MGP INGREDIENTS INC
Form 10-Q
February 09, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2008.

or

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

For the transition period from to

Commission File Number: 0-17196

MGP INGREDIENTS, INC.

(Exact name of registrant as specified in its charter)

KANSAS	**48-0531200**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Commercial Street, Atchison Kansas	**66002**
(Address of principal executive offices)	(Zip Code)

(913) 367-1480

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o 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 definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One)

o Large accelerated filer	o Accelerated filer
o Non-accelerated filer	x Smaller Reporting Company

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Common stock, no par value

16,598,515 shares outstanding

as of December 31, 2008

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements as well as historical information. All statements, other than statements of historical facts, included in this Quarterly Report on Form 10-Q regarding the prospects of our industry and our prospects, plans, financial position and business strategy may constitute forward-looking statements. In addition, forward-looking statements are usually identified by or are associated with such words as intend, plan , believe, estimate, expect, anticipate, hopeful, should, may, will , could and or the negatives of t variations of them or similar terminology. They reflect management s current beliefs and estimates of future economic circumstances, industry conditions, Company performance and financial results and are not guarantees of future performance. All such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those contemplated by the relevant forward-looking statement. Important factors that could cause actual results to differ materially from our expectations include, among others: (i) our ability to continue as a going concern, (ii) the availability and cost of grain, (iii) fluctuations in gasoline prices, (iv) fluctuations in energy costs, (v) competitive environment and related market conditions, (vi) our ability to realize operating efficiencies, (vii) the effectiveness of our hedging programs, (viii) access to capital and (ix) actions of governments. For further information on these and other risks and uncertainties that may affect our business, see *Item 1A. Risk Factors* of our Annual Report on Form 10-K for the fiscal year ended June 30, 2008 and Part II - Item 1A, *Risk Factors* in this Quarterly Report on Form 10-Q.

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PART I

ITEM 1 FINANCIAL STATEMENTS

MGP INGREDIENTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

Dollars in thousands, except per-share amounts

	Quarter Ended		Year to Date Ended	
	December 31, 2008	**December 30, 2007**	**December 31, 2008**	**December 30, 2007**
Net sales	**$ 73,242**	$ 93,995	**$ 172,262**	$ 181,972
Cost of sales: Product costs	**91,443**	90,799	**207,150**	172,916
Unrealized loss on natural gas contract	**5,447**		**5,447**	
Total cost of sales	**96,890**	90,799	**212,597**	172,916
Gross profit (loss)	**(23,648)**	3,196	**(40,335)**	9,056
Selling, general and administrative expenses	**5,737**	4,815	**11,852**	11,094
Impairment of long lived assets	**8,931**		**8,931**	
Severance and early retirement costs	**3,288**		**3,288**	
Other restructuring costs	**5,241**		**5,241**	
Loss from operations	**(46,845)**	(1,619)	**(69,647)**	(2,038)
Other income (expense), net	**33**	(76)	**74**	114
Gain on settlement of litigation, net of related expenses		7,046		7,046
Interest expense	**(797)**	(405)	**(1,525)**	(681)
Equity in loss of joint venture	**(18)**		**(34)**	
(Loss) income before income taxes	**(47,627)**	4,946	**(71,132)**	4,441
Benefit for income taxes	**(4,911)**	(283)	**(11,173)**	(435)
Net income (loss)	**(42,716)**	5,229	**(59,959)**	4,876
Other comprehensive income (loss), net of tax:	**(675)**	4,284	**(2,177)**	5,634
Comprehensive income (loss)	**$ (43,391)**	$ 9,513	**$ (62,136)**	$ 10,510
Per Share Data				
Total basic loss per common share	**$ (2.58)**	$ 0.32	**$ (3.62)**	$ 0.30
Total diluted loss per common share	**$ (2.58)**	$ 0.31	**$ (3.62)**	$ 0.29
Dividends per common share	**$**	$ 0.15	**$**	$ 0.15

See accompanying notes to condensed consolidated financial statements

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MGP INGREDIENTS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

(Unaudited)

