

Edgar Filing: Crimson Wine Group, Ltd - Form 10-Q

Crimson Wine Group, Ltd
Form 10-Q
November 08, 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 September 30, 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 000-54866

CRIMSON WINE GROUP, LTD.

(Exact name of registrant as specified in its Charter)

Delaware

(State or Other Jurisdiction of

Incorporation or Organization)

2700 Napa Valley Corporate Drive, Suite B, Napa, California

(Address of Principal Executive Offices)

(800) 486-0503

(Registrant's Telephone Number, Including Area Code)

13-3607383

(I.R.S. Employer

Identification Number)

94558

(Zip Code)

N/A

(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.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

Edgar Filing: Crimson Wine Group, Ltd - Form 10-Q

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 of the Exchange Act).
YES NOX

On November 2, 2018 there were 23,780,008 outstanding shares of the Registrant's Common Stock, par value \$0.01 per share.

CRIMSON WINE GROUP, LTD.
TABLE OF CONTENTS

	Page Number
PART I. FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	<u>1</u>
<u>Condensed Consolidated Balance Sheets</u> as of September 30, 2018 and December 31, 2017	<u>1</u>
<u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2018 and 2017</u>	<u>2</u>
<u>Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2018 and 2017</u>	<u>3</u>
<u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2018 and 2017</u>	<u>4</u>
<u>Notes to Unaudited Interim Condensed Consolidated Financial Statements</u>	<u>5</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Interim Operations</u>	<u>16</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>23</u>
Item 4. <u>Controls and Procedures</u>	<u>23</u>
PART II. OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>24</u>
Item 1A. <u>Risk Factors</u>	<u>24</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>24</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>24</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>24</u>
Item 5. <u>Other Information</u>	<u>24</u>
Item 6. <u>Exhibits</u>	<u>25</u>
<u>Signatures</u>	<u>26</u>

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CRIMSON WINE GROUP, LTD.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (In thousands, except share amounts and par value)
 (Unaudited)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 13,135	\$ 9,792
Available for sale debt securities	14,706	19,956
Accounts receivable, net	7,313	3,981
Inventory	77,705	75,458
Other current assets	1,530	1,328
Assets held for sale	638	—
Total current assets	115,027	110,515
Property and equipment, net	126,848	129,018
Goodwill	1,262	1,262
Intangible and other non-current assets, net	12,186	13,214
Total non-current assets	140,296	143,494
Total assets	\$ 255,323	\$ 254,009
Liabilities		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 12,602	\$ 10,323
Customer deposits	1,415	593
Current portion of long-term debt, net of unamortized loan fees	1,125	1,125
Total current liabilities	15,142	12,041
Long-term debt, net of current portion and unamortized loan fees	22,462	23,305
Deferred rent, non-current	33	63
Deferred tax liability	4,881	4,881
Total non-current liabilities	27,376	28,249
Total liabilities	42,518	40,290
Commitments and Contingencies (Note 13)		
Equity		
Common shares, par value \$0.01 per share, 150,000,000 shares authorized; 23,780,008 and 23,997,385 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	238	240
Additional paid-in capital	277,520	277,520
Accumulated other comprehensive loss	(24	) (23
Accumulated deficit	(64,929	) (64,018
Total equity	212,805	213,719
Total liabilities and equity	\$ 255,323	\$ 254,009

See accompanying notes to unaudited interim condensed consolidated financial statements.

