

Heritage-Crystal Clean, Inc.
Form 10-Q
July 28, 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 June 18, 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 001-33987

HERITAGE-CRYSTAL CLEAN, INC.
(Exact name of registrant as specified in its charter)

Delaware 26-0351454
State or other jurisdiction of (I.R.S. Employer
Incorporation Identification No.)

2175 Point Boulevard
Suite 375
Elgin, IL 60123
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (847) 836-5670

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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See 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 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

On July 25, 2016, there were outstanding 22,407,811 shares of Common Stock, \$0.01 par value, of Heritage-Crystal Clean, Inc.

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PART I

ITEM 1. FINANCIAL STATEMENTS

Heritage-Crystal Clean, Inc.
Condensed Consolidated Balance Sheets
(In Thousands, Except Share and Par Value Amounts)

| | June 18, 2016 (unaudited) | January 2, 2016 |
|---|---------------------------------|--------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 25,325 | \$ 23,608 |
| Accounts receivable - net | 43,487 | 41,592 |
| Inventory - net | 21,553 | 24,774 |
| Other current assets | 6,578 | 4,810 |
| Total Current Assets | 96,943 | 94,784 |
| Property, plant and equipment - net | 130,997 | 131,365 |
| Equipment at customers - net | 23,148 | 23,172 |
| Software and intangible assets - net | 21,539 | 22,202 |
| Goodwill | 31,511 | 30,325 |
| Total Assets | \$ 304,138 | \$ 301,848 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 25,116 | \$ 25,129 |
| Current maturities of long-term debt | 6,659 | 6,700 |
| Accrued salaries, wages, and benefits | 4,775 | 4,330 |
| Taxes payable | 7,223 | 6,735 |
| Other current liabilities | 5,310 | 3,617 |
| Total Current Liabilities | 49,083 | 46,511 |
| Long term debt, less current maturities | 61,426 | 62,778 |
| Deferred income taxes | 2,843 | 2,726 |
| Total Liabilities | \$ 113,352 | \$ 112,015 |
| STOCKHOLDERS' EQUITY: | | |
| Common stock - 26,000,000 shares authorized at \$0.01 par value, 22,259,042 and 22,213,364 shares issued and outstanding at June 18, 2016 and January 2, 2016, respectively | \$ 223 | \$ 222 |
| Additional paid-in capital | 183,525 | 182,558 |
| Retained earnings | 6,449 | 6,385 |
| Total Heritage-Crystal Clean, Inc. Stockholders' Equity | 190,197 | 189,165 |
| Noncontrolling interest | 589 | 668 |
| Total Equity | \$ 190,786 | \$ 189,833 |
| Total Liabilities and Stockholders' Equity | \$ 304,138 | \$ 301,848 |

See accompanying notes to financial statements.

Heritage-Crystal Clean, Inc.
Condensed Consolidated Statements of Income
(In Thousands, Except per Share Amounts)
(Unaudited)

| | Second Quarter Ended, | | First Half Ended, | |
|--|--------------------------|------------------|-------------------|------------------|
| | June 18, 2016 | June 20, 2015 | June 18, 2016 | June 20, 2015 |
| Revenues | | | | |
| Product revenues | \$24,695 | \$32,223 | \$48,399 | \$66,620 |
| Service revenues | 55,857 | 50,718 | 110,606 | 100,357 |
| Total revenues | \$80,552 | \$82,941 | \$159,005 | \$166,977 |
| Operating expenses | | | | |
| Operating costs | \$61,711 | \$64,363 | \$125,959 | \$134,077 |
| Selling, general, and administrative expenses | 11,521 | 10,615 | 23,729 | 21,681 |
| Depreciation and amortization | 4,118 | 4,298 | 8,246 | 8,631 |
| Other (income) - net | (142) | (154) | (201) | (253) |
| Operating income | 3,344 | 3,819 | 1,272 | 2,841 |
| Interest expense – net | 451 | 408 | 969 | 962 |
| Income before income taxes | 2,893 | 3,411 | 303 | 1,879 |
| Provision for income taxes | 1,062 | 1,413 | 197 | 781 |
| Net income | 1,831 | 1,998 | 106 | 1,098 |
| Income attributable to noncontrolling interest | — | 28 | 42 | 69 |
| Net income attributable to Heritage-Crystal Clean, Inc. common stockholders | \$1,831 | \$1,970 | \$64 | \$1,029 |
| Net income per share: basic | \$0.08 | \$0.09 | \$— | \$0.05 |
| Net income per share: diluted | \$0.08 | \$0.09 | \$— | \$0.05 |
| Number of weighted average shares outstanding: basic | 22,246 | 22,138 | 22,236 | 22,129 |
| Number of weighted average shares outstanding: diluted | 22,419 | 22,403 | 22,392 | 22,374 |

See accompanying notes to financial statements.

Heritage-Crystal Clean, Inc.
 Condensed Consolidated Statement of Stockholders' Equity
 (In Thousands, Except Share Amounts)
 (Unaudited)

| | Shares | Par Value Common | Additional Paid-in Capital | Retained Earnings | Total Heritage-Crystal Clean, Inc. Stockholders' Equity | Noncontrolling Interest | Total Equity |
|------------------------------------|------------|---------------------|----------------------------------|----------------------|---|----------------------------|-----------------|
| Balance at January 2, 2016 | 22,213,364 | \$ 222 | \$ 182,558 | \$ 6,385 | \$ 189,165 | \$ 668 | \$ 189,833 |
| Net income | — | — | — | 64 | 64 | 42 | 106 |
| Distribution | — | — | — | — | — | (121) | (121) |
| Issuance of common stock – ESPP | 23,040 | — | 222 | — | 222 | — | 222 |
| Share-based compensation | 22,638 | 1 | 745 | — | 746 | — | 746 |
| Balance at June 18, 2016 | 22,259,042 | \$ 223 | \$ 183,525 | \$ 6,449 | \$ 190,197 | \$ 589 | \$ 190,786 |

See accompanying notes to financial statements.

Heritage-Crystal Clean, Inc.
Condensed Consolidated Statements of Cash Flows
(In Thousands)
(Unaudited)

| | For the First Half Ended, | |
|---|------------------------------|------------------|
| | June 18, 2016 | June 20, 2015 |
| Cash flows from Operating Activities: | | |
| Net income | \$106 | \$1,098 |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 8,246 | 8,631 |
| Non-cash inventory impairment | 1,651 | 4,415 |
| Bad debt provision | 361 | 721 |
| Share-based compensation | 746 | 590 |
| Deferred taxes | 117 | 647 |
| Amortization of deferred gain on lease conversion | (189) | (176) |
| Other, net | 324 | 6 |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in accounts receivable | (1,895) | 1,483 |
| Decrease (increase) in inventory | 1,598 | (2,191) |
| (Increase) decrease in other current assets | (1,768) | 6,149 |
| Increase (decrease) increase in accounts payable | 2,620 | (8,237) |
| Increase (decrease) in accrued expenses | 2,474 | (3,720) |
| Cash provided by operating activities | \$14,391 | \$9,416 |
| Cash flows from Investing Activities: | | |
| Capital expenditures | \$(8,671) | \$(10,158) |
| Business acquisitions, net of cash acquired | (2,400) | — |
| Cash used in investing activities | \$(11,071) | \$(10,158) |
| Cash flows from Financing Activities: | | |
| Payments on term loan | \$(1,704) | \$(1,152) |
| Payments of notes payable | — | (158) |
| Payments of contingent consideration | — | (96) |
| Proceeds from the issuance of common stock | 222 | 222 |
| Distributions to noncontrolling interest | (121) | (240) |
| Cash used in financing activities | \$(1,603) | \$(1,424) |
| Net increase (decrease) in cash and cash equivalents | 1,717 | (2,166) |
| Cash and cash equivalents, beginning of period | 23,608 | 21,555 |
| Cash and cash equivalents, end of period | \$25,325 | \$19,389 |
| Supplemental disclosure of cash flow information: | | |
| Income taxes paid | \$242 | \$61 |
| Cash paid for interest, net of capitalized interest of \$ — and \$304, respectively | 956 | 724 |
| Supplemental disclosure of non-cash information: | | |
| Payables for construction in progress | \$284 | \$222 |
| See accompanying notes to financial statements. | | |

HERITAGE-CRYSTAL CLEAN, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

June 18, 2016

(1) ORGANIZATION AND NATURE OF OPERATIONS

Heritage-Crystal Clean, Inc., a Delaware corporation and its subsidiaries (collectively the “Company”), provides parts cleaning and hazardous and non-hazardous waste services primarily to small and mid-sized customers in both the manufacturing and vehicle maintenance sectors. The Company's service programs include parts cleaning, containerized waste management, used oil collection, vacuum truck services, waste antifreeze collection and recycling, and field services. The Company also owns and operates a used oil re-refinery through which it recycles used oil into high quality base oil for lubricants as well as other re-refinery byproducts. The Company also has multiple locations where it dehydrates used oil to be sold as recycled fuel oil. The Company's locations are in the United States and Ontario, Canada. The Company conducts its primary business operations through Heritage-Crystal Clean, LLC, its wholly owned subsidiary, and all intercompany balances have been eliminated in consolidation.