	December 31, 2008	December 30, 2007	June 30, 2008
ASSETS			
Current Assets			
Cash and cash equivalents	**$**	$	$
Restricted cash	**1,361**	3	3
Receivables (less allowance for doubtful accounts: December 31, 2008 - $378; December 30, 2007 -$223 and June 30, 2008 -$264)	**26,170**	34,784	34,087
Inventory	**38,637**	61,287	63,620
Prepaid expense	**3,123**	2,167	362
Deposits	**2,162**	3,247	580
Deferred income taxes	**3,627**		394
Refundable income taxes	**4,672**		8,570
Assets held for sale	**3,345**		5,600
Total current assets	**83,097**	101,488	113,216
Property and equipment, at cost	**314,730**	363,867	315,782
Less accumulated depreciation	**(217,232)**	(235,602)	(206,808)
Property and equipment, net	**97,498**	128,265	108,974
Investment in joint venture	**318**	358	399
Other assets	**343**	511	479
Total assets	**$ 181,256**	$ 230,622	$ 223,068
LIABILITIES AND STOCKHOLDERS EQUITY			
Current Liabilities			
Current maturities of long-term debt	**$ 1,602**	$ 3,826	$ 432
Liabilities related to assets held for sale	**7,102**		8,760
Revolving credit facility	**42,483**	10,000	23,000
Accounts payable	**20,932**	16,061	23,315
Accrued expenses	**8,076**	5,303	6,582
Accrued natural gas derivative	**5,447**		
Deferred income taxes		494	
Income taxes payable		21	
Total current liabilities	**85,642**	35,705	62,089
Long-Term debt		7,169	1,301
Deferred credit	**6,687**	9,089	7,127
Other non-current liabilities	**11,027**	8,115	8,047
Deferred income taxes	**3,627**	12,616	7,630
Stockholders Equity			
Capital stock			
Preferred, 5% non-cumulative; $10 par value; authorized 1,000 shares; issued and outstanding 437 shares	**4**	4	4
Common stock			
No par value; authorized 40,000,000 shares; issued 19,530,344 shares	**6,715**	6,715	6,715
Additional paid-in capital	**11,148**	11,696	11,862
Retained earnings	**71,854**	150,205	131,813
Accumulated other comprehensive income (loss)	**(662)**	4,402	1,515
	89,059	173,022	151,909
Treasury stock, at cost			
Common; December 31, 2008 2,931,829 shares; December 30, 2007 - 2,981,841 shares and June 30, 2008 - 2,969,766 shares	**(14,786)**	(15,094)	(15,035)
Total stockholders equity	**74,273**	157,928	136,874
Total liabilities and stockholders equity	**$ 181,256**	$ 230,622	$ 223,068

See accompanying notes to condensed consolidated financial statements

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MGP INGREDIENTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

(Unaudited)

	Year to Date Ended	
	December 31, 2008	**December 30, 2007**
Cash Flows from Operating Activities		
Net income (loss)	**$ (59,959)**	$ 4,876
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	**6,826**	7,644
Loss (gain) on sale of assets	**(53)**	10
Deferred income taxes	**(7,217)**	2,874
Loss on impairment of assets	**8,931**	
Equity in loss of joint venture	**34**	
Changes in working capital items:		
Restricted cash	**(1,358)**	3,333
Accounts receivable	**7,917**	(486)
Inventory	**24,219**	(13,059)
Accounts payable and accrued expenses	**2,540**	348
Deferred credit	**(440)**	(619)
Income taxes payable/receivable	**3,898**	385
Accrual for natural gas derivative	**5,447**	
Gains previously deferred in other comprehensive income	**(2,149)**	
Other	**(4,569)**	(4,360)
Net cash (used in) provided by operating activities	**(15,933)**	946
Cash Flows from Investing Activities		
Additions to property and equipment	**(1,994)**	(3,228)
Investments in and advances to joint venture		(358)
Proceeds from disposition of equipment	**460**	
Net cash used in investing activities	**(1,534)**	(3,586)
Cash Flows from Financing Activities		
Purchase of treasury stock	**(34)**	
Proceeds from stock plans	**12**	372
Tax effect of restricted stock awarded	**(205)**	
Proceeds from long-term debt and capital leases	**150**	
Principal payments on long-term debt	**(1,939)**	(2,096)
Proceeds from line of credit	**61,134**	11,000
Principal payments on line of credit	**(41,651)**	(8,000)
Dividends paid		(2,536)
Net cash provided by (used in) financing activities	**17,467**	(1,260)
Decrease in cash and cash equivalents		(3,900)
Cash and cash equivalents, beginning of year		3,900
Cash and cash equivalents, end of period	**$**	$

See accompanying notes to condensed consolidated financial statements

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MGP INGREDIENTS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Accounting Policies and Basis of Presentation.

