

CONTINENTAL MATERIALS CORP
Form 10-Q
May 15, 2018

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 March 31, 2018

OR

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

For the transition period from to

Commission File number 1-3834

CONTINENTAL MATERIALS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of incorporation or organization)

36-2274391
(I.R.S. Employer Identification No.)

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440 South LaSalle Street, Suite 3100, Chicago, Illinois
(Address of principal executive offices)

60605
(Zip Code)

(312) 541-7200

(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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller reporting company

(Do not check if a smaller reporting company)

Emerging growth company

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

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, \$0.25 par value, shares outstanding at May 10, 2018: 1,698,055.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

CONTINENTAL MATERIALS CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

MARCH 31, 2018 AND DECEMBER 30, 2017

(000's omitted except share data)

	MARCH 31, 2018 (Unaudited)	DECEMBER 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 408	\$ 507
Receivables, net	24,626	24,227
Receivable for insured losses	184	—
Inventories		
Finished goods	6,422	8,391
Work in process	2,303	1,198
Raw materials and supplies	11,497	10,770
Prepaid expenses	2,658	1,901
Refundable income taxes	1,239	57
Total current assets	49,337	47,051
Property, plant and equipment	17,418	22,824
Other assets		
Goodwill	7,229	7,229
Deferred income taxes	2,499	1,616
Other assets	3,698	3,769
	\$ 80,181	\$ 82,489
LIABILITIES		
Current liabilities:		
Revolving bank loan payable	\$ 5,700	\$ 3,500
Accounts payable and accrued expenses	19,605	18,374
Liability for unpaid claims covered by insurance	184	—
Total current liabilities	25,489	21,874

Other long-term liabilities	6,249	6,293
Commitments and contingencies (Note 6)		
SHAREHOLDERS' EQUITY		
Common shares, \$.25 par value; authorized 3,000,000 shares; issued 2,574,264 shares	643	643
Capital in excess of par value	1,930	1,887
Retained earnings	60,794	66,987
Treasury shares, 876,209 and 892,097 at cost	(14,924)	(15,195)
	48,443	54,322
	\$ 80,181	\$ 82,489

See notes to condensed consolidated financial statements.

CONTINENTAL MATERIALS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND APRIL 1, 2017

(Unaudited)

(000's omitted except per-share amounts)

	MARCH 31, 2018	APRIL 1, 2017
Net sales	\$ 36,873	\$ 34,103
Costs and expenses:		
Cost of sales (exclusive of depreciation, depletion and amortization)	31,345	28,072
Depreciation, depletion and amortization	676	638
Selling and administrative	6,111	6,004
Write-off of deferred development	6,934	—
	45,066	34,714
Operating loss	(8,193)	(611)
Interest income	24	18
Interest expense	(108)	(66)
Other income, net	19	20
Loss before income taxes	(8,258)	(639)
Benefit for income taxes	2,065	217
Net loss	(6,193)	(422)
Retained earnings, beginning of period	66,987	65,169
Retained earnings, end of period	\$ 60,794	\$ 64,747
Basic and diluted loss per share	\$ (3.65)	\$ (0.25)
Average shares outstanding	1,696	1,674

See notes to condensed consolidated financial statements

CONTINENTAL MATERIALS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE THREE MONTHS ENDED MARCH 31, 2018 AND APRIL 1, 2017

(Unaudited)

(000's omitted)

	MARCH 31, 2018	APRIL 1, 2017
Net cash used by operating activities	\$ (1,599)	\$ (576)
Investing activities:		
Capital expenditures	(700)	(630)
Net cash used in investing activities	(700)	(630)
Financing activities:		
Borrowings on the revolving bank loan	9,900	5,600
Repayments on the revolving bank loan	(7,700)	(4,400)
Net cash provided by financing activities	2,200	1,200
Net decrease in cash and cash equivalents	(99)	(6)
Cash and cash equivalents:		
Beginning of period	507	301
End of period	\$ 408	\$ 295
Supplemental disclosures of cash flow items:		
Cash paid during the year for:		
Interest, net	\$ 104	\$ 92
Income taxes, net	—	—

See notes to condensed consolidated financial statements

CONTINENTAL MATERIALS CORPORATION

SECURITIES AND EXCHANGE COMMISSION FORM 10-Q

NOTES TO THE QUARTERLY CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

QUARTER ENDED MARCH 31, 2018

(Unaudited)

1. Significant Accounting Policies:

Basis of Presentation:

The unaudited interim condensed consolidated financial statements included herein are prepared pursuant to the Securities and Exchange Commission (the “Commission”) rules and regulations for reporting on Form 10-Q. Accordingly, certain information and footnote disclosures normally accompanying the annual consolidated financial statements have been omitted. The condensed consolidated balance sheet of Continental Materials Corporation (the “Company”) as of December 30, 2017 has been derived from the audited consolidated balance sheet of the Company as of that date. The interim condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s latest annual report on Form 10-K. In the opinion of management, the condensed consolidated financial statements include all adjustments (none of which were other than normal recurring adjustments) necessary for a fair statement of the results for the interim periods and to ensure the financial statements are not misleading. Certain reclassifications have been made to the 2017 consolidated financial statements to conform to the 2018 presentation. The reclassifications had no effect on the consolidated results of operations, the net decrease in cash or the total assets, liabilities or shareholders’ equity of the Company.

Revenue Recognition:

Effective December 31, 2017, the Company adopted Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) and related amendments, which creates a single source of revenue guidance for all companies in all industries and is more principles-based than previous revenue guidance. The Company adopted the standard using the modified retrospective approach. The adoption of this standard did not result in significant changes to the Company’s accounting policies, business processes, systems or controls, or have a material impact on its financial position, consolidated results of operations or consolidated cash flows. As such, prior period financial statements were not recast and there was no cumulative effect adjustment upon adoption.

Sales are recognized when control of the promised goods or services transfers to the Company’s customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. The Company’s payment terms generally range between 30 to 90 days after invoice is billed to the customer. Sales are reported net of sales tax. Shipping and other transportation costs paid by the Company and rebilled to the buyer are recorded gross (as both sales and cost of sales). The Company receives blanket purchase orders from many of its

customers on an annual basis. Generally, such purchase orders and related documents set forth the annual terms, including pricing, related to the products. Such purchase orders generally do not specify the exact products, quantities or delivery times. For example, the Company may receive a blanket order for furnaces; however models are not specifically identified or a customer may provide the Company with an estimated concrete volume for the year without specifying the strength and other variables. The Company generally recognizes revenue from the sale of products at a point in time as the products are shipped.