The Company's fiscal year ends on the Saturday closest to December 31. The most recent fiscal year ended on January 2, 2016. Each of the Company's first three fiscal quarters consists of twelve weeks while the last fiscal quarter consists of sixteen or seventeen weeks.

In the Company's Environmental Services segment, product revenues include sales of solvent, machines, antifreeze, and accessories; and service revenues include drum waste removal services, servicing of parts cleaning machines, vacuum truck services, field services, and other services. In the Company's Oil Business segment, product revenues include sales of re-refined base oil, byproducts, recycled fuel oil, and used oil; and service revenues include revenues from collecting used oil, collecting and recycling of oil filters and collecting and disposing of waste water. Due to the Company's integrated business model, it is impracticable to separately present costs of tangible products and costs of services.

2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company's significant accounting policies are described in Note 2, "Summary of Significant Accounting Policies," in the Company's Annual Report on Form 10-K for the fiscal year ended January 2, 2016. There have been no material changes in these policies or their application.

Recently Issued Accounting Pronouncements

Accounting standards not yet adopted

| Standard | Issuance Date | Description | Our Effective Date | Effect on the Financial Statements |
|--|------------------|--|----------------------|--|
| ASU 2016-09 Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting. (Topic 718) | March 2016 | This update addresses the simplification of accounting for employee share-based payment transactions as it pertains to income taxes, the classification of awards as equity or liabilities, accounting for forfeitures, statutory tax withholding requirements, and certain classifications on the statement of cash flows. Early adoption is permitted. This update was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Early application of the amendments in this update is permitted for all entities. | January 1, 2017 | The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations. |
| ASU 2016-02 Leases (Topic 842) | February 2016 | This update provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Early adoption is permitted. | January 4, 2019 | The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations. |
| ASU 2014-15 Presentation of Financial Statements - Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. (Subtopic 205-40) | August 2014 | This update provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. Early adoption is permitted. | December 31, 2016 | The adoption of ASU 2014-15 is not expected to have an impact on the Company's consolidated financial statements. |
| ASU 2014-09 Revenue from Contracts with Customers, and ASU 2015-14 Revenue from Contracts with Customers: Deferral of the Effective Date (Topic 606) | May 2014 | The underlying principle of this update is that an entity 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 in exchange for those goods or services. Entities have the option of using either a full retrospective or a modified approach to adopt the guidance. Early adoption is | December 31, 2017 | This update could impact the timing and amounts of revenue recognized. The Company is currently evaluating the effect that implementation of this update will have on its consolidated financial position and results of operations upon adoption. |

not permitted.

Recently issued accounting standards adopted

| Standard | Issuance Date | Description | Effective Date | Effect on the Financial Statements |
|---|---------------|---|-----------------|---|
| 2015-03 Interest—Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs, and 2015-15 Interest—Imputation of Interest (Subtopic 835-30) | April 2015 | These updates require debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt, and allows for the presentation of debt issuance costs as an asset regardless of whether or not there is an outstanding balance on the line-of-credit arrangement. | January 3, 2016 | The adoption of ASU 2015-03 resulted in the reclassification of \$1.4 million of unamortized debt issuance costs from "Other current assets" to "Term loan, less current maturities" as of January 2, 2016. |

(3) BUSINESS COMBINATIONS

On March 24, 2016, the Company purchased the assets of Phoenix Environmental Services, Inc. and Pipeline Video and Cleaning North Corporation (together "Phoenix Environmental"). The purchase price for the acquisition was \$2.7 million, including \$0.3 million placed into escrow and including contingent consideration of up to \$0.3 million based on subsequent business performance.

The Company is continuing to evaluate the purchase price allocations. Preliminary purchase price allocations are tentative and subject to revision as the Company finalizes appraisals and other analyses. Measurement period adjustments reflect new information obtained about facts and circumstances that existed as of the acquisition date. Final determination of the fair values may result in further adjustments to the values presented. The Company believes that the preliminary allocations provide a reasonable basis for estimating the fair values of assets acquired based on the information available. The Phoenix Environmental purchase price allocation is preliminary as the Company is still in the process of obtaining information to finalize the purchase price, net cash paid, and estimated fair values of the assets presented below. The Company expects to finalize the purchase price allocation no later than one year from the purchase date.

The following table summarizes the estimated fair values of the assets acquired related to the acquisition:

| (Thousands) | Phoenix Environmental Services |
|--------------------------------|--------------------------------|
| Accounts receivable | \$ 361 |
| Inventory | 27 |
| Property, plant, & equipment | 374 |
| Equipment at customers | 55 |
| Intangible assets | 710 |
| Goodwill ^(a) | 1,173 |
| Total purchase price | 2,700 |
| Less: contingent consideration | (300) |
| Net cash paid | \$ 2,400 |

^(a)Goodwill recognized from the acquisition of Phoenix Environmental represents the excess of the fair value of the net assets acquired over the purchase price, and is based upon the Company's expectations of synergies from combining the operations of Phoenix Environmental and the Company, and the value of intangible assets that are not separately recognized, such as the assembled workforce. All of the goodwill was assigned to the Environmental

Services reporting unit. All goodwill is expected to be deductible for income tax purposes.

Unaudited Pro Forma Financial Information

The pro forma financial information in the table below presents the combined results of the Company as if the Phoenix Environmental acquisition that occurred in fiscal 2016 had occurred January 3, 2015. The pro forma information is shown for illustrative purposes only and is not necessarily indicative of future results of operations of the Company or results of operations of the Company that would have actually occurred had the transactions been in effect for the period presented.

| | Second Quarter Ended, June 18, 2016 | Second Quarter Ended, June 20, 2015 |
|---------------------------------------|---|---|
| (In thousands, except per share data) | | |
| Total revenues | \$80,552 | \$83,670 |
| Net income | 1,831 | 2,023 |
| Income per share | | |
| Basic | \$0.08 | \$0.09 |
| Diluted | 0.08 | 0.09 |
| | First Half Ended, June 18, 2016 | First Half Ended, June 20, 2015 |
| (In thousands, except per share data) | | |
| Total revenues | \$159,709 | \$168,480 |
| Net income | 43 | 1,209 |
| Income per share | | |
| Basic | \$— | \$0.05 |
| Diluted | — | 0.05 |

(4) ACCOUNTS RECEIVABLE

Accounts receivable consisted of the following:

| (Thousands) | June 18, 2016 | January 2, 2016 |
|---------------------------------------|------------------|--------------------|
| Trade | \$41,164 | \$38,379 |
| Less: allowance for doubtful accounts | 2,227 | 2,207 |
| Trade - net | 38,937 | 36,172 |
| Related parties | 972 | 1,250 |
| Other | 3,578 | 4,170 |
| Total accounts receivable - net | \$43,487 | \$41,592 |