Basis of Presentation

The accompanying condensed consolidated financial statements of MGP Ingredients, Inc. and its subsidiaries (Company) reflect all adjustments (consisting only of normal adjustments) which, in the opinion of the Company s management, are necessary to fairly present the financial position, results of operations and cash flows of the Company. These unaudited condensed consolidated financial statements as of and for the period ended December 31, 2008 should be read in conjunction with the consolidated financial statements and notes thereto in the Company s Form 10-K Annual Report for the fiscal year ended June 30, 2008 filed with the Securities and Exchange Commission. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

In accordance with the guidance of Staff Accounting Bulletin No. 108, these interim consolidated financial statements reflect immaterial adjustments made to the Company s December 30, 2007 balance sheet. This adjustment had no impact upon the Company s previously reported earnings. For the balance sheet as of December 30, 2007, the Company reclassified $2.5 million from other current liabilities to additional paid-in capital to reflect equity share-based awards, reclassified deferred credits totaling $9.1 million from current liabilities to non-current liabilities and reclassified current deferred tax assets of $3.7 million to reduce non-current deferred tax liabilities.

The Company s financial statements for the quarter ended December 31, 2008 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The Company has had negative cash flow from operations and has relied on borrowings under its credit agreements to operate. The Company was notified on January 30, 2009 by the lender s agent under the Company s credit facility that it is in default under the credit facility. As a result, its lenders could, at their election and prior to February 27, 2009, the final date of its current forbearance period, terminate the Company s ability to borrow under its credit facility and/or accelerate its obligations to repay amounts borrowed under the credit facility. The agent has advised the Company that in their discretion and subject to change day-to-day, the lenders are willing to continue extending credit to the Company in accordance with the provisions of the credit facility provided the Company has sufficient capacity under its borrowing base and otherwise meets the requirements of the credit facility. The borrowing base under the credit facility and the amount available to the Company thereunder fluctuate daily. From January 29, 2009 to February 4, 2009, the daily amount available to the Company has averaged approximately $1,219,000, ranging from a low of $7,700 to a high of $2,760,000, and the amount available at the close of business on February 4, 2009 was approximately $849,000.The Company s lenders have strongly encouraged the Company to obtain additional financing, and the Company believes that its cash needs over the next several months will exceed amounts available to it from operations and under its credit facility. The Company is currently in discussions with other prospective lenders. The Company s ability to continue as a going concern is dependent on the Company obtaining additional financing in the near term and on the willingness of its existing lenders to exercise further forbearance and extend the facility termination date beyond February 27, 2009. See footnote 2, *Uncured Defaults on Indebtedness*, for more information on the defaults and the rights of the Creditors under the terms of this credit agreement.

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Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Fair Value Accounting

On July 1, 2008, the Company adopted, without any material effect on its consolidated financial statements, the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurement*, for our financial assets and liabilities with respect to which the Company has recognized or disclosed at fair value on a recurring basis. In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. 157-2, *Effective Date of FASB Statement No. 157,* which delays the effective date for nonfinancial assets and non-financial liabilities to fiscal years beginning after November 15, 2008, except for items that are measured at fair value in the financial statements on a recurring basis at least annually. Beginning July 1, 2009, the Company will adopt the provisions for nonfinancial assets and nonfinancial liabilities that are not required or permitted to be measured at fair value on a recurring basis. Management does not expect the provisions of SFAS No. 157 related to these items to have a material effect on the consolidated financial statements.

Overdrafts

The Company s historical policy has been to record book overdrafts, checks outstanding which have not been presented to the bank for payment, as accounts payable. Changes in the amount of book overdrafts outstanding between periods are reported as operating cash flows. The amount of book overdrafts at December 31, 2008 and June 30, 2008 were $4.8 million and $4.4 million respectively.

Impairment

The Company tests its long-lived assets for impairment whenever events or conditions and circumstances indicate a carrying amount of an asset may not be recoverable. During the first two quarters of our fiscal year, declines in overall equity values, including our common stock value, and changes in our operations triggered impairment evaluations. Updated forecasts that reflect recent changes made to our business were used in these analyses. The use of forecasts requires considerable management judgment. Management believes the judgments used in this analysis are reasonable. The testing and analysis as of December 31, 2008 identified certain impaired assets (see Note 10 Restructuring Costs).

