
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

Form 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 31, 2017

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: 001-35577

KMG CHEMICALS, INC.

(Exact name of registrant as specified in its charter)

Texas
(State or other jurisdiction of
incorporation or organization)

300 Throckmorton Street,
Fort Worth, Texas
(Address of principal executive offices)

75-2640529
(I.R.S. Employer
Identification No.)

76102
(Zip Code)

(817)-761-6100
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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

As of March 6, 2017, there were 11,887,513 shares of the registrant's common stock outstanding.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except for share and per share amounts)

	January 31, 2017 <u>(Unaudited)</u>	July 31, 2016
Assets		
Current assets		
Cash and cash equivalents	\$ 30,587	\$ 12,428
Restricted cash	1,000	—
Accounts receivable		
Trade, net of allowances of \$118 at January 31, 2017 and \$210 at July 31, 2016	35,309	33,324
Other	4,465	5,572
Inventories, net	35,870	37,401
Prepaid expenses and other	6,260	6,623
Total current assets	<u>113,491</u>	<u>95,348</u>
Property, plant and equipment, net	76,863	79,739
Goodwill	22,013	22,228
Intangible assets, net	32,542	33,906
Restricted cash	—	1,000
Other assets, net	5,010	4,807
Total assets	<u>\$ 249,919</u>	<u>\$ 237,028</u>
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 26,734	\$ 26,418
Accrued liabilities	10,680	11,252
Employee incentive accrual	3,150	5,999
Total current liabilities	<u>40,564</u>	<u>43,669</u>
Long-term debt	41,000	35,800
Deferred tax liabilities	9,058	9,948
Other long-term liabilities	4,450	4,422
Total liabilities	<u>95,072</u>	<u>93,839</u>
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized, none issued	—	—
Common stock, \$0.01 par value, 40,000,000 shares authorized, 11,887,513 shares issued and outstanding at January 31, 2017 and 11,877,282 shares issued and outstanding at July 31, 2016	119	119
Additional paid-in capital	39,364	36,553
Accumulated other comprehensive loss	(14,718)	(12,047)
Retained earnings	130,082	118,564
Total stockholders' equity	<u>154,847</u>	<u>143,189</u>
Total liabilities and stockholders' equity	<u>\$ 249,919</u>	<u>\$ 237,028</u>

See accompanying notes to condensed consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(In thousands, except for per share amounts)

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2017	2016	2017	2016
Net sales	\$ 79,071	\$ 70,859	\$ 155,566	\$ 147,509
Cost of sales	47,869	42,626	94,681	90,016
Gross profit	31,202	28,233	60,885	57,493
Distribution expenses	9,770	8,819	18,872	18,948
Selling, general and administrative expenses	12,392	12,722	24,293	23,937
Restructuring charges	—	555	—	1,021
Realignment charges	—	—	—	130
Operating income	9,040	6,137	17,720	13,457
Other (expense) income				
Interest expense, net	(172)	(252)	(349)	(404)
Other, net	(285)	149	(55)	132
Total other (expense) income, net	(457)	(103)	(404)	(272)
Income before income taxes	8,583	6,034	17,316	13,185
Provision for income taxes	(2,097)	(2,055)	(5,089)	(4,615)
Net income	\$ 6,486	\$ 3,979	\$ 12,227	\$ 8,570
Earnings per share				
Net income per common share basic	\$ 0.55	\$ 0.34	\$ 1.03	\$ 0.73
Net income per common share diluted	\$ 0.53	\$ 0.33	\$ 1.00	\$ 0.72
Weighted average shares outstanding				
Basic	11,882	11,717	11,881	11,707
Diluted	12,293	11,915	12,203	11,890

See accompanying notes to condensed consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(In thousands)

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2017	2016	2017	2016
Net income	\$ 6,486	\$ 3,979	\$ 12,227	\$ 8,570
Other comprehensive income				
Foreign currency translation loss	(360)	(1,914)	(2,671)	(2,398)
Total comprehensive income	<u>\$ 6,126</u>	<u>\$ 2,065</u>	<u>\$ 9,556</u>	<u>\$ 6,172</u>

See accompanying notes to condensed consolidated financial statements.

KMG CHEMICALS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

	Six Months Ended January 31,	
	2017	2016
Cash flows from operating activities		
Net income	\$ 12,227	\$ 8,570
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	7,048	7,024
Non-cash restructuring and realignment charges	—	105
Stock-based compensation expense	3,087	2,297
Deferred income tax expense	(821)	(1,334)
Excess tax benefit from stock-based awards	(685)	—
Other	53	204
Changes in operating assets and liabilities		
Accounts receivable — trade	(2,585)	894
Accounts receivable — other	2,531	(1,816)
Inventories	1,002	1,159
Other current and noncurrent assets	(302)	3,291
Accounts payable	951	(5,805)
Accrued liabilities and other	(3,083)	(492)
Net cash provided by operating activities	<u>19,423</u>	<u>14,097</u>
Cash flows from investing activities		
Additions to property, plant and equipment	(5,310)	(6,001)
Proceeds — insurance claim	250	—
Net cash used in investing activities	<u>(5,060)</u>	<u>(6,001)</u>
Cash flows from financing activities		
Borrowings under credit facility	17,000	—
Payments under credit facility	(11,800)	(6,000)
Excess tax benefit from stock-based awards	—	15
Payment of dividends	(709)	(703)
Cash payments related to tax withholdings from stock-based awards	(277)	—
Net cash provided by (used in) financing activities	<u>4,214</u>	<u>(6,688)</u>
Effect of exchange rate changes on cash	(418)	(25)
Net increase in cash, cash equivalents and restricted cash	18,159	1,383
Cash, cash equivalents and restricted cash at beginning of period	13,428	8,517
Cash, cash equivalents and restricted cash at end of period	<u>\$ 31,587</u>	<u>\$ 9,900</u>
Supplemental disclosures of cash flow information		
Cash paid for interest	\$ 244	\$ 321
Cash paid for income taxes, net	\$ 4,740	\$ 4,797
Supplemental disclosure of non-cash investing activities		
Purchase of property, plant and equipment through accounts payable	\$ 206	\$ 2,525

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The consolidated balance sheet as of July 31, 2016, which has been derived from audited consolidated financial statements, and the unaudited condensed consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for interim reporting. As permitted under those requirements, certain footnotes or other financial information that are normally required by generally accepted accounting principles in the United States of America (“GAAP”) have been condensed or omitted. The Company believes that the disclosures made are adequate to make the information not misleading and in the opinion of management reflect all adjustments, including those of a normal recurring nature, that are necessary for a fair presentation of financial position and results of operations for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of results of operations to be expected for the full year. The unaudited condensed consolidated financial statements included herein should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended July 31, 2016.

These condensed consolidated financial statements are prepared using certain estimates by management and include the accounts of KMG Chemicals, Inc. and its subsidiaries (collectively, the “Company”). All significant intercompany balances and transactions have been eliminated in consolidation.

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business” (“ASU 2017-01”). ASU 2017-01 affects all companies and other reporting organizations that must determine whether they have acquired or sold a business. For public companies, the amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company will apply the guidance to acquisitions occurring after the effective date to determine whether such acquisitions meet the definition of a business.

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”). To simplify the subsequent measurement of goodwill, ASU 2017-04 eliminates step two from the goodwill impairment test. A public business entity should adopt the amendments for its annual goodwill impairment tests or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The guidance could impact the Company if a goodwill impairment is identified after adoption. The Company plans to adopt the guidance effective August 1, 2017.

In August 2016, the FASB issued ASU No. 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash” (“ASU 2016-18”). ASU 2016-18 is intended to address diversity in practice that exists in the classification and presentation of changes in restricted cash on the statement of cash flows. The amendments require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company early adopted ASU 2016-18 during the three months ended January 31, 2017 and disclosure revisions have been made for the periods presented on the condensed consolidated statements of cash flows. See note 3.