While the return of products is generally not allowed, some large retail customers have been granted the right to return a certain amount at the end of the normal selling season for furnaces and evaporative coolers. Sales returns and allowances are estimated based on current program terms and historical experience. Provisions for estimated returns, discounts, volume rebates and other price adjustments are provided for in the same period the related revenues are recognized and are netted against revenues. Price protection is offered on evaporative coolers sold into certain areas where the competition is selling at a lower margin. Although a credit is granted only after a distributor

requests relief by providing a report of where the units were sold and at what discount, the Company does record an accrual for such credits at the time of sale based upon historical experience.

The Company is responsible for warranty related to the manufacture of its HVAC products; however, the Company estimates the future warranty claims based upon historical experience and management estimates. The Company does not perform installation services except for installation of electronic access and security systems in the Door segment. These installation service contracts are generally short-term in nature, usually less than 30 days. It was determined for the installation service contracts there are two performance obligations, the equipment and the installation services. The transaction price for these contracts is allocated to each performance obligation based on its stated stand-alone selling price. Revenue is recognized at a point in time as each performance obligation is completed. No maintenance or service contracts are offered by the Company.

See Note 7, Segment reporting for disaggregation of revenue by segment.

2. Income taxes are accounted for under the asset and liability method that requires deferred income taxes to reflect the future tax consequences attributable to differences between the tax and financial reporting bases of assets and liabilities. Deferred tax assets and liabilities recognized are based on the tax rates in effect in the year in which differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance when, based on available positive and negative evidence, it is “more likely than not” (greater than a 50% likelihood) that some or all of the net deferred tax assets will not be realized.

On December 22, 2017, the Tax Cuts and Jobs Act (the “Tax Act”) was enacted in the United States. The Tax Act significantly revised the U.S. tax code by, among other items, reducing the Company’s federal tax rate from 34% to 21%, providing for the full expensing of certain depreciable property and eliminating the corporate Alternative Minimum Tax (AMT).

The Tax Act repeals AMT and allows for all existing credit carryforwards to be used to offset regular tax liabilities in 2018 through 2020 or, if not fully usable to offset regular tax liabilities, refunded by 2021. For state tax purposes, net operating losses can be carried forward for various periods for the states that the Company is required to file in. California Enterprise Zone credits can be used through 2023 while Colorado credits can be carried forward for 7 years. The Company has established a valuation reserve related to a portion of the California Enterprise Zone credit not expected to be utilized prior to expiration.

The Company’s income tax returns are subject to audit by the Internal Revenue Service (the “IRS”) and state tax authorities. The amounts recorded for income taxes reflect the Company’s tax positions based on research and interpretations of complex laws and regulations. The Company accrues liabilities related to uncertain tax positions taken or expected to be taken in its tax returns. The Company did not identify any such uncertain tax positions as of

March 31, 2018 or December 30, 2017.

3. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

1

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

2

Level 3 Unobservable inputs supported by little or no market activity that are significant to the fair value of the assets or liabilities. Unobservable inputs reflect the assumptions that market participants would use when pricing the asset or liability including assumptions about risk.

3

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying balance sheet:

6

Cash and Cash Equivalents: The carrying amount approximates fair value and was valued as Level 1.

Revolving Bank Loan Payable: Fair value is estimated based on the borrowing rates then available to the Company for bank loans with similar terms and maturities and determined through the use of a discounted cash flow model. The carrying amount of the Revolving Bank Loan Payable represents a reasonable estimate of the corresponding fair value as the Company's debt is held at variable interest rates and was valued as Level 2.

There were no transfers between fair value measurement levels of any financial instruments in the current quarter.

4. In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This new revenue standard creates a single source of revenue guidance for all companies in all industries and is more principles-based than current revenue guidance. Subsequently, the FASB issued various ASUs to provide further clarification around certain aspects of ASC 606. This standard was adopted by the Company in the first quarter of fiscal 2018. See Note 1 for further discussion of the Company's revenue recognition policies and practices.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), requiring that the statement of cash flows explain the change in total cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. This standard was adopted by the Company in the first quarter of fiscal 2018 and did not have a material impact to the consolidated statement of cash flows.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). This new standard supersedes existing lease guidance to require lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by long-term leases and to disclose additional quantitative and qualitative information about leasing arrangements. The standard will be effective for the Company in the first quarter of fiscal 2019. The original guidance requires adoption using a modified retrospective approach; however, in March 2018, the FASB approved amendments that allow companies the option of using the effective date of the new standard as the date of initial application. The Company continues the task of accumulating information on all of its existing leases. Although not quantified yet, the Company expects that adoption of ASU 2016-02 will have a significant impact on its consolidated balance sheets and disclosures, but does not anticipate a material impact on its consolidated cash flow or consolidated results of operations.

There are no other significant prospective accounting pronouncements that are expected to have a material effect on the Company's consolidated financial statements.

5. Operating results for the first three months of 2018 are not necessarily indicative of performance for the entire year due to the seasonality of most of the Company's products. Historically, sales of the Evaporative Cooling segment are higher in the first and second quarters, sales of the Concrete, Aggregates and Construction Supplies (CACS) segment are higher in the second and third quarters and sales of furnaces in the Heating and Cooling segment are higher in the third and fourth quarters. Sales of the Door segment are generally more evenly spread throughout the year.

6. There is no difference in the calculation of basic and diluted earnings per share (EPS) for the three-month periods ended March 31, 2018 and April 1, 2017 as the Company does not have any dilutive instruments.

7. The Company operates primarily in two industry groups, Heating, Ventilation and Air Conditioning (HVAC) and Construction Products. The Company has identified two reportable segments within each of the industry groups: the Heating and Cooling segment and the Evaporative Cooling segment in the HVAC industry group and the CACS segment and the Door segment in the Construction Products industry group.

The Heating and Cooling segment primarily produces and sells gas-fired wall furnaces, console heaters and fan coils from the Company's wholly-owned subsidiary, Williams Furnace Co. (WFC) of Colton, California. The Evaporative Cooling segment primarily produces and sells evaporative coolers from the Company's wholly-owned subsidiary, Phoenix Manufacturing, Inc. (PMI) of Phoenix, Arizona. Sales of these two segments are nationwide,

but are concentrated in the southwestern United States. Concrete, aggregates and construction supplies are offered from numerous locations along the Southern Front Range of Colorado operated by the Company's wholly-owned subsidiaries Castle Concrete Company and Transit Mix Concrete Co., of Colorado Springs and Transit Mix of Pueblo, Inc. of Pueblo, Colorado (the three companies collectively are referred to as TMC). The Door segment sells hollow metal and wood doors, door frames and related hardware, lavatory fixtures and electronic access and security systems from the Company's wholly-owned subsidiary, McKinney Door and Hardware, Inc. (MDHI), which operates out of facilities in Pueblo and Colorado Springs, Colorado. Sales of these two segments are highly concentrated in the Southern Front Range of Colorado although door sales are also made throughout the United States.