CRIMSON WINE GROUP, LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)
(Unaudited)

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net sales	\$16,820	\$13,505	\$47,331	\$43,361
Cost of sales	9,080	7,049	24,618	21,177
Gross profit	7,740	6,456	22,713	22,184
Operating expenses:				
Sales and marketing	4,205	3,808	12,256	11,660
General and administrative	2,752	2,604	8,081	7,829
Total operating expenses	6,957	6,412	20,337	19,489
Net (gain) loss on disposal of property and equipment	(11	) 196	94	195
Restructuring charges	70	—	662	—
Income (loss) from operations	724	(152	) 1,620	2,500
Other income (expense):				
Interest expense, net	(333	) (276	) (843	) (516
Other income, net	636	169	713	445
Total other income (expense), net	303	(107	) (130	) (71
Income (loss) before income taxes	1,027	(259	) 1,490	2,429
Income tax provision (benefit)	261	(53	) 398	988
Net income (loss)	\$766	\$(206	) \$1,092	\$1,441
Basic and fully diluted weighted-average shares outstanding	23,851	23,997	23,940	23,997
Basic and fully diluted earnings (loss) per share	\$0.03	\$(0.01	) \$0.05	\$0.06

See accompanying notes to unaudited interim condensed consolidated financial statements.

CRIMSON WINE GROUP, LTD.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)
 (Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$766	\$(206)	\$1,092	\$1,441
Other comprehensive loss:				
Net unrealized holding gains (loss) on investments arising during the period, net of tax	17	(1)	(1)	(17)
Comprehensive income (loss)	\$783	\$(207)	\$1,091	\$1,424

See accompanying notes to unaudited interim condensed consolidated financial statements.

CRIMSON WINE GROUP, LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2018	2017
Net cash flows from operating activities:		
Net income	\$ 1,092	\$ 1,441
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization of property and equipment	5,652	5,238
Amortization of intangible assets	1,077	1,169
Amortization of loan fees	12	7
Loss on change in fair value of contingent consideration	9	25
Loss on write-down of inventory	131	83
Net loss on disposal of property and equipment	94	195
Restructuring charges	662	—
Impairment charges	24	—
Deferred rent	(30	) (24
Provision for deferred income taxes	—	32
Net change in operating assets and liabilities:		
Accounts receivable	(3,332	) 358
Inventory	(2,378	) (8,497
Other current assets	(202	) 410
Other non-current assets	(8) —
Accounts payable and accrued liabilities	2,047	2,180
Customer deposits	822	1,363
Net cash provided by operating activities	5,672	3,980
Net cash flows from investing activities:		
Purchase of available for sale debt securities	(6,500	) (5,750
Redemptions of available for sale debt securities	11,750	7,750
Acquisition of property and equipment	(4,588	) (11,983
Proceeds from disposal of property and equipment	51	34
Net cash provided by (used in) investing activities	713	(9,949
Net cash flows from financing activities:		
Proceeds from issuance of long-term debt	—	10,000
Principal payments on long-term debt	(855	) (480
Repurchase of common stock	(2,004) —
Payment of contingent consideration	(141	) (357
Payment of loan fees	(42	) (98
Net cash (used in) provided by financing activities	(3,042	) 9,065
Net increase in cash and cash equivalents	3,343	3,096
Cash and cash equivalents - beginning of period	9,792	4,795
Cash and cash equivalents - end of period	\$ 13,135	\$ 7,891
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest, net of capitalized interest	\$ 1,000	\$ 494
Income taxes	\$ —	\$ —

Edgar Filing: Crimson Wine Group, Ltd - Form 10-Q

Non-cash investing activity:

Net unrealized holding losses on investments, net of tax	\$ (1)	\$ (17)
Acquisition of property and equipment accrued but not yet paid	\$ 133	\$ 657

See accompanying notes to unaudited interim condensed consolidated financial statements.

4

Table of Contents

CRIMSON WINE GROUP, LTD.

Notes to Unaudited Interim Condensed Consolidated Financial Statements

1. Background and Basis of Presentation

Background

Crimson Wine Group, Ltd. and its subsidiaries (collectively, “Crimson” or the “Company”) is a Delaware corporation that has been conducting business since 1991. Crimson is in the business of producing and selling ultra-premium plus wines (i.e., wines that retail for over \$16 per 750ml bottle). Crimson is headquartered in Napa, California and through its subsidiaries owns six wineries: Pine Ridge Vineyards, Archery Summit, Chamisal Vineyards, Seghesio Family Vineyards, Double Canyon and Seven Hills Winery.