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”). ASU 2016-15 is intended to address how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This update addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The amendments are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company early adopted ASU 2016-15 at the beginning of fiscal year 2017, but there was no impact on the consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments—Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 changes the impairment model for most financial assets and certain other instruments, including trade and other receivables, held-to-maturity debt securities and loans, and requires entities to use a new forward-looking expected loss model that will result in the earlier recognition of allowance for losses. This update is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for a fiscal year beginning after December 15, 2018, including interim periods within that fiscal year. Entities will apply the standard’s provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is evaluating the new guidance but does not believe this standard will have a material impact on its consolidated financial statements, as the Company has not experienced significant losses related to its credit accounts. The Company plans to adopt the guidance effective August 1, 2020, the beginning of the first fiscal period after the effective date.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation—Stock Compensation (Topic 718), Improvements to Employee Share-based Payment Accounting.” ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted. The Company has elected to early adopt this ASU beginning in the second quarter of fiscal year 2017, and has applied the effects of the adoption from the beginning of the annual period of adoption. During the three and six month periods ended January 31, 2017, stock-based compensation excess tax benefits or deficiencies are reflected in the consolidated statements of income as a component of the provision for income taxes, whereas they previously were recognized in additional paid in capital on the condensed consolidated balance sheets. Additionally, the consolidated statements of cash flows presents excess tax benefits as an operating activity for the six months ended January 31, 2017, while the historical periods have not been adjusted, which is consistent with the adoption of this portion of the standard on a prospective basis. Further, tax cash payments made on an employee’s behalf for shares withheld upon vesting or settlement are required to be presented as a financing activity, and the consolidated statement of cash flows for the six months ended January 31, 2017 has been revised to reflect these amounts as payments related to stock-based awards. Tax cash payments made on an employee’s behalf for shares withheld upon vesting or settlement for the six months ended January 31, 2016 were immaterial to the condensed consolidated financial statements. Additionally, the Company did not have any unrecognized tax benefits related to its share-based payment awards at the date of adoption. Finally, the Company has elected to account for forfeitures as they occur, rather than estimate expected forfeitures. Historically, estimated forfeitures were immaterial to the consolidated financial statements. The amendments in the standard that required use of a modified retrospective transition method did not materially impact the Company. Therefore, the Company did not recognize a cumulative-effect adjustment to retained earnings upon adoption as of August 1, 2016. See note 12 for information regarding the additional impact on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842),” which is intended to increase transparency and comparability of accounting for lease transactions. The ASU will require all leases with lease terms exceeding one year to be recognized on the balance sheet as lease assets and lease liabilities and will require both quantitative and qualitative disclosures regarding key information about leasing arrangements. Lessor accounting is largely unchanged. The guidance is effective beginning January 1, 2019 with an option to early adopt. The Company is currently scoping its significant lease arrangements to assess the potential impact on its consolidated financial statements. The Company plans to adopt the guidance effective October 31, 2019.

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers”, which requires entities to recognize revenue in a way that depicts 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 in exchange for those goods or services. The new guidance also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB voted to delay the effective date of ASU 2014-09 by one year to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. Adoption can occur using one of two prescribed transition methods. In March, April and December 2016, the FASB issued ASU 2016-08, “Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)”, ASU 2016-10, “Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing,” and ASU 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers,” which provide supplemental adoption guidance and clarification to ASC 2014-09. ASU 2016-08, ASU 2016-10 and ASU 2016-20 must be adopted concurrently with the adoption of ASU 2014-09. The Company is currently scoping its revenue contracts to assess the potential impact on its consolidated financial statements. The Company plans to adopt the revenue guidance effective October 31, 2018, although it has not yet selected a transition method.

2. Acquisitions

Subsequent to the date of the consolidated balance sheets, on February 1, 2017, the Company completed the acquisition of the assets of Sealweld Corporation, a privately held corporation organized under the laws of the Province of Alberta, Canada, for CAD\$22.6 million in cash (or approximately US\$17.4 million, at an exchange rate of 0.77 CAD\$ to US\$). The assets acquired include the ownership interests in Sealweld Corporation’s subsidiaries located in the United States. The acquired business supplies performance products and services for industrial valve and actuator maintenance, including lubricants, sealants, cleaners, valve fittings, tools and equipment, and provides routine and emergency valve maintenance services and technician training for pipeline operators. The acquisition will be accounted for in accordance with ASC 805, *Business Combinations*, with identifiable assets acquired and liabilities assumed recorded at their estimated fair values as of the acquisition date. However, the initial accounting for the acquisition is not complete as certain information and analysis that may impact the initial valuations are still being obtained or reviewed as a result of the short time period since the closing of the acquisition. Accordingly, the Company cannot provide the required details of the significant assets and liabilities that were acquired in the acquisition as of the date of this report. The significant

assets and liabilities acquired for which the initial accounting is incomplete include property, plant and equipment, intangible assets, goodwill, working capital and deferred income taxes.

3. Cash, Cash Equivalents and Restricted Cash

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the unaudited condensed consolidated balance sheets that sum to the total of the same amounts shown in the unaudited statements of cash flows:

Current Presentation	January 31, 2017	January 31, 2016
Cash and cash equivalents	\$ 30,587	\$ 8,900
Restricted cash	1,000	1,000
Total cash, cash equivalents and restricted cash	<u>\$ 31,587</u>	<u>\$ 9,900</u>

The Company's restricted cash includes cash balances which are legally or contractually restricted to use. The Company's restricted cash is included in current assets as of January 31, 2017 and other long term assets as of July 31, 2016 and includes proceeds that were placed in escrow in connection with the sale of the animal health business in fiscal year 2013.

4. Earnings Per Share

Basic earnings per share have been computed by dividing net income by the weighted average shares outstanding. Diluted earnings per share have been computed by dividing net income by the weighted average shares outstanding plus potentially dilutive common shares. There were approximately 412,000 and 321,000 dilutive shares related to stock-based awards for the three and six months ended January 31, 2017, respectively. There were approximately 198,000 and 183,000 dilutive shares related to stock-based awards for the three and six months ended January 31, 2016, respectively.

Outstanding stock-based awards are not included in the computation of diluted earnings per share under the treasury stock method if the effect of including them would be anti-dilutive. All outstanding stock awards were dilutive for the three months ended January 31, 2017. There were 97,000 performance-based shares that were not included in the computation of diluted earnings per share because the performance metrics have not been met as of January 31, 2017. There were 5,580 potentially dilutive securities that were not included for the six months ended January 31, 2017. There were 14,000 potentially dilutive securities that were not included for the three and six months ended January 31, 2016.

5. Inventories, net

Inventories, net are summarized in the following table (in thousands):

	January 31, 2017	July 31, 2016
Raw materials	\$ 7,053	\$ 7,429
Work in process	1,215	1,195
Supplies	970	968
Finished products	27,310	28,463
Less: reserve for inventory obsolescence	(678)	(654)
Inventories, net	<u>\$ 35,870</u>	<u>\$ 37,401</u>

6. Property, Plant and Equipment

Property, plant and equipment and related accumulated depreciation and amortization are summarized as follows (in thousands):

	January 31, 2017	July 31, 2016
Land	\$ 9,528	\$ 9,765
Buildings and improvements	38,422	39,974
Equipment	89,409	88,470
Leasehold improvements	2,460	2,460
	139,819	140,669
Less: accumulated depreciation and amortization	(69,834)	(65,958)
	69,985	74,711
Construction-in-progress	6,878	5,028
Property, plant and equipment, net ⁽¹⁾	<u>\$ 76,863</u>	<u>\$ 79,739</u>

- (1) In fiscal year 2016, as part of the Company's ongoing review of its Milan production facilities, the Company determined that certain other facilities had excess capacity sufficient to absorb the manufacturing operations of one of its Milan plants. As a result, the Company committed to sell properties with a total estimated fair value, less costs to sell, of approximately \$4.3 million at July 31, 2016 and January 31, 2017. Assets held for sale are included in prepaid expenses and other in current assets. The Company expects the sale of the properties to be completed during fiscal year 2017. The fair value measurements were based on recent valuation appraisals.