The following table provides the changes in the Company's allowance for doubtful accounts for the first half ended June 18, 2016 and the fiscal year ended January 2, 2016:

| (Thousands) | For the First Half Ended, June 18, 2016 | For the Fiscal Year Ended, January 2, 2016 |
|---|--|---|
| Balance at beginning of period | \$2,207 | \$3,927 |
| Balance acquired from FCC Environmental, including measurement period adjustments | — | 2,701 |
| Provision for bad debts | 361 | 1,009 |
| Accounts written off, net of recoveries | (341) | (5,430) |
| Balance at end of period | \$2,227 | \$2,207 |

(5) INVENTORY

The carrying value of inventory consisted of the following:

| (Thousands) | June 18, 2016 | January 2, 2016 |
|------------------------------------|------------------|--------------------|
| Used oil and processed oil | \$7,918 | \$ 9,045 |
| Solvents and solutions | 4,658 | 6,285 |
| Machines | 3,408 | 3,827 |
| Drums and supplies | 4,222 | 4,226 |
| Other | 1,678 | 1,681 |
| Total inventory | 21,884 | 25,064 |
| Less: machine refurbishing reserve | 331 | 290 |
| Total inventory - net | \$21,553 | \$ 24,774 |

Inventory consists primarily of used oil, processed oil, solvents and solutions, new and refurbished parts cleaning machines, drums and supplies, and other items. Inventories are valued at the lower of first-in, first-out (FIFO) cost or market, net of any reserves for excess, obsolete, or unsalable inventory. The Company continually monitors its inventory levels at each of its locations and evaluates inventories for excess or slow-moving items. If circumstances indicate the cost of inventories exceed their recoverable value, inventories are reduced to net realizable value. The Company wrote down the value of inventory by \$0.2 million in the second quarter of 2016, compared to a write down of \$1.8 million in the second quarter of 2015. Total inventory write-downs for the first half of fiscal 2016 and the first half of fiscal 2015 were \$1.7 million and \$4.4 million, respectively. Write-downs in the second quarter of 2016 pertain to solvents and solutions inventory. Write-downs in 2015 and the first quarter of 2016 pertain to used oil and processed oil inventory as well as solvents and solutions inventory.

(6) PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment consisted of the following:

| (Thousands) | June 18, 2016 | January 2, 2016 |
|---|------------------|--------------------|
| Machinery, vehicles, and equipment ^(a) | \$77,024 | \$75,129 |
| Buildings and storage tanks | 69,569 | 69,317 |
| Land | 9,308 | 9,295 |
| Leasehold improvements ^(a) | 4,585 | 4,523 |
| Construction in progress | 6,546 | 4,474 |
| Assets held for sale | 148 | 189 |
| Total property, plant and equipment | 167,180 | 162,927 |
| Less: accumulated depreciation | (36,183) | (31,562) |
| Property, plant and equipment - net | \$130,997 | \$131,365 |

| (Thousands) | June 18, 2016 | January 2, 2016 |
|---------------------------------------|------------------|--------------------|
| Equipment at customers ^(a) | \$61,233 | \$59,216 |
| Less: accumulated depreciation | (38,085) | (36,044) |
| Equipment at customers - net | \$23,148 | \$23,172 |

(a) Numbers include preliminary fair values of assets acquired in the acquisition described in Note 3 that may be adjusted as additional information becomes known.

Depreciation expense for the second quarters ended June 18, 2016 and June 20, 2015 was \$3.4 million and \$3.6 million, respectively. Depreciation expense for the first half ended June 18, 2016 and the first half ended June 20, 2015 was \$6.7 million and \$7.4 million, respectively.

(7) GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is measured as a residual amount as of the acquisition date, which in most cases results in measuring goodwill as an excess of the purchase consideration transferred plus the fair value of any noncontrolling interest in the acquiree over the fair value of the net assets acquired, including any contingent consideration. The Company tests goodwill for impairment annually in the fourth quarter and in interim periods if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The Company's determination of fair value requires certain assumptions and estimates, such as margin expectations, market conditions, growth expectations, expected changes in working capital, etc., regarding expected future profitability and expected future cash flows. The Company tests goodwill for impairment at each of its two reporting units, Environmental Services and Oil Business, and the Company does not aggregate reporting units for purposes of impairment testing.

The following table shows changes to our goodwill balances by segment from January 2, 2016, to June 18, 2016:

| (Thousands) | Oil Business | Environmental Services | Total |
|-----------------------------------|-----------------|---------------------------|-----------|
| Balance at January 2, 2016 | \$ — | \$ 30,325 | \$ 30,325 |
| Phoenix Environmental acquisition | — | 1,173 | 1,173 |
| Currency translation adjustments | — | 13 | 13 |
| Balance at June 18, 2016 | \$ — | \$ 31,511 | \$ 31,511 |

Following is a summary of software and other intangible assets:

| (Thousands) | June 18, 2016 | | | January 2, 2016 | | |
|--------------------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Customer & supplier relationships | \$ 22,933 | \$ 5,408 | \$ 17,525 | \$ 22,202 | \$ 4,369 | \$ 17,833 |
| Software | 4,573 | 3,500 | 1,073 | 4,455 | 3,382 | 1,073 |
| Non-compete agreements | 2,940 | 1,936 | 1,004 | 2,930 | 1,713 | 1,217 |
| Patents, formulae, and licenses | 1,769 | 541 | 1,228 | 1,769 | 510 | 1,259 |
| Other | 1,349 | 640 | 709 | 1,354 | 534 | 820 |
| Total software and intangible assets | \$ 33,564 | \$ 12,025 | \$ 21,539 | \$ 32,710 | \$ 10,508 | \$ 22,202 |

Amortization expense was \$0.7 million for the second quarter ended June 18, 2016 and \$0.7 million for second quarter ended June 20, 2015. Amortization expense was \$1.5 million for the first half ended June 18, 2016 and \$1.2 million for first half ended June 20, 2015. The weighted average useful lives of software; customer & supplier relationships; patents, formulae, and licenses; non-compete agreements, and other intangibles were 9 years, 11 years, 15 years, 5 years, and 6 years, respectively.

The expected amortization expense for the remainder of fiscal 2016 and for fiscal years 2017, 2018, 2019, and 2020 is \$1.8 million, \$3.2 million, \$2.9 million, \$2.6 million, and \$2.5 million, respectively. The preceding expected amortization expense is an estimate. Actual amounts of amortization expense may differ from estimated amounts due to additional intangible asset acquisitions, disposal of intangible assets, accelerated amortization of intangible assets,

and other events.

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(8) DEBT AND FINANCING ARRANGEMENTS

Bank Credit Facility

On October 16, 2014, the Company amended its Amended and Restated Credit Agreement ("Credit Agreement", or "Credit Facility"). The Credit Agreement, as amended, allows for up to \$140.0 million in borrowings. As of June 18, 2016 and January 2, 2016, the Company's total borrowings were \$69.2 million and \$70.9 million, respectively, under the term loan which has a maturity date of February 5, 2018. The remaining portion of the Credit Facility is a revolving loan which expires on February 5, 2018. There were no amounts outstanding under the revolver at June 18, 2016 and January 2, 2016. Unamortized debt issuance costs were \$1.1 million and \$1.4 million as of June 18, 2016 and January 2, 2016, respectively.

During the second quarter of fiscal 2016, the Company recorded interest of \$0.5 million on the term loan and capitalized less than \$0.1 million for various capital projects. During the first half of fiscal 2016, the Company recorded interest of \$1.0 million on the term loan, of which less than \$0.1 million was capitalized for various capital projects. During the second quarter of fiscal 2015, the Company recorded interest of \$0.4 million on the term loan and capitalized \$0.2 million for various capital projects. During the first half of fiscal 2015, the Company recorded interest of \$0.8 million on the term loan and capitalized \$0.3 million for various capital projects.

As of June 18, 2016 and January 2, 2016, the Company was in compliance with all covenants under the Credit Agreement. As of June 18, 2016 and January 2, 2016, the Company had \$3.0 million and \$4.4 million of standby letters of credit issued, respectively, and \$19.8 million and \$34.5 million was available for borrowing under the Credit Facility. The actual amount available under the revolving loan portion of the Credit Agreement is limited by the Company's total leverage ratio.