Note 2. Uncured Defaults on Indebtedness

At June 30, 2008, the Company was not in compliance with the tangible net worth and the EBITDA based financial covenants in its Credit Agreement and the fixed charge coverage ratio requirement of its 5.26% Industrial Revenue Bond obligation. Its tangible net worth at such date, as defined in the Credit Agreement, was $132.5 million instead of at least $135 million, its fixed charge coverage ratio was 0.56 to 1 instead of at least 1.5 to 1 and its leverage ratio was (11.03) to 1 instead of at least 3.0 to 1. Its fixed charge coverage ratio, as defined in its lease related to its 5.26% industrial revenue bond lease, was (0.51) to 1 instead of at least 1.5 to 1. As a result, the Company was in default under the Credit Agreement and 5.26% industrial revenue bond lease. Due to cross default provisions, it also was in default under its 5.45% Secured Promissory Note to Commerce Bank and its 5.26% Secured Promissory Note and 5.92% Secured Promissory Note to GECPF and GECC, respectively. As of September 16, 2008,

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GECPF and GECC waived the default under the industrial revenue bond lease and the resulting cross defaults under the Company s 5.26% Secured Promissory Note and 5.92% Secured Promissory Note. (The final payment due under the industrial revenue bond lease was made on August 29, 2008). As of September 3, 2008, Commerce Bank waived the default under the 5.45% Promissory Note and the lenders under the Credit Agreement agreed to a First Amendment to the Credit Agreement providing for a standstill period expiring on October 31, 2008, unless the Company defaulted under interim covenants. The amendment imposed new, monthly interim minimum adjusted EBITDA requirements (as defined in the credit agreement) of $(7,500,000) for July, $(2,500,000) for August and $(1,400,000) for September, and minimum tangible net worth requirements (as defined in the credit agreement) of $125,000,000 at the end of July, $123,000,000 at the end of August and $121,000,000 at the end of September. The Company met the requirements for July and August but did not meet the September requirements and as of October 25, 2008 was in forbearance default under the credit agreement and was also in cross default under its 5.45% Secured Promissory Note to Commerce Bank.

Although it was in forbearance default, the Company s lenders agreed to extend the original expiration date of the forbearance period under its Credit Agreement, as amended, to November 10, 2008, while a new amendment to the Credit Agreement was being discussed. Subsequently, as of November 7, 2008, the lenders under the Credit Agreement entered a Second Amendment extending the standstill period to February 27, 2009, during which the Company is subject to new interim financial covenants. These require the Company to maintain fiscal year to date adjusted EBITDA (EBITDA adjusted to eliminate any mark-to-market adjustments reflected in net income) of ($30.0 million) at the end of October 2008, ($44.0 million) at the end of November 2008, and ($46.0 million) at the end of December 2008 and January 2009. Other terms include (i) an increase in the interest rate on outstanding borrowings from LIBOR plus 2.75% or prime plus 0.50% to prime plus 3%, with prime being not less than the greater of 4%, Agent s prime rate or the federal funds rate plus 1%, (ii) an amendment fee of $110,000 (in addition to the banks out of pocket expenses), (iii) a fee of 1% of the outstanding credit commitment, as defined, payable on February 27, 2009 unless all outstanding obligations are paid in full and the credit agreement is terminated (this fee is expected to be approximately $430,000), (iv) the pledge of substantially all of the Company s remaining unpledged assets, (v) limiting the Company s use of the commitment under the credit agreement to either fund margin calls or for other grain hedging positions to an amount equal to a tax refund received in the second quarter (approximately $9.2 million) , and (vi) requiring the Company to use any portion of such tax refund received after November 7 ($8.0 million) to reduce outstanding borrowings under the credit agreement. In the amendment, Commerce also waived the cross default under the 5.45% Secured Promissory Note to Commerce.

As a result of inventory reductions and continued operating losses, in December 2008, the Company s outstanding borrowings under the Credit Agreement exceeded its borrowing base, and on December 19, 2009 the lenders agreed to a Third Amendment to the Credit Agreement which permitted the Company, on a temporary basis, to obtain loans and other credit extensions under the Credit Agreement in amounts in excess of the borrowing base. Under the terms of the Third Amendment, until January 30, 2009, the Company could obtain credit extensions of $3 million over the borrowing base; thereafter, until February 26, 2009, the Company may obtain credit extensions of $1.5 million over the borrowing base; and thereafter the Company may obtain credit extensions of $500,000 over the borrowing base. The Third Amendment does not affect the standstill period to which the Company is presently subject or otherwise impose any duty on any lender to extend credit to the Company beyond any date after which such lender is not obligated to extend credit pursuant to the Credit Agreement as in effect immediately prior to the Third Amendment.