7. Stock-Based Compensation

The Company has stock-based incentive plans which are described in more detail in the consolidated financial statements in the Company's Annual Report on Form 10-K for fiscal year 2016. The Company recognized stock-based compensation costs of approximately \$1.7 million and \$1.4 million for the three months ended January 31, 2017 and 2016, respectively, and \$3.1 million and \$2.3 million for the six months ended January 31, 2017 and 2016, respectively. The Company also recognized the related tax benefits of \$595,000 and \$482,000 for the three months ended January 31, 2017 and 2016, respectively, and \$1.1 million and \$816,000 for the six months ended January 31, 2017 and 2016, respectively. Stock-based compensation costs are recorded under selling, general and administrative expenses in the condensed consolidated statements of income.

As of January 31, 2017, the unrecognized compensation costs related to stock-based awards was approximately \$9.0 million, which is expected to be recognized over a weighted-average period of 2.08 years.

Performance Shares

There were 503,556 and 328,731 non-vested performance shares outstanding at January 31, 2017 and August 1, 2016, respectively, which reflected the number of shares under the awards expected to vest as of such dates. No performance share awards vested during the six months ended January 31, 2017. As of January 31, 2017, the non-vested performance-based stock awards consisted of Series 1, Series 3 and Series 4 awards granted to certain executives and employees in fiscal years 2017, 2016 and 2015 as summarized below reflecting the target number of shares under the awards.

Date of Grant	Series Award	Target Award Shares	Grant Date Fair Value	Measurement Period Ending	Expected Percentage of Vesting(1)	Shares Expected to Vest
Fiscal Year 2017 Awards						
12/8/2016	Series 1	10,531	\$ 34.95	7/31/2019	100%	10,531
10/21/2016	Series 3	14,000	\$ 29.11	7/31/2017	100%	14,000
10/21/2016	Series 4	88,674	\$ 29.11	7/31/2019	100%	88,674
Fiscal Year 2016 Awards						
3/10/2016	Series 1	14,625	\$ 21.89	10/31/2018		
1/29/2016	Series 1	57,163	\$ 21.80	10/31/2018		
	Forfeitures(2)	(5,350)				
	Total Series 1	66,438			188%	124,634
1/19/2016	Series 3	82,938	\$ 20.89	7/31/2020	100%	82,938
Fiscal Year 2015 Awards						
3/26/2015	Series 1	21,173	\$ 25.85	7/31/2017		
12/9/2014	Series 1	103,499	\$ 17.81	7/31/2017		
	Forfeitures(2)	(12,435)				
	Total Series 1	112,237			163%	182,779

(1) The percentage vesting for Series 1 performance share awards is currently estimated at 100%, 188% and 163% of the target award for the fiscal year 2017, 2016 and 2015 awards, respectively. The percentage vesting for Series 3 performance share awards is currently estimated at 100% of the target award for each of the fiscal year 2017 and 2016 awards. The percentage vesting for Series 4 performance share awards is currently estimated at 100% of the target award for the fiscal year 2017 awards.

(2) Forfeitures include Series 1 awards that were granted in fiscal years 2016 and 2015 to certain employees that were forfeited at the termination of their employment.

Series 1: For the fiscal year 2017, 2016 and 2015 awards, vesting is subject to performance requirements composed of certain objectives including average annual return on invested capital and annual compound growth rate in the Company's diluted earnings per share. These objectives are assessed quarterly using the Company's budget, actual results and long-term projections. For each of the Series 1 awards, the expected percentage of vesting is evaluated through January 31, 2017, and reflects the percentage of shares projected to vest for the respective awards at the end of their measurement periods. For the fiscal year 2017, 2016 and 2015 awards, shares vested may increase to a maximum of 200%, 200% and 167%, respectively, of the target award on achievement of maximum performance objectives.

Series 3: In fiscal year 2017, Mr. Fraser was awarded (i) a performance-based Series 3 award for 10,000 shares of common stock (at maximum) having a performance requirement related to debt payments during the fiscal year, and (ii) a performance-based Series 3 award for 4,000 shares of common stock having certain organizational objectives as a performance requirement, and in each case such awards vest and are measured over a one year period beginning August 1 and ending July 31. These awards are expected to vest at 100% of the target award. In fiscal year 2016, Mr. Fraser was awarded (i) a performance-based Series 3 award for 10,000 shares of common stock (at maximum) having a performance requirement related to debt payments during the fiscal year, and (ii) a performance-based Series 3 award for 4,000 shares of common stock having certain organizational objectives as a performance requirement, and in each case such awards vest and are measured over a one year period beginning August 1 and ending July 31. These awards fully vested as of July 31, 2016 and 14,000 shares were issued on August 5, 2016. Awards to Mr. Fraser for fiscal year 2015 included (i) a performance-based Series 3 award for 10,000 shares of common stock (at maximum) having a performance requirement related to debt payments during the fiscal year, and (ii) a performance-based Series 3 award for 4,000 shares of common stock having certain organizational objectives as a performance requirement, and in each case such awards vest and are measured over a one year period beginning August 1 and ending July 31. The award for fiscal year 2015 was fully vested and 14,000 shares were issued on October 1, 2015. In fiscal year 2016 Mr. Fraser was also awarded a performance-based Series 3 award for 82,938 shares of

common stock (at target) having performance requirements related to cumulative revenue and total stockholder return. The measurement period for the fiscal year 2016 award begins on November 1, 2015 and the award vests one-third (1/3) at July 31, 2018, 2019 and 2020. The shares vested may increase to a maximum of 200% of the target award on achievement of maximum performance objectives. These awards are expected to vest at 100% of the target award.

Series 4: For the fiscal year 2017 awards, each award includes two tranches. For the first tranche, vesting is subject to the achievement of an adjusted earnings before interest, taxes and depreciation and amortization (“EBITDA”) metric. For the second tranche, vesting is subject to performance requirements composed of certain objectives including average annual return on invested capital and annual compound growth rate in the Company’s diluted earnings per share. These objectives are assessed quarterly using the Company’s budget, actual results and long-term projections. For each of the Series 4 awards, the expected percentage vesting is evaluated through January 31, 2017, and reflects the percentage of shares projected to vest at the end of the measurement period. For the fiscal year 2017 awards, the shares vested in the second tranche may increase to a maximum of 200% of the target award on achievement of maximum performance objectives.

The weighted-average per share grant-date fair value of the target award shares for performance-based awards outstanding was \$22.44 and \$17.36 at January 31, 2017 and August 1, 2016, respectively.

The weighted-average per share grant-date fair value of the target award shares for performance-based awards granted during the six months ended January 31, 2017 and 2016 was \$29.64 and \$21.06, respectively.

The weighted-average per share grant-date fair value of awards forfeited during the six months ended January 31, 2017 and 2016 was \$25.85 and \$21.90, respectively.

Time-Based Shares

A summary of activity for time-based stock awards for the six months ended January 31, 2017 is presented below:

	Shares	Weighted-Average Grant-Date Fair Value
Non-vested on August 1, 2016	211,368	\$ 21.28
Granted (1)	18,803	33.25
Vested(2)	(18,474)	24.96
Forfeited	(250)	25.85
Non-vested on January 31, 2017	<u>211,447</u>	<u>22.00</u>

(1) Includes 8,224 shares granted to non-employee directors for service during the six month period ended January 31, 2017.

(2) Includes 8,224 shares granted to non-employee directors for service for the six months ended January 31, 2017. The shares vest on the date of grant, and the Company recognizes compensation expense related to the awards over the respective service periods in accordance with GAAP. Includes 10,250 shares granted to certain employees and executives.

The total fair value of time-based shares vested during the six months ended January 31, 2017 and 2016 was approximately \$461,000 and \$694,000, respectively.