Financial Statement Preparation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. (“GAAP”) and pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) for interim financial information. The unaudited interim condensed consolidated financial statements, which reflect all adjustments (consisting of normal recurring items or items discussed herein) that management believes necessary to fairly state results of interim operations, should be read in conjunction with the Notes to Consolidated Financial Statements (including the Significant Accounting Policies and Recent Accounting Pronouncements) included in the Company’s audited consolidated financial statements for the year ended December 31, 2017, as filed with the SEC on Form 10-K (the “2017 Report”). Results of operations for interim periods are not necessarily indicative of annual results of operations. The unaudited condensed consolidated balance sheet at December 31, 2017 was extracted from the audited annual consolidated financial statements and does not include all disclosures required by GAAP for annual financial statements.

Significant Accounting Policies

Except as described below under Recent Accounting Pronouncements and in Note 2 “Revenue,” there were no changes to the Company’s significant accounting policies during the nine months ended September 30, 2018. See Note 3 to the 2017 Report for a description of the Company’s significant accounting policies.

Recent Accounting Pronouncements

Subsequent to the filing of the 2017 Report there were no accounting pronouncements issued by the Financial Accounting Standards Board (“FASB”) that would have a material effect on Crimson’s unaudited interim condensed consolidated financial statements. The following table provides an update of accounting pronouncements applicable to Crimson that are not yet adopted as of September 30, 2018 and a description of accounting pronouncements that were adopted during the nine months ended September 30, 2018:

Table of Contents

Standard	Description	Date of adoption	Effect on the financial statements or other significant matters
Standards that are not yet adopted			
Accounting Standard Update (“ASU”) 2016-02, Leases (Topic 842) (Subsequently updated with ASU 2018-01)	Increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new leases standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief.	January 1, 2019, early adoption is permitted for the Company.	The Company is currently evaluating the impact of the pending adoption of this new standard on its unaudited interim consolidated financial statements and has yet to determine the overall impact this ASU is expected to have. Management currently anticipates recognizing a right-of-use asset and a lease liability associated with its long-term operating leases.
ASU 2017-04, Goodwill and Other (Topic 350)	Eliminates Step 2 from the goodwill impairment test. Entities should perform their goodwill impairment tests by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value.	January 1, 2020, early adoption is permitted for the Company.	Management is currently evaluating the potential impact of this guidance on the Company’s unaudited interim consolidated financial statements.
ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220)	Allows the company to elect to reclassify the stranded tax effects related to the Tax Cuts and Jobs Act of 2017 from accumulated other comprehensive income into retained earnings.	January 1, 2019, early adoption is permitted for the Company.	Management is currently evaluating the potential impact of this guidance on the Company’s unaudited interim consolidated financial statements.
Standards that were adopted			
ASU 2014-09, Revenue from Contracts with Customers (Topic 606) (Subsequently updated with ASU 2016-08, ASU 2016-11, ASU 2016-10, ASU 2016-12, ASU 2016-20, ASU 2017-13 and ASU 2017-14)	In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), as amended, which is guidance outlining a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers that supersedes most current revenue recognition guidance. Topic 606 defines a five step process to require revenue to be recognized when control of goods is transferred to the customer and consideration is expected to be received. ASU 2014-09 also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments related to revenue recognition.	January 1, 2018	The Company adopted ASU 2014-09 using the modified retrospective method in Q1 2018. Based on the new guidance, the Company will continue to recognize revenue at a particular point in time for its contracts with customers. Therefore, the adoption of ASC 606 did not result in a cumulative-effect adjustment to opening retained earnings. See Note 2 “Revenue,” for further information.