The Company's weighted average interest rate for all debt as of June 18, 2016 and June 20, 2015 was 3.2% and 3.2%, respectively.

(9) SEGMENT INFORMATION

The Company reports in two segments: "Environmental Services" and "Oil Business." The Environmental Services segment consists of the Company's parts cleaning, containerized waste management, vacuum truck service, antifreeze recycling activities, and field services. The Oil Business segment consists of the Company's used oil collection, used oil re-refining activities, and the dehydration of used oil to be sold as recycled fuel oil.

No single customer in either segment accounted for more than 10.0% of consolidated revenues in any of the periods presented. There were no intersegment revenues.

Operating segment results for the second quarters and first halves ended June 18, 2016, and June 20, 2015 were as follows:

Second Quarter Ended,
June 18, 2016

| (Thousands) | Environmental Services | Oil Business | Corporate and Eliminations | Consolidated |
|--|---------------------------|-----------------|----------------------------------|--------------|
| Revenues | | | | |
| Product revenues | \$ 5,106 | \$ 19,589 | \$ — | \$ 24,695 |
| Service revenues | 47,331 | 8,526 | — | 55,857 |
| Total revenues | \$ 52,437 | \$ 28,115 | \$ — | \$ 80,552 |
| Operating expenses | | | | |
| Operating costs | 35,631 | 26,080 | — | 61,711 |
| Operating depreciation and amortization | 1,710 | 1,591 | — | 3,301 |
| Profit before corporate selling, general, and administrative expenses | \$ 15,096 | \$ 444 | \$ — | \$ 15,540 |
| Selling, general, and administrative expenses | | | 11,521 | 11,521 |
| Depreciation and amortization from SG&A | | | 817 | 817 |
| Total selling, general, and administrative expenses | | | \$ 12,338 | \$ 12,338 |
| Other (income) - net | | | (142) | (142) |
| Operating income | | | | 3,344 |
| Interest expense – net | | | 451 | 451 |
| Income before income taxes | | | | \$ 2,893 |

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Second Quarter Ended,
June 20, 2015

| (Thousands) | Environmental Services | Oil Business | Corporate and Eliminations | Consolidated |
|---|---------------------------|-----------------|----------------------------------|--------------|
| Revenues | | | | |
| Product revenues | \$ 5,370 | \$26,853 | \$ — | \$ 32,223 |
| Service revenues | 47,600 | 3,118 | — | 50,718 |
| Total revenues | \$ 52,970 | \$29,971 | \$ — | \$ 82,941 |
| Operating expenses | | | | |
| Operating costs | 35,591 | 28,772 | — | 64,363 |
| Operating depreciation and amortization | 1,671 | 1,840 | — | 3,511 |
| Profit (loss) before corporate selling, general, and administrative expenses | \$ 15,708 | \$(641) | \$ — | \$ 15,067 |
| Selling, general, and administrative expenses | | | 10,615 | 10,615 |
| Depreciation and amortization from SG&A | | | 787 | 787 |
| Total selling, general, and administrative expenses | | | \$ 11,402 | \$ 11,402 |
| Other (income) - net | | | (154) | (154) |
| Operating income | | | | 3,819 |
| Interest expense – net | | | 408 | 408 |
| Income before income taxes | | | | \$ 3,411 |

First Half Ended,
June 18, 2016

| (Thousands) | Environmental Services | Oil Business | Corporate and Eliminations | Consolidated |
|---|---------------------------|-----------------|----------------------------------|--------------|
| Revenues | | | | |
| Product revenues | \$ 10,135 | \$38,264 | \$ — | \$ 48,399 |
| Service revenues | 94,663 | 15,943 | \$ — | 110,606 |
| Total revenues | \$ 104,798 | \$54,207 | \$ — | \$ 159,005 |
| Operating expenses | | | | |
| Operating costs | 72,436 | 53,523 | — | 125,959 |
| Operating depreciation and amortization | 3,424 | 3,171 | — | 6,595 |
| Profit (loss) before corporate selling, general, and administrative expenses | \$ 28,938 | \$(2,487) | \$ — | \$ 26,451 |
| Selling, general, and administrative expenses | | | 23,729 | 23,729 |
| Depreciation and amortization from SG&A | | | 1,651 | 1,651 |
| Total selling, general, and administrative expenses | | | \$ 25,380 | \$ 25,380 |
| Other (income) - net | | | (201) | (201) |
| Operating income | | | | 1,272 |

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| | | |
|----------------------------|-----|--------|
| Interest expense – net | 969 | 969 |
| Income before income taxes | | \$ 303 |

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First Half Ended,
June 20, 2015

| (Thousands) | Environmental Services | Oil Business | Corporate and Eliminations | Consolidated |
|---|---------------------------|-----------------|----------------------------------|--------------|
| Revenues | | | | |
| Product revenues | \$ 10,710 | \$55,910 | \$ — | \$ 66,620 |
| Service revenues | 95,145 | 5,212 | — | 100,357 |
| Total revenues | \$ 105,855 | \$61,122 | \$ — | \$ 166,977 |
| Operating expenses | | | | |
| Operating costs | 74,304 | 59,773 | — | 134,077 |
| Operating depreciation and amortization | 3,398 | 3,704 | — | 7,102 |
| Profit (loss) before corporate selling, general, and administrative expenses | \$ 28,153 | \$(2,355) | \$ — | \$ 25,798 |
| Selling, general, and administrative expenses | | | 21,681 | 21,681 |
| Depreciation and amortization from SG&A | | | 1,529 | 1,529 |
| Total selling, general, and administrative expenses | | | \$ 23,210 | \$ 23,210 |
| Other (income) - net | | | (253) | (253) |
| Operating income | | | | 2,841 |
| Interest expense – net | | | 962 | 962 |
| Income before income taxes | | | | \$ 1,879 |

Total assets by segment as of June 18, 2016 and January 2, 2016 were as follows:

| (Thousands) | June 18, 2016 | January 2, 2016 |
|------------------------------------|------------------|--------------------|
| Total Assets: | | |
| Environmental Services | \$129,740 | \$133,718 |
| Oil Business | 135,226 | 132,556 |
| Unallocated Corporate Assets | 39,172 | 35,574 |
| Total | \$304,138 | \$301,848 |

Segment assets for the Environmental Services and Oil Business segments consist of property, plant, and equipment, intangible assets, accounts receivable, goodwill, and inventories. Assets for the corporate unallocated amounts consist of property, plant, and equipment used at the corporate headquarters, as well as cash and net deferred tax assets.

(10) COMMITMENTS AND CONTINGENCIES

The Company may enter into purchase obligations with certain vendors. They represent expected payments to third party service providers and other commitments entered into during the normal course of our business. These purchase obligations are generally cancelable with or without notice, without penalty, although certain vendor agreements provide for cancellation fees or penalties depending on the terms of the contract.

The Company has purchase obligations in the form of open purchase orders of \$8.0 million as of June 18, 2016, and \$9.8 million as of January 2, 2016, primarily for used oil, solvent, machine purchases, disposal and transportation expenses, and capital expenditures.

The Company may be subject to investigations, claims or lawsuits as a result of operating its business, including matters governed by environmental laws and regulations. The Company may also be subject to tax audits in a variety of jurisdictions. When claims are asserted, the Company evaluates the likelihood that a loss will occur and records a liability for those instances when the likelihood is deemed probable and the exposure is reasonably estimable. The Company carries insurance at levels it believes are adequate to cover loss contingencies based on historical claims activity. When the potential loss exposure is limited to the insurance deductible and the likelihood of loss is determined to be probable, the Company accrues for the amount

of the required deductible, unless a lower amount of exposure is estimated. As of June 18, 2016 and January 2, 2016, the Company had accrued \$5.5 million and \$6.0 million related to loss contingencies and other contingent liabilities, respectively.