8. Intangible Assets

Intangible assets are summarized as follows (in thousands):

	Number of Years Weighted Average Amortization Period	January 31, 2017			
		Original Cost	Accumulated Amortization	Foreign Currency Translation Adjustment	Carrying Amount
Intangible assets subject to amortization (range of useful life):					
Electronic chemicals-related contracts (5-8 years)	6.6	\$ 2,204	\$ (1,233)	\$ (150)	\$ 821
Electronic chemicals-related trademarks and patents (10-15 years)	12.0	117	(93)	—	24
Electronic chemicals-value of product qualifications (5-15 years)	14.1	14,100	(5,049)	(1,092)	7,959
Other chemicals-customer relationships (15 years)	15.0	10,291	(1,201)	—	9,090
Other chemicals-Other related contracts (5 years)	5.0	152	(53)	—	99
Electronic chemicals-Tolling/License Agreements (1-3 years)	1.4	328	(228)	(9)	91
Total intangible assets subject to amortization	13.6	\$ 27,192	\$ (7,857)	\$ (1,251)	\$ 18,084
Intangible assets not subject to amortization:					
Other chemicals-penta product registrations					8,765
Other chemicals-related trade name and trademark					2,885
Other chemicals-proprietary manufacturing process					2,808
Total intangible assets not subject to amortization					14,458
Total intangible assets, net					\$ 32,542

	Number of Years Weighted Average Amortization Period	July 31, 2016			
		Original Cost	Accumulated Amortization	Foreign Currency Translation Adjustment	Carrying Amount
Intangible assets subject to amortization (range of useful life):					
Electronic chemicals-related contracts (5-8 years)	6.6	\$ 2,204	\$ (1,104)	\$ (117)	\$ 983
Electronic chemicals-related trademarks and patents (10-15 years)	12.0	117	(87)	—	30
Electronic chemicals-value of product qualifications (5-15 years)	14.1	14,100	(4,616)	(831)	8,653
Other chemicals-customer relationships (15 years)	15.0	10,291	(858)	—	9,433
Other chemicals-other related contracts (5 years)	5.0	152	(38)	—	114
Electronic chemicals- Tolling/License Agreements (1-3 years)	1.4	328	(93)	—	235
Total intangible assets subject to amortization	13.6	\$ 27,192	\$ (6,796)	\$ (948)	\$ 19,448
Intangible assets not subject to amortization:					
Other chemicals-penta product registrations					8,765
Other chemicals-related trade name and trademark					2,885
Other chemicals-proprietary manufacturing process					2,808
Total intangible assets not subject to amortization					14,458
Total intangible assets, net					\$ 33,906

Intangible assets subject to amortization are amortized over their estimated useful lives. Amortization expense was approximately \$525,000 and \$496,000 for the three month periods ended January 31, 2017 and 2016, respectively, and \$1.1 million and \$995,000 for the six month periods ended January 31, 2017 and 2016, respectively.

9. Dividends

Dividends of approximately \$356,000 (\$0.03 per share) and \$352,000 (\$0.03 per share) were declared and paid in the second quarter of fiscal years 2017 and 2016, respectively. Dividends of approximately \$709,000 (\$0.06 per share) and \$703,000 (\$0.06 per share) were declared and paid in the first six months of fiscal years 2017 and 2016, respectively. A dividend of \$0.03 per share was approved by the Company's board of directors on March 1, 2017 to be paid on March 17, 2017 to shareholders of record on March 10, 2017.

10. Segment Information

The Company has two reportable segments — electronic chemicals and other chemicals. In conjunction with the acquisition of the industrial lubricants business, the Company's management, including the chief executive officer, who is the chief operating decision maker, determined that the Company's operations should be reported as the electronic chemicals and other chemicals business segments.

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2017	2016	2017	2016
	(Amounts in thousands)			
Net sales				
Electronic chemicals	\$ 69,766	\$ 62,521	\$ 136,688	\$ 128,603
Other chemicals	9,305	8,338	18,878	18,906
Other activities	—	—	—	—
Total consolidated net sales	<u>\$ 79,071</u>	<u>\$ 70,859</u>	<u>\$ 155,566</u>	<u>\$ 147,509</u>
Depreciation and amortization (1)				
Electronic chemicals	\$ 2,793	\$ 2,849	\$ 5,645	\$ 5,764
Other chemicals	285	286	572	583
Other activities	418	344	831	677
Total consolidated depreciation and amortization	<u>\$ 3,496</u>	<u>\$ 3,479</u>	<u>\$ 7,048</u>	<u>\$ 7,024</u>
Operating income(2)				
Electronic chemicals	\$ 9,583	\$ 8,470	\$ 17,644	\$ 15,744
Other chemicals	3,023	2,804	6,704	6,568
Other activities	(3,566)	(5,137)	(6,628)	(8,855)
Total consolidated operating income	<u>9,040</u>	<u>6,137</u>	<u>17,720</u>	<u>13,457</u>
Total other income (expense), net	(457)	(103)	(404)	(272)
Income before income taxes	<u>\$ 8,583</u>	<u>\$ 6,034</u>	<u>\$ 17,316</u>	<u>\$ 13,185</u>

(1) Segment depreciation excludes depreciation for restructuring and realignment.

(2) Segment income from operations includes allocated corporate overhead expenses, but excludes restructuring and realignment charges, which are included in other activities.

11. Long-Term Debt

The Company's debt as of January 31, 2017 and July 31, 2016 consisted of the following:

	January 31,	July 31,
	2017	2016
	(Amounts in thousands)	
Senior secured debt:		
Revolving loan facility, maturing on October 9, 2019	\$ 41,000	\$ 35,800

On October 9, 2014, the Company entered into a new credit facility (the "Second Restated Credit Facility") with Wells Fargo Bank, National Association, Bank of America, N.A., HSBC Bank USA, National Association and JPMorgan Chase Bank, N.A. The Second Restated Credit Facility provides for a revolving loan up to \$150.0 million, including an accordion feature that allows for an additional revolving loan increase of up to an additional \$100.0 million with approval from the lenders. The maturity date for the Second Restated Credit Facility is October 9, 2019. At January 31, 2017, the Company had \$41.0 million outstanding under the Second Restated Credit Facility. The maximum available borrowing capacity remaining under the Second Restated Credit Facility as of January 31, 2016 was \$106.3 million, after giving effect to a reduction of \$2.7 million for unused letters of credit.

The revolving loan bears interest at a varying rate of the 30-day LIBOR rate plus a margin based on funded debt to EBITDA.

Ratio of Funded Debt to EBITDA	Margin
Equal to or greater than 3.00 to 1.0	1.875%
Equal to or greater than 2.75 to 1.0, but less than 3.00 to 1.0	1.625%
Equal to or greater than 2.50 to 1.0, but less than 2.75 to 1.0	1.500%
Equal to or greater than 2.25 to 1.0, but less than 2.50 to 1.0	1.375%
Equal to or greater than 2.00 to 1.0, but less than 2.25 to 1.0	1.250%
Equal to or greater than 1.50 to 1.0, but less than 2.00 to 1.0	1.125%
Less than 1.50 to 1.0	1.000%

The Company borrowed \$17.0 million on January 31, 2017 to fund the acquisition of the assets of Sealweld Corporation. See note 2. At January 31, 2017 that \$17.0 million borrowing bore interest at the base rate of 3.75%. However, on February 2, 2017, the base rate loan was converted to a LIBOR rate loan at an interest rate of 1.779%. At January 31, 2017, the remaining \$24.0 million outstanding under the revolver that bore interest at 1.776%. The Company will also incur an unused commitment fee on the unused amount of commitments under the Second Restated Credit Facility from 0.30% to 0.15%, based on the ratio of funded debt to EBITDA.

Loans under the Second Restated Credit Facility are secured by the Company's assets, including inventory, accounts receivable, equipment, intangible assets, and real property. The Second Restated Credit Facility has restrictive covenants, including that the Company must maintain a fixed charge coverage ratio of 1.5 to 1.0 or greater, a ratio of funded debt to EBITDA (as adjusted for non-cash and unusual, non-recurring, and certain acquisition and integration costs) of 3.25 to 1.0 (with a step-up to 3.5 to 1.0 during an acquisition period with lender consent) and a current ratio of at least 1.5 to 1.0. As of January 31, 2017, the Company was in compliance with all covenants of the Second Restated Credit Facility.