The Company met adjusted EBITDA targets imposed by the Second Amendment for each of October and November but did not meet the targets for December because of impairment and other restructuring charges recognized as of quarter end. On January 30, 2009, the lender s agent notified the

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Company that it was in default under the credit facility. It also notified the Company that because of cross default provisions it was in default under its 5.45% Secured Promissory Note to Commerce Bank. Accordingly, the Company has reclassified all long-term debt to current.

As a result of the Company s defaults under the Credit facility, its lenders could, at their election, terminate the Company s ability to borrow under the credit facility and/or accelerate its obligations to repay amounts borrowed under the credit facility. If its lenders were to terminate the credit facility, the Company would not have sufficient funds available to continue normal operations. If the Company s lenders were to accelerate its debt, it could result in the acceleration of debt under other secured obligations, and the Company would be unable to repay its obligations immediately. In the case of acceleration, the Company s lenders might foreclose on some or all of the collateral the Company has pledged to its lenders, consisting of substantially all of its operating assets. The lender s agent has advised the Company that in their discretion and subject to change day-to-day, the lenders are willing to continue extending credit to the Company in accordance with the provisions of the credit facility provided the Company has sufficient capacity under its borrowing base and otherwise meets the requirements of the credit facility. As of February 4, 2009, the Company had $849,000 availability under its borrowing base limits. The Company s lenders have strongly encouraged the Company to obtain additional financing. The Company is currently in discussions with other prospective lenders. The Company s ability to continue as a going concern is dependent on the Company obtaining additional financing in the near term and on the willingness of its existing lenders to exercise further forbearance and extend the credit facility termination date beyond February 27, 2009.

Note 3. Earnings Per Share.

Basic loss per share data is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Potentially dilutive instruments are stock options and unvested restricted stock awards. Antidilutive share units were 1,009,000 and 972,000 for the three and six months ended December 31, 2008 respectively and 156,000 and 132,000 for the three and six months ended December 30, 2007 respectively.

	Quarter Ended		**Year to Date**	
Weighted average shares:	**December 31, 2008**	**December 30, 2007**	**December 31, 2008(1)**	**December 30, 2007**
Basic and Diluted Shares:	**16,582,063**	16,513,162	**16,572,353**	16,505,755
Additional weighted average shares attributable to:				
Stock options:		128,701		169,596
Unvested restricted stock awards:		201,191	**47,455**	218,973
Potentially Diluted Shares(1)	**16,582,063**	16,843,054	**16,619,808**	16,894,324

(1) The stock options and the restricted stock awards have not been considered due to the loss experienced during both periods.

Note 4. Derivative Instruments.

In connection with the purchase of raw materials, principally corn and wheat, for anticipated operating requirements, the Company enters into readily marketable exchange-traded commodity futures and option contracts to reduce the risk of future price increases. Changes in the market value of the Company s futures and option contracts have historically been, and are expected to continue to be, highly effective at offsetting changes in the price of the hedged items. Derivative instruments are recorded as either assets or liabilities and are measured at fair market value.

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Prior to April 1, 2008, changes in the fair market value of the derivative instruments designated as cash flow hedges were recorded either in current earnings or in other comprehensive income, depending on the nature of the hedged transaction, consistent with the application of hedge accounting under Statement of Financial Accounting Standards No. 133 as amended (SFAS 133). Gains or losses recorded in other comprehensive income were reclassified into current earnings in the periods in which the hedged items were consumed. Any ineffective portion of a hedged transaction was immediately recognized in current earnings.

Application of hedge accounting under SFAS 133 requires significant resources, recordkeeping and analytical systems. As a result of the rising compliance costs and the complexity related to the application of hedge accounting under SFAS 133, the Company s management elected to discontinue the use of hedge accounting for all commodity derivative positions effective April 1, 2008. Accordingly, changes in the value of derivatives subsequent to March 31, 2008 have been recorded in cost of sales in the Company s Consolidated Statements of Income.

The Company s production process involves the use of natural gas which it purchases under contracts that require it to commit to the purchase of certain quantities on a monthly basis and allow the Company to lock in prices on such purchase quantities. Because the quantities involved have always been for amounts to be consumed within the normal production process, the Company has excluded the market value of these commitments within its contracts from its hedge accounting consistent with normal purchases and sales as defined under SFAS 138.