In addition to the above reporting segments, an "Unallocated Corporate" classification is used to report the unallocated expenses of the corporate office which provides treasury, insurance and tax services as well as strategic business planning and general management services. Expenses related to the corporate information technology group are allocated to all locations, including the corporate office.

The Company evaluates the performance of its segments and allocates resources to them based on a number of criteria including operating income, return on investment and other strategic objectives. Operating income is determined by deducting operating expenses from all revenues. In computing operating income, none of the following has been added or deducted: unallocated corporate expenses, interest, other income or loss or income taxes.

The following table presents information about reported segments for the three-month periods ended March 31, 2018 and April 1, 2017 along with the items necessary to reconcile the segment information to the totals reported in the financial statements (amounts in thousands):

	Construction Products Industry			HVAC Industry			Unallocated Corporate	Total
	Concrete, Aggregates & Construction Supplies	Doors	Combined Construction Products	Heating and Cooling	Evaporative Cooling	Combined HVAC Products		
Three Months ended March 31, 2018								
Revenues from external customers	\$ 15,064	\$ 4,296	\$ 19,360	\$ 10,993	\$ 6,516	\$ 17,509	\$ 4	\$ 36,873
Depreciation, depletion and amortization	356	40	396	162	107	269	11	676
Operating (loss) income	(7,922)	438	(7,484)	571	(256)	315	(1,024)	(8,193)
Segment assets	34,350	7,047	41,397	19,288	14,910	34,198	4,586	80,181
Capital expenditures	351	33	384	200	65	265	51	700

	Construction Products Industry			HVAC Industry			Unallocated Corporate	Total
	Concrete, Aggregates & Construction Supplies	Doors	Combined Construction Products	Heating and Cooling	Evaporative Cooling	Combined HVAC Products		
Three Months ended April 1, 2017								
Revenues from external customers	\$ 13,483	\$ 3,869	\$ 17,352	\$ 10,436	\$ 6,309	\$ 16,745	\$ 6	\$ 34,103
Depreciation, depletion and amortization	337	35	372	151	107	258	8	638
Operating (loss) income	(584)	292	(292)	565	(57)	508	(827)	(611)
Segment assets	39,020	7,360	46,380	21,543	11,896	33,439	2,670	82,489
Capital expenditures	382	101	483	98	43	141	6	630

(a) Segment assets are as of December 30, 2017.

(b) Capital expenditures are presented on the accrual basis of accounting.

There are no differences in the basis of segmentation or in the basis of measurement of segment profit or loss from the last annual report.

8. On September 15, 2016 a Partial Summary Judgment Order was issued regarding the Company's previously disclosed litigation, Continental Materials Corporation v. Valco, Inc., Civil Action No. 2014-cv-2510, filed in the United States District Court for the District of Colorado. The suit regards a sand and gravel lease between the Company and Valco, Inc. ("Valco") that calls for the payment of royalties over the life of the lease on an agreed 50,000,000 tons of sand and gravel reserves. In the suit the Company sought, among other things, to reform the sand and gravel lease in regard to the agreed amount of sand and gravel reserves and to recover approximately \$1,282,000 of royalty overpayments included in other long-term assets. Valco asserted counterclaims against the Company alleging breach of contract and declaratory judgment regarding the Company's refusal to make further royalty payments under the Lease. In the ordinary course of business and absent any breach by Valco, the Company is required to make quarterly royalty payments amounting to not less than \$300,000 in a calendar year. In response to Valco's breaches of contract, the Company stopped making royalty payments at the start of the 2015 calendar year. The Company has asserted partial failure of consideration as an affirmative defense to Valco's counterclaims to offset the alleged back-due quarterly royalty payments and the amount due on quarterly royalty payments in the future. The Partial Summary Judgment Order resolved many of the Company's claims in Valco's favor, but the Company's claim for the return of royalty overpayments made during the statutorily allowed period is still pending. The Partial Summary Judgment Order did not resolve Valco's counterclaims or the Company's affirmative defense. During the third quarter of 2016, the Company recorded a \$632,000 write-down representing the portion of the royalty overpayment paid prior to the statutorily allowed period because of litigation risk attendant to recovering that amount. The Company sought certification of the Partial Summary Judgment Order because it and its legal counsel believe the court improperly resolved factual issues in its Partial Summary Judgment Order that should have been decided by a jury. The Company and its legal counsel believe there is a likelihood that some, or all, of the issues resolved by the Partial Summary Judgment Order may be reversed on appeal and remanded for trial by jury although there can be no assurance that an appeal will result in reversal. The Company paid royalties on approximately 17,700,000 tons, including the overpayments, of the 50,000,000 tons of sand and gravel reserves through the end of the third quarter of 2014. The impact of these proceedings could have a material financial effect on the Company; however, the Company does not believe that there is a reasonable basis for estimating the financial impact, if any, of the final outcome of these proceedings and accordingly no accrual or reserve has been recorded in compliance with accounting principles generally accepted in the United States of America. On February 23, 2017, the Partial Summary Judgment Order was certified for immediate appeal, and all other claims, counterclaims and affirmative defenses were stayed pending the resolution of that appeal. The Company filed a notice of appeal on March 24, 2017. The appeal is currently pending.

9. The Company issued a total of 16,000 shares to the eight eligible board members effective January 16, 2018 as full payment for their 2018 retainer fee. The Company issued a total of 12,000 shares to the eight eligible board members effective March 8, 2017 as full payment for their 2017 retainer fee. All shares were issued under the 2010 Non-Employee Directors Stock Plan.

10. The Company entered into an Amended and Restated Credit Agreement (the "Credit Agreement") effective November 18, 2011. The Company has negotiated the Ninth Amendment to Credit Agreement which excludes capitalized deferred development expenditures from capital expenditures in the Fixed Charge Coverage Ratio calculation as such expenditures would have caused the Company to fail the covenant. See Note 12 to the condensed consolidated financial statements contained in this Quarterly Report. The Company had previously entered into eight separate amendments to the Credit Agreement. Cumulatively, the amendments were entered into by the Company to, among other things, (i) modify certain of the financial covenants, (ii) adjust the amount of the Revolving Commitment, (iii) terminate the Term Loan Commitment upon the repayment in full of the outstanding principal balance (and accrued interest thereon) of the Term Loan, (iv) modify the Borrowing Base calculation to provide for borrowing availability in respect of new Capital Expenditures, (v) decrease the interest rates on the Revolving Loans, (vi) extend the maturity date and (vii) decrease the Letter of Credit fee rate. Borrowings under the Credit Agreement

are secured by the Company's accounts receivable, inventories, machinery, equipment, vehicles, certain real estate and the common stock of all of the Company's subsidiaries. Borrowings under the Credit Agreement bear interest based on a London Interbank Offered Rate (LIBOR) or prime rate based option.