12. Income Taxes

Income tax expense for the interim periods was computed using an estimated annual effective income tax rate applied to year-to-date income before income tax expense. In determining the estimated annual effective income tax rate, the Company analyzes various factors, including forecasts of projected annual earnings and the ability to use tax credits and net operating loss carry forwards. The overall effective income tax rate for the three and six month periods ended January 31, 2017 was 24.4% and 29.4%, respectively. For the three and six month periods ended January 31, 2016, the overall effective income tax rate was 34.1% and 35.0%, respectively.

Through the six month period ended January 31, 2017, stock-based compensation excess tax benefits of \$685,000 were reflected in the consolidated statements of income as a component of the provision for income taxes as a result of the early adoption of ASU 2016-09. See note 1 for more details regarding the adoption of ASU 2016-09.

13. Litigation and Other Contingencies

The Company is subject to contingencies, including litigation relating to environmental laws and regulations, commercial disputes and other matters. Certain of these contingencies are discussed below. The ultimate resolution of these contingencies is subject to significant uncertainty, and should the Company fail to prevail in any of them or should several of them be resolved against the Company in the same reporting period, these matters could, individually or in the aggregate, be material to the consolidated financial statements. The ultimate outcome of these matters, however, cannot be determined at this time, nor can the amount of any potential loss or range of loss be reasonably estimated, and as a result except where indicated no amounts have been recorded in the Company's consolidated financial statements.

The Company records legal costs associated with loss contingencies as expenses in the period in which they are incurred.

The EPA has listed the Star Lake Canal Superfund Site near Beaumont, Texas on the National Priorities List. The Company's subsidiary, KMG-Bernuth, was notified in October 2014 that the EPA considered it to have potential liability under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, also known as "CERCLA," in connection with this site by virtue of its relationship with certain alleged successor companies, including Idacon, Inc. (f/k/a Sonford Chemical Company). The EPA has estimated that the remediation will cost approximately \$22.0 million. The Company and approximately seven other parties entered into an interim agreement with the EPA in September 2016 to complete a remedial design phase of the remediation of the site. No assurance can be given that the EPA will not designate the Company's subsidiary as a potentially responsible party. The Company established a liability of \$1.3 million in the third quarter of fiscal year 2015 in connection with this matter. As of January 31, 2017, the liability remaining was \$1.0 million.

The Company is subject to federal, state, local and foreign laws and regulations and potential liabilities relating to the protection of the environment and human health and safety including, among other things, the cleanup of contaminated sites, the treatment, storage and disposal of wastes, the emission of substances into the air or waterways, and various health and safety matters. The

Company expects to incur substantial costs for ongoing compliance with such laws and regulations. The Company may also face governmental or third-party claims, or otherwise incur costs, relating to cleanup of, or for injuries resulting from, contamination at sites associated with past and present operations. The Company accrues for environmental liabilities when a determination can be made that they are probable and reasonably estimable.

14. Restructuring and Realignment Events

As part of the Company's global restructuring of its electronic chemicals operations, the Fremont, California manufacturing site acquired in the acquisition from OM Group was closed in fiscal year 2014, and production has been shifted primarily to the Company's Hollister, California and Pueblo, Colorado facilities. The Company closed one of its facilities in Milan, Italy in December 2015, and shifted some production to facilities in France and the United Kingdom. Accelerated depreciation with respect to the closed facilities has been completed.

At January 31, 2017, the accrued liability associated with restructuring and other related charges consisted of the following (in thousands):

	<u>Employee Costs</u>	<u>Decommissioning and Environmental</u>	<u>Other</u>	<u>Total</u>
Accrued liability at August 1, 2016	\$ 721	\$ 36	\$ —	\$ 757
Payments	(196)	(19)	(6)	(221)
Adjustment	(27)	—	6	(21)
Accrued liability at January 31, 2017	<u>\$ 498</u>	<u>\$ 17</u>	<u>\$ —</u>	<u>\$ 515</u>

Total accelerated depreciation for the three months ended October 31, 2015 was \$105,000. There was no additional accelerated depreciation recorded for the three months ended January 31, 2016. There was no accelerated depreciation for the three and six months ended January 31, 2017.

In October 2014, the Company announced a realignment of its hydrofluoric acid business and subsequently exited the facility operated for the Company by Chemtrade Logistics ("Chemtrade") in Bay Point, California. Under the manufacturing agreement, the Company is obligated to pay or reimburse Chemtrade for certain costs associated with the cessation of operations at Bay Point, including certain employee costs and the decommissioning, dismantling and removal of the Company's manufacturing equipment at the site. Operations ceased in the third quarter of fiscal year 2015. The Company incurred total charges of \$4.8 million for accelerated depreciation during fiscal year 2015. Additionally, the Company incurred certain employee costs of \$747,000. All assets have been fully depreciated as of July 31, 2015.

The changes to the asset retirement obligation associated with this realignment during the six months ended January 31, 2017 are as follows (in thousands):

Asset retirement obligation at August 1, 2016	\$	168
Charges		—
Payments		(3)
Asset retirement obligation at January 31, 2017	<u>\$</u>	<u>165</u>

The Company incurred no charges for accelerated depreciation for the assets previously associated with the operations at Bay Point during the three and six month periods ended January 31, 2017 and 2016. The Company incurred certain employee costs of \$130,000 during the three and six month periods ended January 31, 2016. There were no such employee costs during the three and six month periods ended January 31, 2017.

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

We manufacture, formulate and globally distribute specialty chemicals. We operate businesses engaged in selling electronic chemicals, industrial valve lubricants and sealants and industrial wood treating chemicals. Our electronic chemicals are sold to the semiconductor industry, where they are used primarily to clean and etch silicon wafers in the production of semiconductors. Our valve lubricants and sealants enable optimal valve operation and provide important safety and environmental benefits, including preventing fugitive emissions and minimizing costly downtime at oil and gas storage facilities and pipelines. Our wood treating chemicals, based on pentachlorophenol ("penta"), are used by industrial customers primarily to extend the useful life of utility poles and cross-arms.

Acquisition of Sealweld Corporation

On February 1, 2017, we completed the acquisition of the assets of Sealweld Corporation ("Sealweld"), a privately held corporation organized under the laws of the Province of Alberta, Canada, for CAD\$22.6 million in cash (or approximately US\$17.4 million, at an exchange rate of 0.77 CAD\$ to US\$ at February 1, 2017), including estimated net working capital of CAD\$5.8 million (or approximately US\$4.5 million, at an exchange rate of 0.77 CAD\$ to US\$ at February 1, 2017). Sealweld is based in Calgary, Alberta, Canada, with additional facilities in the United States and the United Arab Emirates. Sealweld is a leading global supplier of high-performance products and services for industrial valve and actuator maintenance, including lubricants, sealants, cleaners, valve fittings, tools and equipment. Additionally, Sealweld provides routine and emergency valve maintenance services and technician training for many of the world's largest pipeline operators. The financial condition and results of operation of the acquired business are expected to be included in our Quarterly Report on Form 10-Q for the fiscal quarter ended April 30, 2017.

Acquisition of Nagase Finechem Singapore (Pte) Ltd.

On April 4, 2016, we completed the acquisition of Nagase Finechem Singapore (Pte) Ltd. ("NFC"), a Singapore-based manufacturer of electronic chemicals, for a cash purchase price of \$2.9 million, including \$1.1 million of estimated net working capital. NFC's five-acre Singapore site comprises a manufacturing and packaging facility, warehouse, laboratory and cleanroom. The acquired company manufactures wet process chemicals, including solvents, acids and custom blends for the liquid crystal display, electronics and semiconductor markets and provides recycling and refining services for certain customers. We recorded a \$1.8 million bargain purchase gain for the year ended July 31, 2016.