Edgar Filing: Crimson Wine Group, Ltd - Form 10-Q

ASU 2017-01, Business Combinations (Topic 805)	Clarifies the definition of a business to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses.	January 1, 2018	The adoption of this standard did not have an impact on the Company's unaudited interim consolidated financial statements.
ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10)	Requires equity investments that are not accounted for under the equity method of accounting to be measured at fair value with changes recognized in net income and updates certain presentation and disclosure requirements.	January 1, 2018	The adoption of this standard did not have an impact on the Company's unaudited interim consolidated financial statements.

Table of Contents

2. Revenue

Revenue Recognition

Revenue is recognized once performance obligations under the terms of the Company's contracts with its customers have been satisfied; this occurs at a point in time when control of the promised product or service is transferred to customers. Generally, all of the Company's contracts with its customers have a single performance obligation and are short term in nature. Revenue is measured in an amount that reflects the consideration the Company expects to receive in exchange for those products or services. Revenue is recognized net of any taxes collected from customers, which are subsequently remitted to governmental authorities. The Company accounts for shipping and handling activities as costs to fulfill its promise to transfer the associated products. Accordingly, the Company records amounts billed for shipping and handling costs as a component of net sales, and classifies such costs as a component of costs of sales. The Company's products are generally not sold with a right of return unless the product is spoiled or damaged. Historically, returns have not been material to the Company.

Wholesale Segment

The Company sells its wine to wholesale distributors under purchase orders. The Company transfers control and recognizes revenue for these orders upon shipment of the wine out of the Company's third-party warehouse facilities. Payment terms to wholesale distributors typically range from 30 to 120 days. The Company pays depletion allowances to its wholesale distributors based on their sales to their customers. The Company estimates these depletion allowances and records such estimates in the same period the related revenue is recognized, resulting in a reduction of wholesale product revenue and the establishment of a current liability. Subsequently, wholesale distributors will bill the Company for actual depletions, which may be different from the Company's estimate. Any such differences are recognized in sales when the bill is received. The Company has historically been able to estimate depletion allowances without material differences between actual and estimated expense.

Direct to Consumer Segment

The Company sells its wine and other merchandise directly to consumers through wine club memberships, at the wineries' tasting rooms and through the internet.

Wine club membership sales are made under contracts with customers, which specify the quantity and timing of future wine shipments. Customer credit cards are charged in advance of quarterly wine shipments in accordance with each contract. The Company transfers control and recognizes revenue for these contracts upon shipment of the wine to the customer.

Tasting room and internet wine sales are paid for at the time of sale. The Company transfers control and recognizes revenue for this wine when the product is either received by the customer (on-site tasting room sales) or upon shipment to the customer (internet sales).

Other

From time to time, the Company sells grapes or bulk wine because the wine does not meet the quality standards for the Company's products, market conditions have changed resulting in reduced demand for certain products, or because the Company may have produced more of a particular varietal than it can use. Grape and bulk sales are made under contracts with customers which include product specification requirements, pricing and payment terms. Payment terms under grape contracts are generally structured around the timing of the harvest of the grapes and are generally due 30 days from the time the grapes are delivered. Payment terms under bulk wine contracts are generally

30 days from the date of shipment and may include an upfront payment upon signing of the sales agreement. The Company transfers control and recognizes revenue for grape sales when product specification has been met and title to the grapes has transferred, which is generally on the date the grapes are harvested, weighed and shipped. The Company transfers control and recognizes revenue for bulk contracts upon shipment.

Estates hold various public and private events for customers and their wine club members. Upfront consideration received from the sale of tickets or under private event contracts for future events is recorded as deferred revenue. The balance of payments are due on the date of the event. The Company recognizes event revenue on the date the event is held.

Other revenue also includes tasting fees and retail sales, which are paid for and received or consumed at the time of sale. The Company transfers control and recognizes revenue at the time of sale.

Refer to Note 12 "Business Segment Information," for revenue by sales channel amounts for the three and nine months ended September 30, 2018 and 2017.