The Credit Agreement either limits or requires prior approval by the lender of additional borrowings, acquisition of stock of other companies, purchase of treasury shares and payment of cash dividends. Payment of accrued interest is due monthly or at the end of the applicable LIBOR period.

The Credit Agreement as amended provides for the following:

- The Revolving Commitment is \$20,000,000.
- Borrowings under the Revolving Commitment are limited to (a) 80% of eligible accounts receivable, (b) the lesser of 50% of eligible inventories and \$8,500,000 plus (c) 80% of new Capital Expenditures not to exceed \$5,500,000 in any fiscal year (excluding the aggregate amount of any Capital Expenditures financed with the proceeds of a Revolving Line Advance).
- The Minimum Fixed Charge Coverage Ratio is not permitted to be below 1.15 to 1.0 for each trailing twelve month period measured at the end of each Fiscal Quarter.
- The Company must not permit Tangible Net Worth as of the last day of any Computation Period to be less than \$31,000,000 (provided that the required amount of Tangible Net Worth shall increase (but not decrease) by an amount equal to 50% of the Consolidated Net Income for the immediately preceding Fiscal Year). Therefore, the required Tangible Net Worth as of March 31, 2018 is \$33,752,000.
- The Balance Sheet Leverage Ratio as of the last day of any Computation Period may not exceed 1.00 to 1.00.
- The maturity date of the credit facility is May 1, 2020.
- Interest rate pricing for the revolving credit facility is currently LIBOR plus 2.25% or the prime rate.

Definitions under the Credit Agreement as amended are as follows:

- Tangible Net Worth is defined as net worth plus subordinated debt, minus intangible assets (goodwill, intellectual property, prepaid expenses, deposits and deferred charges), minus all obligations owed to the Company or any of its subsidiaries by any affiliate or any of its subsidiaries and minus all loans owed by its officers, stockholders, subsidiaries or employees.
 - Fixed Charge Coverage Ratio is defined as, for any computation period, the ratio of (a) the sum for such period of (i) EBITDA, as defined, minus (ii) the sum of income taxes paid in cash, the amount expended related to the development of the mining property discussed in Note 12 and all unfinanced capital expenditures to (b) the sum for such period of interest expense related to the Credit Agreement.
- Balance Sheet Leverage Ratio is defined as the ratio of Total Debt to Tangible Net Worth.
- EBITDA means for any Computation Period (or another time period to the extent expressly provided for in the Credit Agreement) the sum of the following with respect to the Company and its Subsidiaries each as determined in accordance with GAAP: (a) Consolidated Net Income, plus (b) federal, state and other income taxes deducted in the determination of Consolidated Net Income, plus (c) Interest Expense deducted in the determination of Consolidated Net Income, plus (d) depreciation, depletion and amortization expense deducted in the determination of Consolidated Net Income, plus (e) for 2014, charges directly related to the closing and reclamation of the Pueblo aggregates mining site, plus (f) any other non-cash charges and any extraordinary charges deducted in the determination of Consolidated Net Income, including any asset impairment charges (including write downs of goodwill), minus (g) any gains from Asset Dispositions, any extraordinary gains and any gains from discontinued operations included in the determination of Consolidated Net Income.

Outstanding funded revolving debt was \$5,700,000 as of March 31, 2018 compared to \$3,500,000 as of December 30, 2017. The highest balance outstanding during the first three months of 2018 and 2017 was \$6,200,000 and \$3,650,000, respectively. Average outstanding funded debt was \$3,792,000 and \$1,895,000 for the first three months of 2018 and 2017, respectively. At March 31, 2018, the Company had outstanding letters of credit totaling \$4,955,000. At all times since the inception of the Credit Agreement, the Company has had sufficient qualifying and eligible assets such that the available borrowing capacity exceeded the cash needs of the Company and this situation is expected to continue for the foreseeable future.

The Company believes that its existing cash balance, anticipated cash flow from operations and borrowings available under the Credit Agreement will be sufficient to cover expected cash needs, including planned capital

expenditures, for the next twelve months. The Company expects to be in compliance with all debt covenants, as amended, throughout the facility's remaining term.

11. The Company is involved in litigation matters related to its business. In the Company's opinion, none of these proceedings, when concluded, will have a material adverse effect on the Company's consolidated results of operations or financial condition as the Company has established adequate accruals for matters that are probable and estimable. The Company does not accrue estimated future legal costs related to the defense of these matters but rather expenses legal costs as incurred. Additionally, see Note 8 for discussion of litigation regarding the Pueblo sand and gravel lease.

12. During July 2015, TMC began development of a granite mining property south of Colorado Springs. These costs included drilling the property to ascertain its suitability for mining, engineering studies and legal expenses related to the preparation of TMC's application to obtain the required mining permits from the State of Colorado and El Paso County.

TMC made its initial application for a permit from the state in 2016. The state's Reclamation Mining and Safety Division (DRMS) of the Colorado Department of Natural Resources rejected issuing the permit by a 3 to 2 vote with one recusal and one absent for the vote. The DRMS invited TMC to resubmit its request to address the concerns raised during the 2016 hearing. TMC filed its second application to the state in November 2017 addressing the issues cited during the first hearing. The Colorado Department of Natural Resources staff reviewed the mining application and recommended that the mining plan be approved as submitted. On April 26, 2018 despite the staff recommendation to approve the application, the head of the Department of Natural Resources, who has a seat on the DRMS Committee, voted against the permit. The permit was rejected 3 to 2 with two members recusing themselves.

Although written notification of the final decision has not yet been received, the Company has written off all capitalized costs associated with the permit application in the first quarter of 2018. As of December 30, 2017 the Company had capitalized \$5,430,000 of deferred development which was included in Property, plant and equipment on the consolidated balance sheet. As of March 31, 2018, TMC had invested \$6,308,000 in the project. An estimated \$626,000 of additional expenses were incurred during April 2018 and were also written off as of March 31, 2018 bringing the total charge to \$6,934,000.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to help investors understand the Company's results of operations, financial condition and current business environment. The MD&A is provided as a supplement to, and should be read in conjunction with, the Company's unaudited consolidated financial statements and related notes included elsewhere in this Quarterly Report and the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

Company Overview

For an overview of the Company's operations and operating structure, see Note 7 to the condensed consolidated financial statements contained in this Quarterly Report.

Liquidity and Capital Resources

Sales of the Company's HVAC products are seasonal except for fan coils. Sales of furnaces, heaters and evaporative coolers are sensitive to weather conditions particularly during their respective peak selling seasons. Fan coil sales are, to a significant extent, dependent on commercial construction, particularly of hotels. Revenues in the CACS segment are primarily dependent on the level of construction activity along the Southern Front Range in Colorado. Sales for the Door segment are not as seasonal nor are they much affected by weather conditions. Historically, the Company has experienced operating losses during the first quarter except when the weather is mild and demand strong along the Southern Front Range. Operating results typically improve in the second and third quarters

reflecting more favorable weather conditions in southern Colorado and the seasonal sales of the Evaporative Cooling segment. Fourth quarter results can vary based on weather conditions in Colorado as well as in the principal markets for the Company's heating equipment.