Restructuring and Realignment

As part of the global restructuring of our electronic chemicals operations, we have closed our Fremont, California manufacturing site acquired in our acquisition of the electronic chemicals business subsidiaries of OM Group, Inc. and production was shifted primarily to our Hollister, California and Pueblo, Colorado facilities. We also closed one of our facilities in Milan, Italy, and shifted production to our facilities in France and the United Kingdom. Decommissioning of certain manufacturing equipment in Milan was essentially complete in fiscal year 2016.

In October, 2014, we announced a realignment of our hydrofluoric acid business and subsequently exited the facility operated for us by Chemtrade Logistics in Bay Point, California. Operations ceased in the third quarter of fiscal year 2015. We incurred certain employee costs of \$0.1 million in the first quarter of fiscal year 2016. There were no such costs in the six month period ended January 31, 2017.

See Note 14 to the condensed consolidated financial statements included in this report.

Results of Operations

Three and Six Month Periods Ended January 31, 2017 compared with the Three and Six Month Periods Ended January 31, 2016

Segment Net Sales

Segment data is presented for our two reportable segments for the three and six month periods ended January 31, 2017 and 2016. The segment data should be read in conjunction with our condensed consolidated financial statements and related notes thereto included elsewhere in this report.

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2017	2016	2017	2016
	(Amounts in thousands)		(Amounts in thousands)	
Sales				
Electronic chemicals	\$ 69,766	\$ 62,521	\$ 136,688	\$ 128,603
Other chemicals	9,305	8,338	18,878	18,906
Total sales for reportable segments	<u>\$ 79,071</u>	<u>\$ 70,859</u>	<u>\$ 155,566</u>	<u>\$ 147,509</u>

Net Sales

Net sales for reportable segments increased \$8.2 million, or 11.6%, to \$79.1 million in the second quarter of fiscal year 2017, from \$70.9 million for the same period of the prior year. The increase in net sales for the second quarter was due primarily to higher sales volume in both the electronic chemicals and other chemicals segments. For the six months ended January 31, 2017, net sales for reportable segments increased \$8.1 million, or 5.5%, to \$155.6 million from \$147.5 million for the same period of the prior year. For the six months period, the increase in net sales was due primarily to higher sales volume within the electronic chemicals segment.

In the second quarter of fiscal year 2017, the electronic chemicals segment had net sales of \$69.8 million, an increase of \$7.3 million, or 11.5%, as compared to \$62.5 million for the same period of the prior year. For the six month period ended January 31, 2017, net sales in the electronic chemicals segment increased \$8.1 million, or 6.3%, to \$136.7 million from \$128.6 million for the same period of the prior year. For the quarterly and six month periods, net sales increased compared to the prior year periods because of increased sales volume globally, including the effect of sales from the NFC business acquired in April 2016.

Net sales of other chemicals increased \$1.0 million, or 12.0%, to \$9.3 million in the second quarter of fiscal year 2017 as compared to \$8.3 million for the same period of the prior year. For the quarterly period, the increase in net sales was from higher sales volume. For the six month period ended January 31, 2017, net sales in the other chemicals segment remained flat at \$18.9 million compared to the same period of the prior year.

Gross Profit

Gross profit increased by \$3.0 million, or 10.6%, to \$31.2 million in the second quarter of fiscal year 2017 from \$28.2 million in the same quarter of the prior year. For the six month period ended January 31, 2017, gross profit increased \$3.4 million, or 5.9%, to \$60.9 million from \$57.5 million in the same period of the prior year. The increase in aggregate gross profit was primarily due to increased sales volume in the electronic chemicals segment and operating efficiencies realized in each segment. In addition, sales from the NFC business acquired in April 2016 further contributed to the increase in aggregate gross profit. Gross profit as a percentage of sales of 39.5% in the second quarter of fiscal year 2017 remained essentially unchanged from 39.8% in the second quarter of fiscal year 2016. For the six months ended January 31, 2017, gross profit as a percentage of sales of 39.1% remained essentially unchanged from 39.0% in the same period of the prior year.

Other companies may include certain costs that we record in cost of sales as distribution expenses or selling, general and administrative expenses, and may include certain of the costs that we record in distribution expenses or selling, general and administrative expenses as a component of cost of sales, resulting in a lack of comparability between our gross profit and that reported by other companies.

Distribution Expenses

Distribution expenses were higher in the second quarter of fiscal year 2017 by \$1.0 million, or 11.4%, to \$9.8 million as compared to \$8.8 million in the second quarter of fiscal year 2016. Distribution expenses were flat as a percentage of net sales for the second quarter of fiscal years 2017 and 2016, respectively. Distribution expenses for the six month period ended January 31, 2017 were \$18.8 million, a decrease of \$0.1 million, or 0.5%, from \$18.9 million for the same period of the prior year. Distribution

expenses as a percentage of sales for the six month periods ended January 31, 2017 and 2016 were 12.1% and 12.8%, respectively. The electronic chemicals segment represents approximately 97% of distribution expenses.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased \$0.3 million, or 2.4%, to \$12.4 million in the second quarter of fiscal year 2017 from \$12.7 million in the same quarter of fiscal year 2016. Those expenses were 15.7% and 17.9% of net sales in the second quarter of fiscal years 2017 and 2016, respectively. The decrease from the prior year was primarily due to lower professional fees, partially offset by an increase in stock-based compensation. For the six month period ended January 31, 2017, those expenses increased \$0.4 million, or 1.7%, to \$24.3 million from \$23.9 million in the same period of the prior year. Those expenses were 15.6% and 16.2% of net sales in the six month periods ended January 31, 2017 and 2016, respectively. The increase over the prior year period was primarily due to a \$1.5 million increase in employee related compensation, including stock-based and short term incentive compensation, partially offset by a decrease in professional fees of \$1.0 million.

Segment Income from Operations

In the second quarter of fiscal year 2017, operating income in the electronic chemicals segment was \$9.6 million, an increase of \$1.1 million, or 12.9%, as compared to \$8.5 million for the same period of the prior year. For the six month period ended January 31, 2017, operating income in the electronic chemicals segment increased \$1.9 million, or 12.1%, to \$17.6 million from \$15.7 million in the same period of the prior year. The improvement was primarily driven by higher sales volume and operating efficiencies.

In our other chemicals segment, operating income increased approximately \$0.2 million, or 7.1%, to \$3.0 million in the second quarter of fiscal year 2017 as compared to \$2.8 million for the same period of the prior year. For the six month period ended January 31, 2017, operating income in the other chemicals segment increased \$0.1 million, or 1.5%, to \$6.7 million from \$6.6 million in the same period of the prior year. Operating income in other chemicals increased due to higher sales volume in our industrial lubricants business.

Other corporate expenses are not allocated to segments in calculating a segment's income from operations. Other corporate expenses primarily represent employee stock-based compensation expenses and public entity expenses, such as board compensation, audit expense and fees related to the listing of our common stock. For fiscal quarters ended January 31, 2017 and 2016, other corporate expenses were \$3.6 million and \$4.5 million, respectively. For the six months ended January 31, 2017 and 2016, other corporate expenses were \$6.6 million and \$7.7 million, respectively. The decrease in other corporate expenses for both the quarterly and six month comparisons, was primarily due to the allocation of enterprise resource planning post-implementation support costs to our segments for the second quarter of fiscal year 2017 that were previously not allocated.

Net Income, Adjusted EBITDA, Adjusted Net Income and Adjusted Diluted Earnings Per Share

Net income was \$6.5 million in the second quarter of fiscal year 2017, an increase of \$2.5 million, or 62.5%, as compared to \$4.0 million in the second quarter of fiscal year 2016. For the six month period ended January 31, 2017, net income was \$12.2 million, an increase of \$3.6 million, or 41.9%, from \$8.6 million in the same period of the prior year. Diluted earnings per share was \$0.53 and \$0.33 in the second quarter of fiscal years 2017 and 2016, respectively, and \$1.00 and \$0.72 for six month periods ended January 31, 2017 and 2016, respectively.