Table of Contents

Contract Balances

When the Company receives payments from customers prior to transferring goods or services under the terms of a contract, the Company records deferred revenue, which it classifies as customer deposits on its condensed consolidated balance sheets, and represents a contract liability.

The following table reflects changes in the contract liability balance during the nine months ended September 30, 2018 and 2017 (in thousands):

	September 30, 2018	September 30, 2017
Outstanding at beginning of period (December 31)	\$ 593	\$ 367
Increase (decrease) attributed to:		
Upfront payments	38,728	36,138
Revenue recognized	(37,906)	(34,775)
Outstanding at end of period	\$ 1,415	\$ 1,730

Revenue recognized during the nine months ended September 30, 2018 and 2017, which was included in the opening contract liability balances for those periods, consisted primarily of wine club revenue, grape and bulk sales and event fees.

Accounts Receivable

Accounts receivable are reported at net realizable value. Credit is extended based upon an evaluation of the customer's financial condition. Accounts are charged against the allowance to bad debt as they are deemed uncollectable based upon a periodic review of the accounts. In evaluating the collectability of individual receivable balances, the Company considers several factors, including the age of the balance, the customer's historical payment history, its current credit worthiness and current economic trends. The Company's account receivable balance is net of an allowance for doubtful accounts of \$0.1 million at September 30, 2018 and December 31, 2017.

3. Restructuring

During the first quarter of 2018, the Company committed to various restructuring activities including the termination of a vineyard operating lease agreement in Oregon and certain departmental reorganizations.

Restructuring charges of \$0.7 million incurred in the nine months ended September 30, 2018 consisted of \$0.4 million of asset impairment charges associated with leasehold improvements under the terminated operating lease agreement, \$0.2 million employee related costs, and \$0.1 million of other restructuring costs associated with departmental reorganization activities. The fair value of impaired leasehold improvements were determined using the undiscounted cash flows expected to result from the use and eventual disposition of the assets. The Company expects to incur an additional \$0.7 million in other restructuring charges in the fourth quarter of 2018, and it may incur additional charges in future periods should additional restructuring activities be rolled out. The Company will continue to assess the need for additional restructuring activities during 2018 and expects the restructuring program to be completed by the end of the fourth quarter of 2018.

A roll forward of the liability recognized related to restructuring activities as of September 30, 2018 is as follows (in thousands):

Additions Payments

Edgar Filing: Crimson Wine Group, Ltd - Form 10-Q

	Balance at December 31, 2017		Balance at September 30, 2018
Employee related restructuring activity	\$ —	\$ 183	\$ (101)
			\$ 82

8

Table of Contents

4. Inventory

A summary of inventory at September 30, 2018 and December 31, 2017 is as follows (in thousands):

	September 30, December	
	2018	31, 2017
Finished goods	\$ 42,170	\$ 40,778
In-process goods	34,992	34,080
Packaging and bottling supplies	543	600
Total inventory	\$ 77,705	\$ 75,458

5. Property and Equipment

A summary of property and equipment at September 30, 2018 and December 31, 2017 and depreciation and amortization expense for the three and nine months ended September 30, 2018 and 2017, is as follows (in thousands):

	Depreciable Lives (in years)	September 30, 2018	December 31, 2017
Land and improvements	N/A	\$ 46,164	\$ 46,566
Buildings and improvements	20-40	59,487	58,946
Winery and vineyard equipment	3-25	38,477	38,631
Vineyards, orchards and improvements	7-25	36,530	37,090
Caves	20-40	5,639	5,639
Vineyards under development	N/A	3,762	3,353
Construction in progress	N/A	3,646	1,814
Total		193,705	192,039
Accumulated depreciation and amortization		(66,857)	(63,021)
Total property and equipment, net		\$ 126,848	\$ 129,018

	Three months ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Capitalized into inventory	\$ 1,468	\$ 1,378	\$ 4,400	\$ 4,096
Expensed to general and administrative	435	387	1,252	1,142
Total depreciation and amortization	\$ 1,903	\$ 1,765	\$ 5,652	\$ 5,238