(11) INCOME TAXES

The Company deducted for federal income tax purposes accelerated "bonus" depreciation on the majority of its capital expenditures for assets placed in service in fiscal 2011 through fiscal 2015. Therefore, the Company recorded a noncurrent deferred tax liability to reflect difference between the book basis and the tax basis of those assets. In addition, as a result of the federal bonus depreciation, the Company recorded a Net Operating Loss ("NOL") of \$44.7 million, which will begin to expire in 2031. The balance remaining on the NOL, which is primarily the result of bonus depreciation, as of June 18, 2016 was \$50.3 million, and the remaining deferred tax asset related to the Company's state and federal NOL was a tax effected balance of \$18.9 million.

The Company recognizes windfall tax benefits associated with the exercise of stock options directly to stockholders' equity only when realized. Consequently, deferred tax assets are not recognized for NOLs resulting from windfall tax benefits. At June 18, 2016, deferred tax assets do not include \$2.5 million of excess tax benefits from share-based compensation.

The Company's effective tax rate for the second quarter of fiscal 2016 was 36.7% compared to 41.4% in the second quarter of fiscal 2015. The rate difference is principally attributable to the differing treatment for financial reporting and income tax reporting for certain expenditures. These expenditures are shown net of the anticipated reimbursement from an unrelated third party for financial reporting purposes, whereas for income tax purposes the expenditures are recorded on a gross basis.

The Company's effective tax rate for the first half of fiscal 2016 was 65.0% compared to 41.6% in the first half of fiscal 2015. The rate increase is primarily attributed to certain state income taxes which are computed on a tax base that reflects substantial modifications to federal taxable income, and that has created comparatively high tax expense when compared to relatively low year-to-date pre-tax income in the first half of 2016.

The Company establishes reserves when it is more likely than not that the Company will not realize the full tax benefit of a position. The Company had a reserve of \$2.5 million for uncertain tax positions as of June 18, 2016 and January 2, 2016. The gross unrecognized tax benefits would, if recognized, decrease the Company's effective tax rate.

(12) SHARE-BASED COMPENSATION

The aggregate number of shares of common stock which may be issued under the Company's 2008 Omnibus Plan ("Plan") is 1,902,077 plus any common stock that becomes available for issuance pursuant to the reusage provision of the Plan. As of June 18, 2016, the number of shares available for issuance under the Plan was 553,427 shares.

Stock Option Awards

A summary of stock option activity under this Plan is as follows:

| Outstanding Stock Options | Number of Options Outstanding | Weighted Average Exercise Price | Weighted Remaining Contractual Term (in years) | Aggregate Average Intrinsic Value as of Date Listed (in thousands) |
|--|-------------------------------------|--|--|--|
| Options outstanding at January 2, 2016 | 534,428 | \$ 10.97 | 2.34 | \$ 224 |
| Exercised | — | — | | |
| Options outstanding at June 18, 2016 | 534,428 | \$ 10.97 | 1.88 | \$ 1,093 |

Restricted Stock Compensation/Awards

Annually, the Company grants restricted shares to its Board of Directors. The shares become fully vested one year from their grant date. The fair value of each restricted stock grant is based on the closing price of the Company's stock on the date of grant. The Company amortizes the expense over the service period, which is the fiscal year in which the award is granted. On May 8, 2015, the Company granted 22,638 restricted shares for service in fiscal 2015, which vested in the second quarter of fiscal 2016. On May 5, 2016, the Company granted 28,674 restricted shares to the Board of Directors for service in fiscal 2016. As of June 18, 2016, there was \$0.2 million unrecognized expense associated with these grants, which will be recorded throughout fiscal 2016. Expense related to the Board of Directors' restricted stock in both the first half of fiscal 2016 and the first half of fiscal 2015 was \$0.1 million.

In February 2014, the Company granted certain members of management 132,107 restricted shares based on the Company's performance in fiscal 2013. These restricted shares are subject to a graded vesting schedule over a three year period which started January 1, 2015. There was approximately \$0.3 million and \$0.5 million in unrecognized compensation expense remaining related to these awards as of June 18, 2016 and January 2, 2016, respectively. In the first half of fiscal 2016 and the first half of fiscal 2015, \$0.3 million and \$0.2 million of compensation expense was recorded related to these awards, respectively.

In February 2015, the Company granted certain members of management 38,372 restricted shares based on their services in fiscal 2014 and contingent upon continued service. The restricted shares vest over a three year period which started January 1, 2016. As of June 18, 2016 and January 2, 2016, there was approximately \$0.2 million in unrecognized compensation expense remaining related to these awards. In each of the first halves of fiscal 2016 and fiscal 2015, approximately \$0.1 million was recorded as compensation expense related to these awards.

In January 2016, the Company granted certain members of management 42,208 restricted shares based on their services in fiscal 2015 and contingent upon the employees' continued employment with the Company. The restricted shares vest over a period of approximately three years, beginning with the grant date in January 2016 and ending with the final vesting in January 2019. As of June 18, 2016 and January 2, 2016, there was approximately \$0.3 million in unrecognized compensation expense remaining related to these awards. In the first half of fiscal 2016 and fiscal 2015, approximately \$0.1 million and \$0.2 million was recorded as compensation expense related to these awards,

respectively.

The following table summarizes the restricted stock activity for the period ended June 18, 2016:

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| Restricted Stock (Nonvested Shares) | Number of Shares | Weighted Average Grant-Date Fair Value Per Share |
|---|------------------|--|
| Nonvested shares outstanding at January 2, 2016 | 91,529 | \$ 14.47 |
| Granted | 70,882 | 9.90 |
| Vested | (22,638) | 12.59 |
| Nonvested shares outstanding at June 18, 2016 | 139,773 | \$ 12.46 |

Employee Stock Purchase Plan

As of June 18, 2016, the Company had reserved 72,944 shares of common stock available for purchase under the Employee Stock Purchase Plan of 2008. In the first half of fiscal 2016, employees purchased 23,040 shares of the Company's common stock with a weighted average fair market value of \$10.12 per share.

(13) EARNINGS PER SHARE

The following table reconciles the number of shares outstanding for the second quarters of fiscal 2016 and 2015, respectively, to the number of weighted average basic shares outstanding and the number of weighted average diluted shares outstanding for the purposes of calculating basic and diluted earnings per share:

| (Thousands) | Second Quarter Ended, | | First Half Ended, | |
|--|-----------------------|---------------|-------------------|---------------|
| | June 18, 2016 | June 20, 2015 | June 18, 2016 | June 20, 2015 |
| Net income | \$1,831 | \$1,998 | \$106 | \$1,098 |
| Less: Income attributable to noncontrolling interest | — | 28 | 42 | 69 |
| Net income attributable to Heritage-Crystal Clean, Inc. available to common stockholders | \$1,831 | \$1,970 | \$64 | \$1,029 |
| Weighted average basic shares outstanding | 22,246 | 22,138 | 22,236 | 22,129 |
| Dilutive shares from share-based compensation plans | 173 | 265 | 156 | 245 |
| Weighted average diluted shares outstanding | 22,419 | 22,403 | 22,392 | 22,374 |
| Net income per share: basic | \$0.08 | \$0.09 | \$— | \$0.05 |
| Net income per share: diluted | \$0.08 | \$0.09 | \$— | \$0.05 |

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

Disclosure Regarding Forward-Looking Statements

You should read the following discussion in conjunction with our consolidated financial statements and related notes in our Annual Report on Form 10-K filed with the SEC on March 16, 2016. In addition to historical information, this discussion contains forward-looking statements that involve risks, uncertainties and assumptions that could cause actual results to differ materially from our expectations. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They use words such as "aim," "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "project," "should," "will be," "will continue," "will likely result," "would" and other words and terms of similar meaning in conjunction with a discussion of future or estimated operating or financial performance. You should read statements that contain these words carefully, because they discuss our future expectations, contain projections of our future results of operations or of our financial position or state other "forward-looking" information. Forward-looking statements speak only as of the date of this quarterly report. Factors that could cause such differences include those described in the section titled "Risk Factors" and elsewhere in our Annual Report on Form 10-K for fiscal 2015 filed with the SEC on March 16, 2016. Except as required under federal securities laws and the rules and regulations of the SEC, we do not have any intention, and do not undertake, to update any forward-looking statements to reflect events or circumstances arising after the date of this quarterly report, whether as a result of new information, future events or otherwise. As a result of these risks and uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements included in this quarterly report or that may be made elsewhere from time to time by, or on behalf of, us. All forward-looking statements attributable to us are expressly qualified by these cautionary statements. Certain tabular information may not foot due to rounding. Our fiscal year ends on the Saturday closest to December 31. Interim results are presented for the twelve weeks ("second quarter" or "quarter") and twenty-four weeks (first "half") ended June 18, 2016 and June 20, 2015, respectively. "Fiscal 2015" represents the 52-week period ended January 2, 2016 and "Fiscal 2016" represents the 52-week period ended December 31, 2016.