Adjusted EBITDA (as defined below under Non-GAAP Financial Measures) excludes costs associated with the restructuring of our manufacturing operations in Europe and corporate relocation expenses in fiscal year 2016 and our acquisition, integration and corporate relocation expenses in fiscal year 2017. In the second quarter of fiscal year 2017, adjusted EBITDA was \$13.1 million, an increase of \$2.1 million, or 19.1%, as compared to \$11.0 million in the second quarter of fiscal year 2016. For the six month period ended January 31, 2017, adjusted EBITDA was \$25.7 million, an increase of \$3.2 million, or 14.2%, compared to \$22.5 million for the same period of the prior year. The increase in adjusted EBITDA was a result of higher sales volume in electronic chemicals globally. In addition, the acquisition of the NFC business in April 2016 contributed to the increase in adjusted EBITDA over the prior year.

In the second quarter of fiscal year 2017 adjusted diluted earnings per share was \$0.57, compared to \$0.40 in the second quarter of fiscal year 2016. For the six month period ended January 31, 2017, adjusted diluted earnings per share was \$1.05, compared to \$0.82 for the same period of the prior year. The increase in adjusted diluted earnings per share was a result of higher sales volume in electronic chemicals, which included the impact of the acquisition of the NFC business in April 2016.

Non-GAAP Financial Measures

We provide non-GAAP financial information to complement reported GAAP results including adjusted EBITDA, adjusted net income and adjusted diluted earnings per share. We believe that analysis of our financial performance is enhanced by an understanding of these non-GAAP financial measures. We believe that these measures aid in evaluating the underlying operational performance of our business and facilitate comparisons between periods. Non-GAAP financial information, such as adjusted EBITDA, is used externally by users of our consolidated financial statements, such as analysts and investors. A similar calculation of adjusted EBITDA is utilized internally for executives' compensation and by our lenders for a key debt compliance ratio.

We define adjusted EBITDA as earnings from continuing operations before interest, taxes, depreciation, amortization, acquisition and integration expenses, restructuring and realignment charges and other designated items. Adjusted EBITDA is a primary measurement of cash flow from operations and a measure of our ability to invest in our operations and provide shareholder returns. Adjusted EBITDA is not intended to represent U.S. GAAP definitions of cash flow from operations or net income/(loss). Adjusted net income adjusts net income for acquisition and integration expenses, restructuring and realignment charges and other relevant items, while adjusted diluted earnings per share is adjusted net income divided by diluted weighted average shares outstanding.

Adjusted EBITDA, adjusted net income and adjusted diluted earnings per share should be viewed as supplements to, and not substitutes for, U.S. GAAP measures of performance.

The table below provides a reconciliation of net income to adjusted EBITDA.

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2017	2016	2017	2016
	(Amounts in thousands)		(Amounts in thousands)	
Net income	\$ 6,486	\$ 3,979	\$ 12,227	\$ 8,570
Interest expense, net	172	252	349	404
Income taxes	2,097	2,055	5,089	4,615
Depreciation and amortization ⁽¹⁾	3,496	3,479	7,048	7,129
EBITDA	12,251	9,765	24,713	20,718
Acquisition and integration expenses	501	—	584	—
Corporate relocation expense	316	729	366	729
Restructuring and realignment charges, excluding accelerated depreciation	—	555	—	1,046
Adjusted EBITDA	\$ 13,068	\$ 11,049	\$ 25,663	\$ 22,493

(1) Includes \$0.1 million of depreciation related to restructuring and realignment included in non-cash restructuring and realignment charges on the statement of cash flows for the six months ended January 31, 2016.

The table below provides a reconciliation of net income to adjusted net income and adjusted diluted earnings per share.

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2017	2016	2017	2016
	(Amounts in thousands)		(Amounts in thousands)	
Net income	\$ 6,486	\$ 3,979	\$ 12,227	\$ 8,570
Items impacting pre-tax income:				
Acquisition and integration expenses	501	—	584	—
Corporate relocation expense	316	729	366	729
Restructuring and realignment charges	—	555	—	1,151
Income taxes ⁽¹⁾	(286)	(449)	(332)	(658)
Adjusted net income	\$ 7,017	\$ 4,814	\$ 12,845	\$ 9,792
Diluted earnings per share	\$ 0.53	\$ 0.33	\$ 1.00	\$ 0.72
Adjusted diluted earnings per share	\$ 0.57	\$ 0.40	\$ 1.05	\$ 0.82
Weighted average diluted shares outstanding	12,293	11,915	12,203	11,890

(1) Represents the aggregate tax-effect assuming a 35% tax rate of the items impacting pre-tax income.

Interest Expense, net

Interest expense, net was \$0.2 million and \$0.3 million in the second quarter of fiscal years 2017 and 2016, respectively, and was \$0.3 million and \$0.4 million in the first six months ended January 31, 2017 and 2016, respectively. For the quarterly and six month period comparisons, interest expense was lower compared to the prior year due to lower average debt levels outstanding during the course of the periods.

Income Taxes

The overall effective income tax rate for the three and six month periods ended January 31, 2017 was 24.4% and 29.4%, respectively. For the three and six month periods ended January 31, 2016, the overall effective tax rate was 34.1% and 35.0%, respectively. The primary reason for the reduction compared to the prior year is due to stock-based compensation excess tax benefits of \$0.7 million realized as a result of the early adoption of Accounting Standards Update 2016-09. See note 1 to the condensed consolidated financial statements included in this report. In addition, we had a favorable mix of earnings in jurisdictions with income tax rates lower than the U.S. statutory rate.

Liquidity and Capital Resources

Cash Flows

Net cash provided by operating activities was \$19.4 million and \$14.1 million for the six months ended January 31, 2017 and 2016, respectively.

For the six months ended January 31, 2017, operating cash flows were favorably impacted by higher margins in our electronic chemicals segment. In addition, we incurred \$1.0 million less in restructuring and realignment expenses compared to the same period of the prior year. We also had a \$1.5 million decrease in working capital.

Net cash provided by (used in) financing activities was \$4.2 million and (\$6.7) million for the six months ended January 31, 2017 and 2016, respectively. During the six months ended January 31, 2017, we borrowed \$17.0 million for the acquisition of Sealweld on February 1, 2017, and made repayments of \$11.8 million on our revolving credit facility. During the six months ended January 31, 2016, we had no borrowings and made repayments of \$6.0 million on our revolving credit facility.

Working Capital

On October 9, 2014, we refinanced our then existing revolving loan facility and entered into a new amended and restated credit agreement (the "Second Restated Credit Facility") under which we have a revolving line of credit of \$150.0 million. At January 31, 2017, we had \$41.0 million outstanding under the revolving facility, and an additional \$2.7 million was reserved for outstanding letters of credit, with up to an additional \$106.3 million of additional borrowing capacity. The amount that may be borrowed under the revolving facility is limited by a covenant for funded debt to pro-forma earnings before interest, taxes and depreciation ("EBITDA"), and at January 31, 2017, that covenant did not limit our additional borrowing capacity.

Management believes that the Second Restated Credit Facility, combined with cash flows from operations, will adequately provide for our working capital needs for current operations for the next twelve months.

Long Term Obligations

The Second Restated Credit Facility is with Wells Fargo Bank, National Association, Bank of America, N.A., HSBC Bank USA, National Association and JPMorgan Chase Bank, N.A. The Second Restated Credit Facility provides for a revolving loan up to \$150.0 million, including an accordion feature that allows for an additional revolving loan increase of up to \$100.0 million with approval from our lenders. The maturity date for the Second Restated Credit Facility is October 9, 2019.

The revolving loan under the Second Restated Credit Facility bears interest at varying rate of the 30-day LIBOR rate plus a margin based on funded debt to EBITDA, as described in the table.