During 2018, the Company began actively marketing 36 acres of apple orchards for sale as it does not intend to replant these orchards with vineyards. As of September 30, 2018, the Company had \$0.6 million of assets held for sale classified as current assets on the condensed consolidated balance sheets that represent the net book value of these apple orchards. During the nine months ended September 30, 2018, the Company recorded an impairment charge of less than \$0.1 million to write-down the carrying value of the apple orchards to fair value less cost to sell. This impairment charge was recorded to other income (expense), net in the condensed consolidated statements of operations. The Company expects to complete the sale of the apple orchards within the next twelve months.

6. Financial Instruments

The Company's material financial instruments include cash and cash equivalents, investments classified as available for sale and short-term and long-term debt. Investments classified as available for sale are the only assets or liabilities that are measured at fair value on a recurring basis. All of the Company's investments mature within two years or less.

Table of Contents

The par value, amortized cost, gross unrealized gains and losses and estimated fair value of investments classified as available for sale as of September 30, 2018 and December 31, 2017 are as follows (in thousands):

September 30, 2018	Par Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Level 1	Level 2	Total Fair Value Measurements
Certificates of Deposit	\$14,750	\$14,750	\$ —	\$ (44)	\$—	\$14,706	\$ 14,706
December 31, 2017							
U.S. Treasury Note	\$6,000	\$6,000	\$ —	\$ (1)	\$5,999	\$—	\$ 5,999
Certificates of Deposit	14,000	14,000	2	(45)	—	13,957	13,957
Total	\$20,000	\$20,000	\$ 2	\$ (46)	\$5,999	\$13,957	\$ 19,956

Gross unrealized losses on available-for-sale securities were less than \$0.1 million as of September 30, 2018, and the Company believes the gross unrealized losses are temporary as it does not intend to sell these securities and it is more likely than not that the Company will not be required to sell these securities before the recovery of their amortized cost basis.

As of September 30, 2018 and December 31, 2017, other than the assets which were impaired in the current period, the Company did not have any assets or liabilities measured at fair value on a nonrecurring basis. For cash and cash equivalents, the carrying amounts of such financial instruments approximate their fair values. For short-term liabilities, the carrying amounts of such financial instruments approximate their fair values. As of September 30, 2018, the Company has estimated the fair value of its outstanding debt to be approximately \$20.9 million compared to its carrying value of \$23.6 million, based upon discounted cash flows with Level 3 inputs, such as the terms that management believes would currently be available to the Company for similar issues of debt, taking into account the current credit risk of the Company and other factors.

The Company does not invest in any derivatives or engage in any hedging activities.

7. Intangible and Other Non-Current Assets

A summary of intangible and other non-current assets at September 30, 2018 and December 31, 2017, and amortization expense for the three and nine months ended September 30, 2018 and 2017, is as follows (in thousands):

	Amortizable lives (in years)	September 30, 2018			December 31, 2017		
		Gross carrying amount	Accumulated amortization	Net book value	Gross carrying amount	Accumulated amortization	Net book value
Brand	15 - 17	\$18,000	\$ 7,638	\$10,362	\$18,000	\$6,841	\$11,159
Distributor relationships	10 - 14	2,700	1,389	1,311	2,700	1,242	1,458
Customer relationships	7	1,900	1,900	—	1,900	1,787	113
Legacy permits	14	250	131	119	250	118	132
Trademark	20	200	101	99	200	93	107
Total		\$23,050	\$ 11,159	\$11,891	\$23,050	\$10,081	\$12,969
Other non-current assets				295			245
Total intangible and other non-current assets, net				\$12,186			\$13,214
				Three months ended September 30, 2018	Three months ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Amortization expense							

Total amortization expense	\$321	\$390	\$1,077	\$1,169
----------------------------	-------	-------	---------	---------

10

Table of Contents

The estimated aggregate future amortization of intangible assets as of September 30, 2018 is identified below (in thousands):