The Company typically experiences operating cash flow deficits during the first half of the year reflecting operating results, the use of sales dating programs (extended payment terms) related to the Evaporative Cooling segment and payments of the prior year's accrued incentive bonuses and Company profit-sharing contributions, if any. As a result, the Company's borrowings against its revolving credit facility tend to peak during the second quarter and then decline over the remainder of the year.

Cash used by operations was \$1,599,000 during the first three months of 2018 compared to \$576,000 used during the first three months of 2017. The current year use of cash includes \$878,000 related to deferred development of a mining property which was written-off in the current quarter. See Note 12 to the condensed consolidated financial statements contained in this Quarterly Report for further discussion. The prior year use of cash was attributable to operating results combined with changes in working capital items, primarily increases in inventory levels partially offset by decreases in receivables.

During the three months ended March 31, 2018, investing activities used \$700,000 of cash compared to \$630,000 of cash used in the prior year's period. Capital expenditures during the first three months of 2018 were \$700,000 compared to \$630,000 during the first three months of 2017.

Financing activities during the first three months of 2018 provided \$2,200,000 as borrowings were used to partially finance the increase in working capital and the pursuit of mining permits for a property south of Colorado Springs. Subsequent to March 31, 2018, the Company was denied the permits and the related investment of \$6,934,000 was written-off in the current quarter. See Note 12 to the condensed consolidated financial statements contained in this Quarterly Report for further discussion. During the first three months of 2017 financing activities provided \$1,200,000 as borrowings were used to partially finance the increase in working capital. See also the discussion of the Revolving Credit and Term Loan Agreement below.

Revolving Credit and Term Loan Agreement

As discussed in Note 10 to the condensed consolidated financial statements contained in this Quarterly Report, the Company maintains a Credit Agreement, which, as amended, provides for a Revolving Commitment of \$20,000,000. Borrowings under the Credit Agreement are secured by the Company's accounts receivable, inventories, machinery, equipment, vehicles, certain real estate and the common stock of all of the Company's subsidiaries. Borrowings under the Revolving Commitment are limited to (a) 80% of eligible accounts receivable, (b) the lesser of 50% of eligible inventories and \$8,500,000 plus (c) 80% of new Capital Expenditures not to exceed \$5,500,000 in any fiscal year (excluding the aggregate amount of any Capital Expenditures financed with the proceeds of a Revolving Line advance). Borrowings under the Credit Agreement bear interest based on a LIBOR or prime rate based option.

The Credit Agreement either limits or requires prior approval by the lender of additional borrowings, acquisition of stock of other companies, purchase of treasury shares and payment of cash dividends. Payment of accrued interest is due monthly or at the end of the applicable LIBOR period. The Credit Agreement has a maturity date of May 1, 2020.

The Company's outstanding borrowings against the revolving credit facility were \$5,700,000 at March 31, 2018. At all times since the inception of the Credit Agreement, the Company has had sufficient qualifying and eligible assets such that the entire revolving credit facility was available to the Company. This situation is expected to continue for the foreseeable future.

As of March 31, 2018 the Company was in compliance with all covenants in the Credit Agreement, as amended, and expects to be in compliance with all loan covenants for the remaining term of the Credit Agreement. The Company believes that its existing cash balance, anticipated cash flow from operations and borrowings available under the

Credit Agreement will be sufficient to cover expected cash needs, including planned capital expenditures, for the next twelve months. The Company expects to be in compliance with all debt covenants, as amended, throughout the facility's remaining term.

Results of Operations - Comparison of Quarter Ended March 31, 2018 to the Quarter Ended April 1, 2017

(In the ensuing discussions of the results of operations the Company defines the term gross profit as the amount determined by deducting cost of sales before depreciation, depletion and amortization from sales. The gross profit ratio is gross profit divided by sales.)

Consolidated sales in the first quarter of 2018 were \$36,873,000, an increase of \$2,770,000, or 8.1%, compared to the first quarter of 2017. All segments reported improved current quarter sales. The CACS segment reported an increase of \$1,581,000 (11.7%) and the Door segment reported a \$427,000 (11.0%) increase in sales. The Heating and Cooling and Evaporative Cooling segments also reported increased sales of \$557,000 (5.3%) and \$207,000 (3.3%), respectively, in the first quarter of 2018 compared to the first quarter of 2017.

The consolidated gross profit ratio in the first quarter of 2018 was 15.0% compared to 17.7% in the same period of 2017. All segments, with exception of the Door segment, reported declines in gross profit margin in the first quarter of 2018 compared to the prior year first quarter. The Door segment gross profit percentage increased 1.7 points, in the first quarter of the current year compared to the first quarter of the prior year. The decreases in gross profit for the other three segments are addressed in the discussion of segments below.

Consolidated selling and administrative expenses were \$107,000 higher in the first quarter of 2018 than the comparable prior year quarter. As a percentage of consolidated sales, selling and administrative expenses decreased to 16.6% in the first quarter of 2018 from 17.6% in the first quarter of 2017.

Consolidated depreciation and amortization charges were up \$38,000, or 6.0%, in the first quarter of 2018 compared to the first quarter of 2017.

The first quarter of 2018 includes the write-off of \$6,934,000 of deferred development costs previously capitalized in property, plant and equipment on the consolidated balance sheet or incurred in the current period. These costs included exploration of the land to determine suitability for mining as well as costs associated with the Company's pursuit of mining permits for the property south of Colorado Springs. Subsequent to March 31, 2018 the permits were denied by the State of Colorado for the second time. See Note 12 to the condensed consolidated financial statements contained in this Quarterly Report for further discussion.

The consolidated operating loss in the first quarter of 2018, before the \$6,934,000 write-off of deferred development related to a mining property discussed above, was \$1,259,000 compared to a consolidated operating loss of \$611,000 in the first quarter of 2017. The Door segment reported an increase of \$145,000 in operating profit in the first quarter of 2018 compared to the first quarter of 2017. The Heating and Cooling segment reported a smaller increase of \$6,000 for the same comparison period. The CACS and Evaporative Cooling segments reported increased operating losses, \$404,000 and \$199,000, respectively, for the current first quarter compared to the prior year first quarter.