Ratio of Funded Debt to EBITDA	Margin
Equal to or greater than 3.00 to 1.0	1.875%
Equal to or greater than 2.75 to 1.0, but less than 3.00 to 1.0	1.625%
Equal to or greater than 2.50 to 1.0, but less than 2.75 to 1.0	1.500%
Equal to or greater than 2.25 to 1.0, but less than 2.50 to 1.0	1.375%
Equal to or greater than 2.00 to 1.0, but less than 2.25 to 1.0	1.250%
Equal to or greater than 1.50 to 1.0, but less than 2.00 to 1.0	1.125%
Less than 1.50 to 1.0	1.000%

We borrowed \$17.0 million on January 31, 2017 to fund the Sealweld acquisition. At January 31, 2017 that \$17.0 million borrowing bore interest at the base rate of 3.75%. However, on February 2, 2017, the base rate loan was converted to a LIBOR rate loan at an interest rate of 1.779%. At January 31, 2017, the remaining \$24.0 million outstanding under the revolving that bore interest at 1.776%. Advances under the revolving loan bore interest at 1.496% as of July 31, 2016.

Loans under the Second Restated Credit Facility are secured by our assets, including stock in subsidiaries, inventory, accounts receivable, equipment, intangible assets and real property. The credit facility has restrictive covenants, including that the Company must maintain a fixed charge coverage ratio of 1.5 to 1.0 or greater, and ratio of funded debt to EBITDA (as adjusted for non-cash and unusual, non-recurring, and certain acquisition and integration costs) of no more than 3.25 to 1.0 (with a step-up to 3.5 to 1.0 during an acquisition period with lender consent), and a current ratio of at least 1.5 to 1.0. On January 31, 2017, we were in compliance with all of our debt covenants.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements, such as financing or unconsolidated variable interest entities, other than operating leases.

Disclosure Regarding Forward Looking Statements

This report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as future capital expenditures, business strategy, competitive strengths, goals, growth of our business and operations, plans and references to future successes may be considered forward-looking statements. Also, when we use words such as “anticipate,” “believe,” “estimate,” “intend,” “plan,” “project,” “forecast,” “may,” “should,” “budget,” “goal,” “expect,” “probably” or similar expressions, we are making forward-looking statements. Many risks and uncertainties may impact the matters addressed in these forward-looking statements. Our forward-looking statements speak only as of the date made and we will not update forward-looking statements unless the securities laws require us to do so.

Some of the key factors which could cause our future financial results and performance to vary from those expected include:

- the loss or significant reduction in business from primary customers;
- the loss of key suppliers;
- the implementation of our strategy with respect to the expansion of operations in Singapore taking longer or being more costly than currently believed, and the failure to achieve all the planned benefits of that effort;

- our ability to implement productivity improvements, cost reduction initiatives or facilities expansions;
- market developments affecting, and other changes in, the demand for our products and the entry of new competitors or the introduction of new competing products;
- volatility in oil and natural gas prices, which may impact our customers' activity levels and spending for our products and services and which could impact goodwill impairment testing for our industrial lubricants business;
- increases in the price of energy, affecting our primary raw materials and active ingredients;
- the timing of planned capital expenditures;
- our ability to identify, develop or acquire, and market additional product lines and businesses necessary to implement our business strategy and our ability to finance such acquisitions and development;
- our ability to realize the anticipated benefits of business acquisitions and to successfully integrate previous or future business acquisitions;
- the condition of the capital markets generally, which will be affected by interest rates, foreign currency fluctuations and general economic conditions;
- cost and other effects of legal and administrative proceedings, settlements, investigations and claims, including environmental liabilities which may not be covered by indemnity or insurance;
- the effects of weather, earthquakes, other natural disasters and terrorist attacks;
- the impact of penta being banned or restricted as a persistent organic pollutant under the Stockholm Convention Treaty and the ability to obtain registration and re-registration of our products under applicable law;
- exposure to movements in foreign currency exchange rates as a result of geographic diversity of our operations;
- the political and economic climate in the foreign or domestic jurisdictions in which we conduct business; and
- other United States or foreign regulatory or legislative developments which affect the demand for our products generally or increase the environmental compliance cost for our products or impose liabilities on the manufacturers and distributors of such products.

The information contained in this report, including the information set forth under the heading "Risk Factors" contained herein and in our Annual Report on Form 10-K for the fiscal year ended July 31, 2016, identifies additional factors that could cause our results or performance to differ materially from those we express in our forward-looking statements. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions and, therefore, the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements which are included in this report and the exhibits and other documents incorporated herein by reference, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to certain market risks in the ordinary course of our business, arising primarily from changes in interest rates and to a lesser extent foreign currency exchange rate fluctuations. Generally we do not utilize derivative financial instruments or hedging transactions to manage that risk. Our exposure to interest rate risk and foreign currency risk is discussed in our Annual Report on Form 10-K for the fiscal year ended July 31, 2016. There has been no material change in that information.

ITEM 4. CONTROLS AND PROCEDURES

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. This term refers to the controls and procedures of a company that are designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission. Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There were no changes to our internal control over financial reporting during the quarterly period covered by this Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth in Note 13 to the condensed consolidated financial statements is incorporated herein by reference.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors contained in our Annual Report on Form 10-K for the fiscal year ended July 31, 2016, as filed with the SEC.

ITEM 6. EXHIBITS

The financial statements are filed as part of this report in Part 1, Item 1. The following documents are filed as exhibits. Documents marked with an asterisk (*) are management contracts or compensatory plans, and portions of documents marked with a dagger (†) have been granted confidential treatment.

- 10.15 Asset Purchase Agreement dated as of January 31, 2017, among KMG Chemicals, Inc., KMG Industrial Lubricants Canada, Inc., KMG Electronic Chemicals Luxembourg Holdings S.a.r.l., as Purchasers, Sealweld Corporation, Chisholm Asset Corporation, Sealweld Corporation FZE, as Sellers, and Dean Chisholm, as Shareholder, filed as Exhibit 10.15 to the Company's report on Form 8-K filed February 1, 2017, and incorporated herein by reference.
- 31.1 Certificate under Section 302 the Sarbanes-Oxley Act of 2002 of the Chief Executive Officer.
- 31.2 Certificate under Section 302 the Sarbanes-Oxley Act of 2002 of the Chief Financial Officer.
- 32.1 Certificate under Section 906 of the Sarbanes-Oxley Act of 2002 of the Chief Executive Officer.
- 32.2 Certificate under Section 906 of the Sarbanes-Oxley Act of 2002 of the Chief Financial Officer.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Schema Document
- 101.CAL XBRL Calculation Linkbase Document
- 101.DEF XBRL Definition Linkbase Document
- 101.LAB XBRL Label Linkbase Document
- 101.PRE XBRL Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KMG Chemicals, Inc.

By: /s/ Christopher T. Fraser Date: March 13, 2017
Christopher T. Fraser
President and Chief Executive Officer

By: /s/ Marcelino Rodriguez Date: March 13, 2017
Marcelino Rodriguez
Chief Financial Officer

CERTIFICATE

I, Christopher T. Fraser, certify that:

1. I have reviewed this quarterly report on Form 10-Q of KMG Chemicals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 13, 2017

/s/ Christopher T. Fraser

Christopher T. Fraser
President and Chief Executive Officer

CERTIFICATE

I, Marcelino Rodriguez, certify that:

1. I have reviewed this quarterly report on Form 10-Q of KMG Chemicals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: March 13, 2017

/s/ Marcelino Rodriguez
Marcelino Rodriguez
Chief Financial Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with this report of KMG Chemicals, Inc. (the "Company") on Form 10-Q for the quarterly period ended January 31, 2017, I, Christopher T. Fraser, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 13, 2017

/s/ Christopher T. Fraser

Christopher T. Fraser
Chief Executive Officer

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with this report of KMG Chemicals, Inc. (the "Company") on Form 10-Q for the quarterly period ended January 31, 2017, I, Marcelino Rodriguez, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 13, 2017

/s/ Marcelino Rodriguez

Marcelino Rodriguez
Chief Financial Officer

