The Company has appropriately considered these changes in its design of and testing for effectiveness of internal controls over financial reporting and concluded, as part of the evaluation described in the above paragraph, that the implementation of the new ERP in these circumstances has not materially changed the effectiveness of its internal control over financial reporting.

There were no changes, other than those described herein, in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the fiscal quarter ended January 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the CEO and CFO, do not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II – OTHER INFORMATION

Items 1A, 2, 3 and 5 of this Part II are either inapplicable or are answered in the negative and are omitted pursuant to the instructions to Part II.

ITEM 1. LEGAL PROCEEDINGS

We are party to various legal actions from time to time that are ordinary in nature and incidental to the operation of our business. While it is not possible at this time to determine with certainty the ultimate outcome of these lawsuits, we believe that none of the pending proceedings will have a material adverse effect on our business, financial condition, results of operations or cash flows; however, some proceedings, particularly the matters described below, could have a more significant impact than others.

On February 3, 2015, we brought suit in the United States District Court for the Northern District of Illinois, Eastern Division, against Nestlé Purina PetCare Company ("Nestlé") seeking monetary damages and injunctive relief based on Nestlé's alleged infringement of a patent held by us. The case was stayed for approximately two years, pending the Inter Partes Review ("IPR") discussed immediately below; the stay was lifted in March 2017, and fact discovery and expert discovery are now complete in the case. The Court provided the parties with a claim construction decision on September 5, 2018, and has set a March 18, 2019 trial date.

On February 14, 2015, Nestlé filed a petition for the IPR with the Patent Trial and Appeal Board ("PTAB") of the United States Patent and Trademark Office to challenge certain of the claims in our patent. The PTAB agreed to consider Nestlé's petition, but on June 20, 2016, issued an order stating that Nestlé had not shown by a preponderance of the evidence that any of the challenged claims in our patent are unpatentable. In July 2016, Nestlé filed a motion for reconsideration of the PTAB's decision, which was denied in February 2017. Nestlé timely filed an appeal of the PTAB's decision to the U.S. Court of Appeals for the Federal Circuit. In November 2017, Nestlé filed a motion in that Court to remand the case to the PTAB for consideration of additional evidence that it claims should have been provided to the PTAB. On June 11, 2018, the Federal Circuit remanded the case back to the Board based on the agreement of the parties to consider an expanded record, as well as for the Board to consider the previously non-instituted grounds set forth in Nestle's IPR Petition. Briefing concerning these issues has been completed, and the parties are awaiting a final decision in the IPR from the Board.

Due to the nature and current legal standing of the litigation with Nestlé, we cannot estimate the possible damages, if any, and the total expense associated with the lawsuits. Although no assurances can be given as to the results of the lawsuits, based on the present status, management does not believe that such results will have a material adverse effect on our financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Our mining operations are subject to regulation by the Mine Safety and Health Administration under authority of the Federal Mine Safety and Health Act of 1977, as amended. Information concerning mine safety violations or other regulatory matters required by section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K is included in Exhibit 95 to this Quarterly Report on Form 10-Q.

ITEM 6. EXHIBITS

Exhibit No.	Description	SEC Document Reference
10.1	Letter Agreement, dated as of December 10, 2018, between Oil-Dri Corporation of America and Daniel Smith*	Filed herewith.
10.2	Letter Agreement, dated as of December 18, 2018, between Oil-Dri Corporation of America and Mark Lewry.*	Filed herewith.
10.3	Fifth Amendment, dated as of January 31, 2019 to the Credit Agreement by and among Oil-Dri Corporation of America, the Guarantors, and BMO Harris Bank N.A. dated as of January 27, 2006	Incorporated by reference to Exhibit 10.1 to Oil-Dri's (file No. 001-12622) Current Report on Form 8-K filed on January 31, 2019.
10.4	Annex A to the Fifth Amendment to Credit Agreement: Credit Agreement by and among Oil-Dri Corporation of America, the Guarantors, and BMO Harris Bank N.A.	Incorporated by reference to Exhibit 10.2 to Oil-Dri's (file No. 001-12622) Current Report on Form 8-K filed on January 31, 2019.
11	Statement re: Computation of Earnings per Share.	Filed herewith.
31	Certifications pursuant to Rule 13a–14(a).	Filed herewith.
32	Certifications pursuant to Section 1350 of the Sarbanes-Oxley Act of 2002.	Furnished herewith.
95	Mine Safety Disclosures	Filed herewith.
101.INS	XBRL Taxonomy Instance Document	Filed herewith.
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith.
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document	Filed herewith.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase	Filed herewith.

* Management contract or compensatory plan or arrangement.

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.

OIL-DRI CORPORATION OF AMERICA
(Registrant)

BY /s/ Daniel S. Jaffee
Daniel S. Jaffee
Chairman, President and Chief Executive Officer

BY /s/ Susan M. Kreh
Susan M. Kreh
Chief Financial Officer

Dated: March 11, 2019

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95	Mine Safety Disclosures
101.INS	XBRL Taxonomy Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

* Management contract or compensatory plan or arrangement.
[1] Incorporated by reference to Exhibit 10.1 to Oil-Dri's (file No. 001-12622) Current Report on Form 8-K filed on January 31, 2019.
[2] Incorporated by reference to Exhibit 10.2 to Oil-Dri's (file No. 001-12622) Current Report on Form 8-K filed on January 31, 2019.

Note: Stockholders may receive copies of the above listed exhibits, without fee, by written request to Investor Relations, Oil-Dri Corporation of America, 410 North Michigan Avenue, Suite 400, Chicago, Illinois 60611-4213, by telephone at (312) 321-1515 or by e-mail to info@oildri.com.