Interest expense in the first quarter of 2018 was \$108,000 compared to \$66,000 in the first quarter of 2017. Interest expense includes interest on outstanding funded debt, finance charges on outstanding letters of credit, the fee on the unused revolving credit line and other recurring fees charged by the lending bank. The increase from the prior year quarter is attributable to higher average borrowings partially offset by lower average interest rates. Average outstanding funded debt in the first quarter of 2018 was \$3,792,000 compared to \$1,895,000 for the first quarter of 2017. The weighted average interest rate on outstanding funded debt in the first quarter of 2018, including the fee on the unused line of credit and other recurring bank charges but excluding finance charges on letters of credit, was approximately 6.7% compared to 8.1% in the first quarter of 2017. The lower interest rate was due to the lower rates negotiated on revolving debt in the Eight Amendment to Credit Agreement effective in the second quarter of 2017.

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At the end of the first quarter of 2018 the outstanding funded debt was \$5,700,000 compared to \$3,200,000 at the end of the first quarter of 2017.

The Company's effective income tax rate reflects federal and state statutory income tax rates adjusted for non-deductible expenses, tax credits and other tax items. The estimated effective income tax rate in the first quarter of 2018 was a benefit of 25.0% compared to a benefit of 34.0% for the first quarter of 2017. The decrease in benefit is attributable to the recently enacted Tax Act which reduced the Company's Federal Tax Rate from 34.0% to 21.0%.

The Company operates four businesses in two industry groups. The businesses are generally seasonal, weather sensitive and subject to cyclical factors. The following addresses various aspects of operating performance focusing on the reportable segments within each of the two industry groups.

Construction Products

The table below presents a summary of operating information for the two reportable segments within the Construction Products industry group for the quarters ended March 31, 2018 and April 1, 2017 (dollar amounts in thousands):

	Concrete, Aggregates and Construction Supplies	Door		
Three Months ended March 31, 2018				
Revenues from external customers	\$ 15,064	\$ 4,296		
Segment gross profit	692	1,211		
Gross profit as percent of sales	4.6	% 28.2	%	
Segment operating (loss) income	\$ (7,922)	\$ 438		
Operating (loss) income as a percent of sales	(52.6)	% 10.2	%	
Segment assets as of March 31, 2018	\$ 34,350	\$ 7,047		
Return on assets	(23.1)	% 6.2	%	
Three Months ended April 1, 2017				
Revenues from external customers	\$ 13,483	\$ 3,869		
Segment gross profit	1,050	1,025		
Gross profit as percent of sales	7.8	% 26.5	%	
Segment operating (loss) income	\$ (584)	\$ 292		
Operating (loss) income as a percent of sales	(4.3)	% 7.5	%	
Segment assets as of April 1, 2017	\$ 34,863	\$ 6,865		
Return on assets	(1.7)	% 4.3	%	

Concrete, Aggregates and Construction Supplies Segment

The product offerings of the CACS segment consist of ready-mix concrete, aggregates and construction supplies. Ready-mix concrete and aggregates are produced at multiple locations in or near Colorado Springs and Pueblo, Colorado. Construction supplies encompass numerous products purchased from third party suppliers and sold to the construction trades, particularly concrete sub-contractors. During the three months ended March 31, 2018, concrete, aggregates and construction supplies accounted for approximately 75%, 19% and 6% of the sales of the CACS segment, respectively, including aggregates consumed internally in the production of concrete. In the first quarter of 2017, the sales mix between concrete, aggregates and construction supplies was 74%, 20% and 6%, respectively. Sales including aggregates consumed internally increased \$1,658,000 (10.9%) from the first quarter of 2017 to the current year quarter. Sales to third parties increased by \$1,581,000 (11.7%) between the same periods. The gross profit reported by the CACS segment declined to 4.6% in the first quarter of 2018 from 7.8% in the first quarter of the prior year. The decrease is attributable to TMC's concrete and aggregates operations as discussed below.

Ready-mix concrete sales, excluding flow fill material, increased 11.6% in the first quarter of 2018 versus the first quarter of 2017. Concrete volume, on the same basis, was 5.4% higher in the first quarter of 2018 compared to the prior year quarter. Average concrete prices for the first quarter of 2018 increased by approximately 5.9% over the comparable 2017 quarter largely due to increased material costs. The market remains sharply competitive especially on large construction projects. Cement is the highest cost raw material used in the production of ready-mix concrete. Cement costs per yard increased by 3.5% in the first quarter of the current year compared to the same quarter of 2017. Higher cement and rock costs, including delivery, were partially offset by lower fly ash and other admixture costs. Batching cash costs per yard increased by 5.0% while delivery cash costs per yard increased 15.3% during the first quarter of the current year over the first quarter of the prior year. The increase in batching costs is attributable to higher repair and maintenance costs. The increase in delivery costs is also attributable to higher repair and maintenance costs as well as higher fuel and contract trucking costs.

The CACS segment also produces and sells sand, crushed limestone and gravel (collectively “aggregates”) from deposits in and around Colorado Springs. Sales volume (tons) of construction aggregates, including those used internally in the production of ready-mix concrete, decreased 10.1% in the first quarter of 2018 compared to the comparable 2017 quarter. Average selling prices, excluding freight, increased 10.1% due to the higher ratio of concrete rock and concrete sand to filler sand sales. The sand operation remained profitable in the first quarter of 2018 and one of the quarries improved its operating profit by 9.5%. However, increased operating expenses in the sand operation, primarily labor costs, reduced the related gross profit by 26.6% per ton in the first quarter of 2018 compared to the first quarter of 2017. This decline combined with the impact of mining challenges at two quarries and carrying costs related to the closed Pueblo quarry contributed to the \$487,000 loss reported by the aggregates operations in the first quarter of 2018 compared to a \$428,000 loss for the first quarter of 2017.

Sales of construction supplies increased by \$186,000 (22.4%) in the first quarter of 2018 compared to the prior year quarter. Challenges with a certain project increased costs such that the division reported a first quarter 2018 negative gross profit higher than the negative gross profit reported in the first quarter of 2017.

Depreciation and amortization charges increased by \$19,000 in the first quarter of 2018 compared to the first quarter of 2017.

Selling and administrative expenses were \$27,000 higher in the first quarter of 2018 compared to the same period in 2017. The increase was attributable primarily to increased legal fees. Litigation fees related to the Pueblo aggregate lease were \$200,000 during the first quarter of 2018 compared to \$176,000 incurred during the comparable period of 2017. As a percentage of sales selling and administrative expenses decreased to 8.8% in the first quarter of 2018 compared to 9.6% in the first quarter of 2017.

The first quarter of 2018 includes a \$6,934,000 write-off of deferred development costs associated with a mining property for which the Company had applied to the state of Colorado for the required mining permits. Subsequent to March 31, 2018 the permits were denied by the state’s Reclamation Mining and Safety Division. See Note 12 to the condensed consolidated financial statements contained in this Quarterly Report for further discussion.