Overview

We provide parts cleaning, containerized waste management, used oil collection, vacuum truck services, antifreeze recycling, and field services, and we own and operate a used oil re-refinery. We are the second largest provider of industrial and hazardous waste services to small and mid-sized customers in both the vehicle maintenance and manufacturing services sector in North America, and we have the second largest used oil re-refining capacity in North America. Our services help our customers manage their used chemicals and liquid and solid wastes while also helping to minimize their regulatory burdens. We operate from a network of 81 branch facilities providing services to customers in 45 states and parts of Canada. We conduct business through two operating segments: Environmental Services and Oil Business.

Our Environmental Services segment revenues are generated primarily from providing parts cleaning services, containerized waste management, vacuum truck services, antifreeze recycling, and field services. Revenues from this segment accounted for approximately 66% of our total company revenues for the first half of fiscal 2016. In the Environmental Services segment, we define and measure same-branch revenues for a given period as the subset of all our branches that have been open and operating throughout and between the periods being compared, and we refer to these as established branches. We calculate average revenues per working day by dividing our revenues by the number of non-holiday weekdays in the applicable fiscal year or fiscal quarter.

Our Oil Business segment consists of our used oil collection, used oil re-refining activities, and recycled fuel oil ("RFO") sales which accounted for approximately 34% of our total company revenues in the first half of fiscal 2016.

Our operating costs include the costs of the materials we use in our products and services, such as used oil purchased from third party collectors, solvent, and other chemicals. The used solvent that we retrieve from customers in our product reuse program is accounted for as a reduction in our net cost of solvent under operating costs, whether placed in inventory or sold to a purchaser for reuse. Changes in the price of crude oil can impact operating costs indirectly as it may impact the price we pay for solvent or used oil, although we attempt to offset volatility in the oil markets by managing the spread between the costs we pay for our materials and the prices we charge for our products and services. Operating costs also include transportation of solvents and waste, payments to third parties to recycle or dispose of the waste materials that we collect, and the costs of operating our re-refinery, recycling centers, hubs, and branch system including personnel costs (including commissions), facility rent, truck leases, fuel, and maintenance. Our operating costs as a percentage of sales generally increase in relation to the number of new branch openings. As new branches achieve route density and scale efficiencies, our operating costs as a percentage of sales generally decrease.

We use profit before corporate selling, general and administrative expenses ("SG&A") as a key measure of segment profitability. We define profit before SG&A expense as revenues less operating costs and depreciation and amortization from operations.

We operate a used oil re-refinery located in Indianapolis, Indiana, through which we recycle used oil into high quality lubricant base oil and byproducts. We supply the base oil to firms that produce and market finished lubricants. Our used oil re-refinery currently has an input capacity of approximately 75 million gallons of used oil feedstock per year when operating at full capacity.

Our selling, general, and administrative expenses include the costs of performing centralized business functions, including sales management at or above the regional level, business management, billing, receivables management, accounting and finance, information technology, environmental health and safety, and legal.

On March 24, 2016, we purchased the assets of Phoenix Environmental Services, Inc. and Pipeline Video and Cleaning North Corporation (together Phoenix Environmental"). The purchase price for the acquisition was \$2.7 million including \$0.3 million placed into escrow, plus contingent consideration of up to \$0.3 million based on subsequent business performance.

For further discussion on these acquisitions, see Note 3 in our consolidated financial statements included elsewhere in this document.

Critical Accounting Policies

Critical accounting policies are those that are both important to the accurate portrayal of a company's financial condition and results and require subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain.

In order to prepare financial statements that conform to accounting principles generally accepted in the United States, commonly referred to as GAAP, we make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may be significantly different from our expectations.

There were no material changes in the first half of fiscal 2016 to the information provided under the heading "Critical Accounting Policies" included in our Annual Report on Form 10-K for the fiscal year ended January 2, 2016.

RESULTS OF OPERATIONS

General

The following table sets forth certain operating data as a percentage of revenues for the periods indicated:

| (Thousands) | For the Second Quarter Ended, | | For the First Half Ended, | |
|--|-------------------------------|------------------|---------------------------|------------------|
| | June 18, 2016 | June 20, 2015 | June 18, 2016 | June 20, 2015 |
| Revenues | | | | |
| Product revenues | \$24,695 | \$32,223 | \$48,399 | \$66,620 |
| | 30.7% | 38.9% | 30.4% | 39.9% |
| Service revenues | 55,857 | 50,718 | 110,606 | 100,357 |
| | 69.3% | 61.1% | 69.6% | 60.1% |
| Total Revenues | \$80,552 | \$82,941 | \$159,005 | \$166,977 |
| | 100.0% | 100.0% | 100.0% | 100.0% |
| Operating expenses - | | | | |
| Operating costs | \$61,711 | \$64,363 | \$125,959 | \$134,077 |
| | 76.6% | 77.6% | 79.2% | 80.3% |
| Selling, general and administrative expenses | 11,521 | 10,615 | 23,729 | 21,681 |
| | 14.3% | 12.8% | 14.9% | 13.0% |
| Depreciation and amortization | 4,118 | 4,298 | 8,246 | 8,631 |
| | 5.1% | 5.2% | 5.2% | 5.2% |
| Other (income) - net | (142) | (154) | (201) | (253) |
| | (0.2)% | (0.2)% | (0.1)% | (0.2)% |
| Operating income | 3,344 | 3,819 | 1,272 | 2,841 |
| | 4.2% | 4.6% | 0.8% | 1.7% |
| Interest expense – net | 451 | 408 | 969 | 962 |
| | 0.6% | 0.5% | 0.6% | 0.6% |
| Income before income taxes | 2,893 | 3,411 | 303 | 1,879 |
| | 3.6% | 4.1% | 0.2% | 1.1% |
| Provision for income taxes | 1,062 | 1,413 | 197 | 781 |
| | 1.3% | 1.7% | 0.1% | 0.5% |
| Net income | 1,831 | 1,998 | 106 | 1,098 |
| | 2.3% | 2.4% | 0.1% | 0.7% |
| Income attributable to noncontrolling interest | — | 28 | 42 | 69 |
| | —% | —% | —% | —% |
| Net income attributable to Heritage-Crystal Clean, Inc. common stockholders | \$1,831 | \$1,970 | \$64 | \$1,029 |
| | 2.3% | 2.4% | —% | 0.6% |

Revenues

For the second quarter of fiscal 2016, revenues decreased \$2.4 million, or 2.9%, from \$82.9 million in the second quarter of fiscal 2015 to \$80.6 million in the second quarter of fiscal 2016. For the first half of fiscal 2016, revenues decreased \$8.0 million, or 4.8%, from \$167 million in the first half of fiscal 2015 to \$159.0 million in the first half of fiscal 2016. The declines in revenues in our Environmental Services segment were mainly due to the downturn in activity at customers directly involved in and related to the energy sector, as well as lower energy surcharge revenues. The declines in revenue in our Oil Business segment were mainly due to lower selling prices for our base oil and RFO products, partially offset by higher base oil volume sales and higher used oil collection charges.