With the shutdown of protein and starch operations and the reduction and temporary idling of distillery operations at the Company s Pekin plant, commitments for the purchase of natural gas through the remainder of the fiscal year under a single contract for the Company s Pekin plant are in excess of projected consumption after adjusting for such reduced production. Accordingly, the Company anticipates settling its commitments for the difference between the prices to which the Company committed to and the market price of natural gas upon settlement. The Company has recorded a charge of $5.4 million to cost of sales for unrealized losses as of December 31, 2008, for projected settlements and will continue to mark this obligation to market through June 30, 2009 as the settlements come due.

Note 5. Contingencies.

The Company is a party to various legal proceedings which are of an ordinary, routine nature and incidental to its operations. Except for the following matters, management considers that the aggregate liabilities, if any, arising from such actions would not have a material adverse effect on the consolidated financial position or operations of the Company.

The Company is party to a lawsuit filed August 19, 2008 styled *Daniel Martin v. MGP Ingredients, Inc.*, et al., No. 08-L-697 in the Circuit Court for the Third Circuit, Madison County, Illinois. This suit was originally brought against the Company and approximately 70 other defendants, wherein the claimant alleges that he contracted desmoplastic mesothelioma from exposure to asbestos. The Company understands that of the original group of defendants, the claim is being actively pursued against a lesser number of defendants but including the Company. The claimant alleges that in the late 1980 s or early 1990 s his company was retained to install insulation at the Pekin, Illinois facility at the same time that the Company was conducting asbestos abatement projects in the facility. The claimant seeks unspecified compensatory and punitive damages. The matter remains in discovery, and is scheduled for trial in April, 2009. Management is unable to estimate the amount of potential loss to the Company with respect to this claim.

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Since September 16, 2008, tests on the Company s feed drying unit have not complied with the volatile organic compound emission limit established in the Consent Agreement and Final Order (CAFO) entered into with the Kansas Department of Health and Environment (KDHE) on January 11, 2006. The Company has retained the services of the feed dryer manufacturer to assist in returning the unit to compliance with the CAFO limit. Areas of concern were ascertained and addressed and pretesting performed in January 2009 demonstrated the unit to be in compliance. Official compliance testing for the system is scheduled during the second week of February 2009. The KDHE has discretion under its penalty policy to pursue an enforcement action against the Company for failing to comply with the emission limit. The Company s management has provided regular updates to the KDHE on efforts to bring the unit into compliance with the permit. Although no formal action has been taken, the KDHE may seek a penalty, but the Company is unable to predict the magnitude of any penalty that KDHE may ultimately assess against it.

Note 6. Operating Segments.

The Company is a fully integrated producer of ingredient solutions, distillery and other products. Products included within the ingredient solutions segment consist of vital wheat gluten, commodity wheat starch, specialty wheat starches and proteins and mill feeds. Distillery products consist of food grade alcohol (consisting of beverage and industrial alcohol), fuel grade alcohol, commonly known as ethanol, and distillers grain and carbon dioxide, which are co-products of the Company s distillery operations. Other products include pet treat resins and plant-based biopolymers as well as other products. For the quarter and year to date period ended December 31, 2008, revenues from products in the other segment represent less than 2.0 percent of the Company s consolidated revenues. As noted in Note 10, during the second quarter the Company closed the flour mill at its Atchison facility and ceased protein and starch production operations at its Pekin, Illinois plant. Other than the production of fuel alcohol as a by-product of high quality alcohol, the Company is ceasing production of fuel alcohol in the third quarter.

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The operating results for each segment is based on net sales less identifiable operating expenses directly attributable to each segment. Indirect selling, general and administrative as well as interest expense, investment income and other general miscellaneous expenses have been excluded from segment operations and classified as Corporate, consistent with the measurements used to evaluate segment performance internally.

Receivables, inventories and equipment have been identified with the segments to which they relate. All other assets are considered as Corporate.

	Quarter Ended		Year to Date Ended	
(in thousands)	**December 31, 2008**	**December 30, 2007**	**December 31, 2008**	**December 30, 2007**
Sales to Customers				
Ingredient solutions	**$ 22,455**	$ 24,963	**$ 48,352**	$ 47,251
Distillery products	**49,733**	67,523	**121,115**	131,881
Other	**1,054**	1,509	**2,795**	2,840
Total	**73,242**	93,995	**172,262**	181,972
Depreciation and amortization				
Ingredient solutions				