The prices of two commodities, cement and diesel fuel, can have a significant effect on the results of operations of this segment. Management negotiates cement prices with producers who have production facilities in or near the concrete markets that the Company serves. Management may negotiate separate cement prices for large construction projects depending on the demand for and availability of cement from the local producers. The Company buys diesel fuel from local distributors and occasionally enters into a short term arrangement with a distributor whereby the price of diesel fuel is fixed for a period of up to six months. In the past year the Company has not hedged diesel fuel prices. Increases in the cost of these two commodities have a direct effect on the results of operations depending upon whether competitive conditions prevailing in the marketplace enable the company to adjust its selling prices to recover such increases.

Door Segment

The Door segment sells hollow metal doors, door frames and related hardware, wood doors, lavatory fixtures and electronic access and security systems. Nearly all of the Door segments sales are for commercial and institutional buildings such as schools and healthcare facilities. Approximately 65% to 70% of the sales of the Door segment are related to jobs obtained through a competitive bidding process. Bid prices may be higher or lower than bid prices on similar jobs in the prior year. The Door segment does not track unit sales of the various products through its accounting or management reporting systems. Management focuses on the level of the sales backlog, the trend in sales and the gross profit rate in managing the business.

Door sales in the first quarter of 2018 were \$427,000 (11.0%) higher than in the first quarter of the previous year. Bidding prices remain competitive. The gross profit ratio in the first quarter of 2018 was 28.2%, up from 26.5% in the comparable quarter of 2017. The improvement in the gross profit ratio is attributable to favorable material pricing and mix of products shipped during the first quarter of 2018.

Sales and administrative expenses were \$35,000 higher in the first quarter of 2018 compared to the first quarter of 2017. As a percentage of sales, these expenses were 17.1% and 18.0% in the first quarters of 2018 and 2017, respectively.

The Door segment sales backlog at the end of the first quarter of 2018 was \$4,790,000 compared to \$5,797,000 at the end of the first quarter of 2017 due to several large jobs shipping in March 2018.

HVAC Products

The table below presents a summary of operating information for the two reportable segments within the HVAC products industry group for the quarters ended March 31, 2018 and April 1, 2017 (dollar amounts in thousands):

	Heating and Cooling	Evaporative Cooling
Three Months ended March 31, 2018		
Revenues from external customers	\$ 10,993	\$ 6,516
Segment gross profit	2,611	1,010
Gross profit as percent of sales	23.8	% 15.5
Segment operating income (loss)	\$ 571	\$ (256)
Operating income (loss) as a percent of sales	5.2	% (3.9)
Segment assets as of March 31, 2018	\$ 19,288	\$ 14,910

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Return on assets	3.0	%	(1.7)	%
Three Months ended April 1, 2017				
Revenues from external customers	\$ 10,436		\$ 6,309	
Segment gross profit	2,795		1,155	
Gross profit as percent of sales	26.8	%	18.3	%
Segment operating income (loss)	\$ 565		\$ (57)	
Operating income (loss) as a percent of sales	5.4	%	(0.9)	%
Segment assets as of April 1, 2017	\$ 20,085		\$ 15,714	
Return on assets	2.8	%	(0.4)	%

Heating and Cooling Segment

In the first quarter of 2018, approximately 73% of sales in the Heating and Cooling segment consisted of wall furnaces and heaters. Fan coils accounted for 26% of the segment's sales and other products were about 1%. In the first quarter of 2017 these shares of total segment sales were 68%, 30% and 2%, respectively. Overall sales in the Heating and Cooling segment in the first quarter of 2018 increased by \$557,000 (5.3%) compared to the same period in 2017.

Sales of furnaces and heaters increased 12.4% in the three months ended March 31, 2018 compared to the three months ended April 1, 2017. Unit shipments of furnaces and heaters were 10.2% higher in the first quarter of 2018. Average sales prices for furnaces and heaters were about 1.9% higher compared to a year ago as a result of changes in product mix. The gross profit from furnaces and heaters declined in the first quarter of 2018 due to lower production levels.

Sales of fan coils during the first quarter of 2018 declined 11.5% from the comparable 2017 quarter. The fan coil sales backlog at March 31, 2018 was \$3,173,000 compared to \$4,441,000 at April 1, 2017. Typically, approximately 90% of the sales of fan coils are custom-made systems for hotels and other commercial buildings. Fan coil jobs are obtained through a competitive bidding process. Since every bid job is a unique configuration of materials and parts, the Company does not track units of sales or production as such unit volume data would not be useful in managing the business. Management focuses on the contribution margin by job, the current level of sales and the sales backlog in managing the fan coil business. Contribution margin is measured by deducting variable manufacturing costs and variable selling expenses from sales for a particular product line and is used as an internal measure of profitability for a product or product line. The fan coil contribution margin percentage in the first quarter of 2017 was 29.6%, down from 34.0% in the first quarter of 2017. Reduced production levels were the primary cause of the lower contribution margin. Both quarters' margins were considered to be acceptable performance levels.

The Heating and Cooling segment's gross profit ratio for the first quarter of 2018 was 23.8% compared to 26.8% in the first quarter of 2017. The lower gross profit ratio is attributable primarily to the reduced production levels discussed above.

Selling and administrative expenses in the first quarter of 2018 were \$201,000 lower than the first quarter of the previous year. The decrease was attributable to reduced compensation costs and lower legal fees. As a percentage of sales, selling and administrative expenses were 17.1% in the first quarter of 2018 and 19.9% in the first quarter of 2017.

The Heating and Cooling segment's operating profit increased \$6,000 (1.1%) for the first quarter of 2018 compared to the first quarter of 2017. This is attributable to higher overall sales combined with lower selling and administrative expenses partially offset by higher material costs and a lower level of production.

Evaporative Cooling Segment

Sales of evaporative coolers increased \$207,000 (3.3%) in the first quarter of 2018 compared to the first quarter of 2017. Unit sales of evaporative coolers in the first quarter of 2018 were consistent with unit sales in the first quarter of 2017, down less than 1%. Average selling prices, including parts sales, were up 3.8% between the first quarter of 2018 and the first quarter of 2017. The gross profit ratio in the first quarter of 2018 was 15.5% compared to 18.3% in the

first quarter of 2017. The decline in gross profit ratio is attributable to higher material costs, notably steel, and increased labor costs, including overtime.

Selling and administrative expenses were \$54,000 (4.9%) higher in the first quarter of 2018 primarily due to higher compensation related costs. As a percentage of sales, selling and administrative expenses increased to 17.8% in the current quarter of 2018 from 17.5% in the prior year first quarter.

The Evaporative Cooler segment reported an operating loss of \$256,000 for the first quarter of 2018 compared to an operating loss of \$57,000 for the first quarter of 2017. Higher material and labor costs in the first quarter of 2018 more than offset the increased sales.