Operating expenses

Operating costs

Operating costs decreased \$2.7 million, or 4.1%, from the second quarter of fiscal 2015 to the second quarter of fiscal 2016, and \$8.1 million, or 6.1%, from the first half of fiscal 2015 to the first half of fiscal 2016. The decrease in operating costs was primarily a result of lower costs for oil-based inventory due to decreases in crude oil prices year over year. Additionally, lower crude oil prices resulted in lower solvent costs in our Environmental Services segment. We expect that in the future our operating costs in the Environmental Services business will continue to increase as our service volume increases, however, a decrease in crude oil prices could partially offset this cost increase because a decrease in crude oil price could cause a decline in the price we pay for parts cleaning solvent and diesel fuel. In the Oil Business, we expect our operating costs will also increase in the future as our throughput capacity has increased at

our re-refinery. We also expect that a change in the price for crude oil could impact our used oil collection costs and processing costs at our re-refinery either favorably or unfavorably.

Selling, general, and administrative expenses

Selling, general, and administrative expenses increased \$0.9 million, or 8.5%, from the second quarter of fiscal 2015 to the second quarter of fiscal 2016. Selling, general, and administrative expenses increased \$2.0 million, or 9.4%, from the first half of fiscal 2015 to the first half of fiscal 2016. The increases in expense was mainly driven by increased legal fees, partially offset by lower outsourcing costs pertaining to information technology. Legal fees were \$1.8 million and \$3.3 million in the second quarter of 2016 and the first half of 2016, respectively, compared to \$0.1 million and \$0.4 million in the second quarter of 2015 and the first half of 2015, respectively. The higher legal expenses in fiscal 2016 pertain primarily to arbitration proceedings and environmental matters described in Part II, Item 1 "Legal Proceedings."

Interest expense

Interest expense for the second quarter of fiscal 2016 was \$0.5 million compared to interest expense of \$0.4 million in the second quarter of fiscal 2015. In both the first half of fiscal 2016 and the first half of fiscal 2015, interest expense was \$1.0 million. In the first half of fiscal 2016 we capitalized less than \$0.1 million in interest compared to the first half of 2015 when we capitalized \$0.3 million in interest.

Provision for income taxes

Our effective tax rate for the first half of fiscal 2016 was 65.0% compared to 41.6% in first half of fiscal 2015. The rate increase is primarily attributed to certain state income taxes which are computed on a tax base that reflects substantial modifications to federal taxable income, and that has created comparatively high tax expense when compared to relatively low year-to-date pre-tax income in the first half of 2016.

Segment Information

The following table presents revenues by operating segment:

| | For the Second Quarter Ended, | | Change | |
|---------------------------|----------------------------------|------------------|-----------|---------|
| (Thousands) | June 18, 2016 | June 20, 2015 | \$ | % |
| Revenues: | | | | |
| Environmental Services | \$52,437 | \$52,970 | \$(533) | (1.0)% |
| Oil Business | 28,115 | 29,971 | (1,856) | (6.2)% |
| Total | \$80,552 | \$82,941 | \$(2,389) | (2.9)% |
| | For the First Half Ended, | | Change | |
| (Thousands) | June 18, 2016 | June 20, 2015 | \$ | % |
| Revenues: | | | | |
| Environmental Services | \$104,798 | \$105,855 | \$(1,057) | (1.0)% |
| Oil Business | 54,207 | 61,122 | (6,915) | (11.3)% |
| Total | \$159,005 | \$166,977 | \$(7,972) | (4.8)% |

In the second quarter of fiscal 2016, Environmental Services revenues decreased by approximately \$0.5 million, or 1.0%, from \$53.0 million in the second quarter of fiscal 2015 to \$52.4 million in the second quarter of fiscal 2016. In the first half of fiscal 2016, Environmental Services revenues decreased \$1.1 million, or 1.0%, from \$105.9 million in the first half of fiscal 2015 to \$104.8 million in the first half of fiscal 2016. The decline in revenue was mainly due to downturn in activity of customers directly involved in, or related to, the energy sector, the loss of certain customers, and lower energy surcharge revenue.

At the end of the second quarter of fiscal 2016, the Environmental Services segment was operating in 81 branch locations compared with 83 at the end of the second quarter of fiscal 2015. There were 80 branches that were in operation throughout both the second quarters of fiscal 2016 and fiscal 2015. Same branch sales decreased \$1.0 million, or 1.9%, in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. In the first half of fiscal 2016, same branch sales decreased \$0.4 million, or 0.4% compared to the first half of fiscal 2015. The decline in second quarter and first half revenue during 2016 was primarily due to the decreased activity of our energy sector customers.

In the second quarter of fiscal 2016, Oil Business revenues decreased \$1.9 million compared to the second quarter of fiscal 2015. In the first half of fiscal 2016, Oil Business revenues decreased \$6.9 million compared to the first half of fiscal 2015. The revenue decrease was mainly due to lower selling prices for our base oil and RFO products, which was partially offset by higher base oil sales volume. The decline in revenue was further offset by increased revenue from used oil collection charges and stop fees of approximately \$5.0 million in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015, and an approximate increase of \$8.3 million in the first half of fiscal 2016 compared to the first half of 2015.

During the second quarter of fiscal 2016, the average spot market price for the type of lubricating base oil we produce declined over 27% compared to the second quarter of fiscal 2015. However, the average spot market price during the second quarter was up approximately 12% compared to the first quarter of fiscal 2016.

Segment Profit (Loss) Before Corporate Selling, General and Administrative Expenses ("SG&A")

The following table presents profit by operating segment before corporate SG&A expense:

| (Thousands) | For the Second Quarter Ended, | | Change | |
|---|----------------------------------|------------------|---------|----------|
| | June 18, 2016 | June 20, 2015 | \$ | % |
| Profit (loss) before corporate SG&A* | | | | |
| Environmental Services | \$15,096 | \$15,708 | \$(612) | (3.9)% |
| Oil Business | 444 | (641) | 1,085 | (169.3)% |
| Total | \$15,540 | \$15,067 | \$473 | 3.1% |
| | For the First Half Ended, | | Change | |
| | June 18, 2016 | June 20, 2015 | \$ | % |
| Profit (loss) before corporate SG&A* | | | | |
| Environmental Services | \$28,938 | \$28,153 | \$785 | 2.8% |
| Oil Business | (2,487) | (2,355) | (132) | 5.6% |
| Total | \$26,451 | \$25,798 | \$653 | 2.5% |

*Includes depreciation and amortization related to operating activity but not depreciation and amortization related to corporate selling, general, and administrative activity. For further discussion see Note 9 in our consolidated financial statements included elsewhere in this document.

Environmental Services profit before corporate SG&A expense decreased 3.9% in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015. This decrease was mainly due to decreased revenues of 1.0%. Environmental Services profit before corporate SG&A expense increased 2.8% in the first half of fiscal 2016 compared to the first half of fiscal 2015 mainly due to \$1.8 million in lower disposal charges, partially offset by a \$1.1 million decrease in revenue.

The recovery of used solvent from customers participating in our product reuse program for parts cleaning is not accounted for as revenues, but rather as a reduction in our net cost of solvent under operating costs. As a result of falling solvent prices, sales of reuse solvent provided a negative impact on profit before corporate SG&A expense during the first half of fiscal 2016 of \$0.3 million, compared to a negative impact of \$0.9 million in the first half of fiscal 2015. Sales of reuse solvent did not provide a material impact during the second quarter of fiscal 2016 or in the second quarter of fiscal 2015.

Oil Business income before corporate SG&A expense increased \$1.1 million in the second quarter of fiscal 2016, from a loss of \$0.6 million in the second quarter of fiscal 2015, to income of \$0.4 million in the second quarter of fiscal 2016. This improvement was primarily driven by the increase in used oil collection related charges of approximately \$5.0 million in the second quarter of fiscal 2016 compared to the second quarter of fiscal 2015.

Oil Business loss before corporate SG&A expense was \$2.5 million in the first half of fiscal 2016, compared to a loss of \$2.4 million in the first half of fiscal 2015. Oil Business margins were negatively impacted by lower base oil and Recycled Fuel Oil ("RFO") pricing which more than offset the increase in used oil collection related revenue.

FINANCIAL CONDITION

Liquidity and Capital Resources

Cash and Cash Equivalents

As of June 18, 2016 and January 2, 2016, cash and cash equivalents were \$25.3 million and \$23.6 million, respectively. Our primary sources of liquidity are cash flows from operations and funds available to borrow under our term loan and revolving bank credit facility.

Debt and Financing Arrangements

On October 16, 2014, in connection with our acquisition of FCC Environmental, we amended our Amended and Restated Credit Agreement ("Credit Agreement", or "Credit Facility") to allow for up to \$140.0 million in borrowings. As of June 18, 2016 and January 2, 2016, our total borrowings were \$69.2 million and \$70.9 million, respectively, under the term loan portion of our Credit Facility which has a maturity date of February 5, 2018. The remaining portion of the Credit Facility is a revolving loan which expires on February 5, 2018. There were no amounts outstanding under the revolver at June 18, 2016 and January 2, 2016.

During the second quarter of fiscal 2016, we recorded interest of \$0.5 million on the term loan and capitalized less than \$0.1 million of recorded interest for various capital projects. During the first half of fiscal 2016, we recorded interest of \$1.0 million on the term loan, of which less than \$0.1 million was capitalized for various capital projects. During the second quarter of fiscal 2015, we recorded interest of \$0.4 million on the term loan and capitalized \$0.2 million for various capital projects. During the first half of fiscal 2015, we recorded interest of \$0.8 million on the term loan and capitalized \$0.3 million for various capital projects.

Certain covenants of the Credit Agreement, among other things, restrict our ability to incur indebtedness, grant liens, make investments, and sell assets. The Credit Agreement, as amended, contains customary events of default, covenants, and representations and warranties. Financial covenants include:

- ▲ An interest coverage ratio (based on interest expense and EBITDA) of at least 3.5 to 1.0;
- ▲ A total leverage ratio no greater than 3.0 to 1.0; and
- ▲ A capital expenditures covenant limiting annual capital expenditures to \$15.0 million

As of June 18, 2016 and January 2, 2016, we were in compliance with all covenants under the Credit Agreement. As of June 18, 2016 and January 2, 2016, we had \$3.0 million and \$4.4 million of standby letters of credit issued, respectively, and \$19.8 million and \$34.5 million was available for borrowing under the bank Credit Facility, respectively. The actual amount available under the revolving loan portion of the Credit Agreement is limited by our total leverage ratio.

Our weighted average interest rate for all debt outstanding as of June 18, 2016 and June 20, 2015 was 3.2% and 3.2%, respectively.

We believe that our existing cash, cash equivalents, available borrowings and other sources of financings will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. We cannot assure you that this will be the case or that our assumptions regarding revenues and expenses underlying this belief will be accurate. If, in the future, we require more liquidity than is available to us under our Credit Facility, we may need to raise additional funds, including through debt or equity offerings. Adequate funds may not be available when needed or may not be available on terms favorable to us. If additional funds are raised by issuing equity securities, dilution to existing stockholders may result. If we raise additional funds by obtaining loans

from third parties, the terms of those financing arrangements may include negative covenants or other restrictions on our business that could impair our operational flexibility, and would also require us to fund additional interest expense. If funding is insufficient at any time in the future, we may be unable to develop or enhance our products or services, take advantage of business opportunities or respond to competitive pressures, any of which could have a material adverse effect on our business, financial condition and results of operations.

Summary of Cash Flow Activity

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| | For the First Half Ended, (Dollars in thousands) | |
|--|---|------------------|
| | June 18, 2016 | June 20, 2015 |
| Net cash provided by (used in): | | |
| Operating activities | \$ 14,391 | \$ 9,416 |
| Investing activities | (11,071) | (10,158) |
| Financing activities | (1,603) | (1,424) |
| Net increase (decrease) in cash and cash equivalents | \$ 1,717 | \$ (2,166) |

The most significant items affecting the comparison of our operating activities for the first half of fiscal 2016 and the first half of fiscal 2015 are summarized below:

Net Cash Provided by Operating Activities —

Accounts Payable — The increase in accounts payable favorably affected cash flows from operations by \$10.9 million in the first half of fiscal 2016 compared to the first half of fiscal 2015. The increase in accounts payable in the first half of fiscal 2016 was mainly driven by higher legal fees. In the first half of fiscal 2015, accounts payable decreased significantly due to the lower unit cost of raw materials such as used oil and solvent.

Accrued expenses — In the first half of fiscal 2016, accrued expenses increased \$6.2 million compared to the first half of fiscal 2015 driven mainly by higher legal fee accruals year over year. In the first half of fiscal 2015, accrued expenses decreased due to reductions in accrued severance and lower accrued wages and benefits.

Accounts Receivable — The increase in accounts receivable had a negative impact on cash provided by operating activities of \$3.4 million compared to the first half of fiscal 2016 compared to the first of fiscal 2015.

Other current assets — Cash provided by operating activities was negatively impacted by \$7.9 million in the first half of fiscal 2016 compared to the first half of fiscal 2015 primarily due to a decrease in other current assets in fiscal 2015 that did not recur in fiscal 2016. In fiscal 2015 deposits to secure letters of credit, which were recorded in other current assets, were liquidated and returned to the Company's bank accounts. Similar events have not happened in fiscal 2016.

Net Cash Used in Investing Activities —

Capital expenditures — We used \$8.7 million and \$10.2 million for capital expenditures during the first halves of fiscal 2016 and fiscal 2015, respectively. During the first half of fiscal 2016, we spent \$4.8 million for capital improvements to the re-refinery, compared to \$4.2 million on capital improvements at the re-refinery in the first half of fiscal 2015. Additionally, in the first half of fiscal 2016, approximately \$2.0 million of the capital expenditures were for purchases of parts cleaning machines compared to \$3.2 million in the first half of fiscal 2015. The remaining \$1.9 million in the first half of fiscal 2016 was for other items including leasehold improvements and intangible assets compared to approximately \$2.0 million spent in the first half of fiscal 2015.

Acquisitions — In the first half of fiscal 2016, we used \$2.4 million for the purchase of the assets of Phoenix Environmental Services, Inc. and Pipeline Video and Cleaning North Corporation.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to interest rate risks primarily through borrowings under our bank Credit Facility. Interest on this facility is based upon variable interest rates. Our weighted average borrowings under our Credit Facility during the second quarter of fiscal 2016 were \$70.1 million, and the annual effective interest rate for the Credit Facility for the second quarter of fiscal 2016 was 3.2%. We currently do not hedge against interest rate risk. Based on the foregoing, a hypothetical 1% increase or decrease in interest rates would have resulted in a change of \$0.7 million to our interest expense in the second quarter of fiscal 2016.

ITEM 4. CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by this report, that the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding financial disclosures.

There was no change in the Company's internal control over financial reporting that occurred during the second fiscal quarter of 2016 that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

On July 1, 2015, we received a grand jury subpoena from the U.S. Department of Justice ("DOJ"), along with the U.S. Environmental Protection Agency ("EPA"), requesting certain materials related to the transportation and disposal of wastewater by International Petroleum Corp. of Delaware ("IPC"), and the due diligence documents provided to us in connection with our acquisition of IPC. We continue to cooperate with the EPA and DOJ on their information requests. We have received indirect communication that the City of Wilmington, Delaware may seek recovery of an undetermined amount related to municipal services allegedly incurred prior to our acquisition of IPC. Our acquisition of the IPC business is governed by a Stock Purchase Agreement which obligates the Seller to indemnify us for certain costs that may arise in connection with this matter. With the exception of attorney's fees and related expenses, no amounts have been accrued related to this investigation as a prediction of the ultimate outcome of this matter cannot be determined.

We are involved in an arbitration with the sellers of IPC and FCC Environmental in order to enforce our rights under the stock purchase agreement. The arbitration includes the matters described above as well as other routine post-closing items related to our acquisition of IPC and FCC Environmental. We expect the arbitration process to be completed by the end of fiscal 2016.

ITEM 6. EXHIBITS

- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 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

*In accordance with Regulation S-T, the XBRL-related information in Exhibits 101 to this Quarterly Report on Form 10-Q shall be deemed to be "furnished" and 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.

HERITAGE-CRYSTAL CLEAN, INC.

Date: July 28, 2016 By: /s/ Mark DeVita

Mark DeVita
Chief Financial Officer