Both businesses in the HVAC group are sensitive to changes in prices for a number of different raw materials, commodities and purchased parts. Prices of steel and copper in particular can have a significant effect on the results of operations of this group. Neither company is currently a party to any hedging arrangements with regard to steel or copper.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The condensed consolidated financial statements contained in this Quarterly Report have been prepared in accordance with accounting principles generally accepted in the United States of America which require the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of March 31, 2018 and December 30, 2017 and affect the reported amounts of revenues and expenses for the periods reported. Actual results could differ from those estimates.

Information with respect to the Company's critical accounting policies which the Company believes could have the most significant effect on the Company's reported results and require subjective or complex judgments by management, is contained in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, of the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2017.

OUTLOOK

The Company expects consolidated sales in 2018 to exceed the 2017 level. The level of construction activity along the Front Range in Southern Colorado appears to be slightly stronger in 2018 although some of this demand may be due to unfavorable weather conditions during most of the first half of 2017 which pushed some scheduled projects into 2018. Concrete prices have increased, largely in response to higher material costs, although labor and other costs also increased modestly. Pricing on most bid jobs remains sharply competitive. Operating results for the remainder of the year will depend on the ability of the Company to pass on increased material and/or fuel costs, should they occur, as well as weather conditions following a normal annual pattern. The Door segment is expected to report 2018 results similar to those reported for 2017.

The Company's Heating and Cooling segment anticipates some increase in sales in 2018 as price increases, in response to higher steel costs, have been announced for the second quarter. This sales price increase is expected to principally affect the furnace lines as unit sales are ahead of the 2017 level. Fan coil sales are below the 2017 year-to-date level although the backlog and bidding opportunities have increased. In the Evaporative Cooling segment, residential coolers are sold primarily for replacement purposes and unit sales have been stagnant in recent years. Industrial coolers have performed well and management hopes to increase the unit volume of these sales. Sales of furnaces and residential coolers can be significantly influenced by weather conditions, particularly during their respective selling seasons.

RECENTLY ISSUED ACCOUNTING STANDARDS

See Note 4 to the condensed consolidated financial statements contained in this Quarterly Report for a discussion of recently issued accounting standards.

MATERIAL CHANGES TO CONTRACTUAL OBLIGATIONS

There were no material changes to contractual obligations that occurred during the quarter ended March 31, 2018.

FORWARD-LOOKING STATEMENTS

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended. Such forward-looking statements are based on the beliefs of the Company's management as well as on assumptions made by and information available to the Company at the time such statements were made. When used in this Quarterly Report, words such as "anticipates," "believes," "contemplates," "estimates," "expects," "plans," "projects," "will," "continue" and similar expressions are intended to identify forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements as a result of various factors including but not limited to: the amount of new construction, weather, interest rates, availability of raw materials and their related costs, economic conditions and competitive forces in the regions where the Company does business, changes in governmental regulations and policies and the ability of the Company to obtain credit on commercially reasonable terms. Changes in accounting pronouncements as well as the ultimate resolution of the

Pueblo lease litigation could also alter projected results. Other factors not currently anticipated may also materially and adversely affect the Company's results of operations, cash flows and financial position. Forward-looking statements speak only as of the date they were made and we undertake no obligation to publicly update them.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is a smaller reporting company as defined by Item 10(f) of Regulation S-K and, as such, is not required to provide information in response to this item.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer, with the participation of management, have evaluated the effectiveness of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act) as of March 31, 2018. The Chief Executive Officer and Chief Financial Officer, based on that evaluation, concluded that the Company's disclosure controls and procedures are effective and were reasonably designed to ensure that all material information relating to the Company (including its subsidiaries) required to be disclosed in the reports filed and submitted by the Company under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Commission.

(b) Changes in Internal Control Over Financial Reporting.

During the quarter ended March 31, 2018, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Items 1, 1A, 3 and 5 are not applicable or the Company has nothing to report thereunder; therefore, the items have been omitted and no reference is required in this Quarterly Report.

Item 2.Unregistered Sales of Equity Securities and Use of Proceeds

The Company reserved 150,000 treasury shares representing the maximum number allowed to be granted under the 2010 Non-Employee Directors Stock Plan (Plan) to non-employee directors in lieu of the base director retainer fee. The Company issued a total of 16,000 shares to the eight eligible board members effective January 16, 2018 as full payment for their 2018 retainer fee. In 2017 the Company issued shares to the eight eligible board members as full payment of their 2017 retainer fee during the first quarter. Transactions pursuant to the Plan are exempt from registration under the Securities Act of 1933, as amended (the “Securities Act”) pursuant to Section 4(a)(2) of the Securities Act, as the shares authorized under the plan may only be issued to the Company’s directors and are not offered to the public. At March 31, 2018, a total of 38,000 shares remain eligible for issuance under the Plan.

Item 4.Mine Safety Disclosure

The Company’s aggregates mining operations, all of which are surface mines, are subject to regulation by the Federal Mine Safety and Health Administration (MSHA) under the Federal Mine Safety and Health Act of 1977 (as amended, the “Mine Act”). MSHA inspects these operations on a regular basis and issues various citations and orders when it believes a violation of the Mine Act has occurred. Information concerning mine safety violations and other regulatory matters required to be disclosed by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of SEC Regulation S-K is included in Exhibit 95 to this Quarterly Report.

Item 6.Exhibits

Exhibit No.	Description
10	<u>Ninth Amendment to Credit Agreement dated May 15, 2018, among Continental Materials Corporation, the financial institutions that are or may from time to time become parties to the Credit Agreement and CIBC BANK USA, an Illinois state chartered bank formerly known as The PrivateBank and Trust Company as Administrative Agent, filed herewith.</u>
31.1	<u>Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e) and Exchange Act Rules 13a-15(f) and 15d-15(f), filed herewith.</u>

- 31.2 Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e) and Exchange Act Rules 13a-15(f) and 15d-15(f), filed herewith.
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 filed herewith.
- 95 Mine Safety Disclosures filed herewith.
- 101 The following financial information from Continental Materials Corporation's Quarterly Report on Form 10-Q for the period ended March 31, 2018 filed with the SEC on May 15, 2018, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations and Retained Earnings for the three-month periods ended March 31, 2018 and April 1, 2017, (ii) the Condensed Consolidated Balance Sheets at March 31, 2018 and April 1, 2017, (iii) the Condensed Consolidated Statements of Cash Flows for the three-month periods ended March 31, 2018 and April 1, 2017, and (iv) Notes to the Quarterly Condensed Consolidated Financial Statements.

SIGNATURE

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

CONTINENTAL MATERIALS
CORPORATION

Date: May 15, 2018 By: /s/ Mark S. Nichter
Mark S. Nichter, Vice President, Secretary
and Chief Financial Officer