	Amortization
Remainder of 2018	\$ 324
2019	1,286
2020	1,286
2021	1,286
2022	1,286
Thereafter	6,423
Total	\$ 11,891

8. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consisted of the following as of September 30, 2018 and December 31, 2017 (in thousands):

	September 30, December 31,	
	2018	2017
Accrued compensation related expenses	\$ 2,329	\$ 2,225
Accounts payable	7,295	5,412
Sales and marketing	553	324
Production and farming	716	307
Litigation settlement accrual	390	390
Accrued interest	313	324
Depletion allowance	283	608
Contingent liability related to Seven Hills Winery	146	308
Acquisition of property and equipment	133	264
Other accrued expenses	444	161
Total accounts payable and accrued liabilities	\$ 12,602	\$ 10,323

Table of Contents

9. Debt

Details of the Company's debt as of September 30, 2018 and December 31, 2017 were as follows (dollars in thousands):

	September 30, 2018			December 31, 2017			Interest Rate	Maturity Date
	Current	Long-term	Total	Current	Long-term	Total		
2015 Term Loan	\$640	\$13,600	\$14,240	\$640	\$14,080	\$14,720	5.24%	October 1, 2040
2017 Term Loan	500	9,000	9,500	500	9,375	9,875	5.39%	July 1, 2037
Total debt	1,140	22,600	23,740	1,140	23,455	24,595		
Unamortized loan fees	(15)	(138)	(153)	(15)	(150)	(165)		
Total debt, net of unamortized loan fees	\$1,125	\$22,462	\$23,587	\$1,125	\$23,305	\$24,430		
Revolving Credit Facility								

In March 2013, Crimson and its subsidiaries entered into a \$60.0 million revolving credit facility (the "2013 Revolving Credit Facility") with American AgCredit, FLCA, as agent for the lenders identified in the 2013 Revolving Credit Facility, comprised of a revolving loan facility (the "Revolving Loan") and a term revolving loan facility (the "Term Revolving Loan"), which together are secured by substantially all of Crimson's assets. In March 2018, Crimson and its subsidiaries entered into the second amendment to the 2013 Revolving Credit Facility with American AgCredit, FLCA (the "Second Amendment"). The Second Amendment modified certain provisions of the 2013 Revolving Credit Facility, including, among other things, extending the Revolving Loan and Term Revolving Loan termination dates to March 31, 2023, extending the Term Revolving Loan conversion date to March 31, 2023 and extending the Term Revolving Loan maturity date to March 31, 2033.

The Revolving Loan is for up to \$10.0 million of availability in the aggregate for a five year term, and the Term Revolving Loan is for up to \$50.0 million in the aggregate for a fifteen year term. All obligations of Crimson under the 2013 Revolving Credit Facility are collateralized by certain real property, including vineyards and certain winery facilities of Crimson, accounts receivable, inventory and intangible assets. In addition to unused line fees ranging from 0.15% to 0.25%, rates for the borrowings are priced based on a performance grid tied to certain financial ratios and the London Interbank Offered Rate. The 2013 Revolving Credit Facility can be used to fund acquisitions, capital projects and other general corporate purposes. Covenants include the maintenance of specified debt and equity ratios, limitations on the incurrence of additional indebtedness, limitations on dividends and other distributions to shareholders and restrictions on certain mergers, consolidations and sales of assets. No amounts have been borrowed under the revolving credit facility to date.

Term Loans

Term loans consist of the following:

(i) On November 10, 2015, Pine Ridge Winery, LLC ("PRW Borrower"), a wholly-owned subsidiary of Crimson, entered into a senior secured term loan agreement (the "2015 Term Loan") with American AgCredit, FLCA ("Lender") for an aggregate principal amount of \$16.0 million. Amounts outstanding under the 2015 Term Loan bear a fixed interest rate of 5.24% per annum.

The 2015 Term Loan will mature on October 1, 2040 (the "2015 Loan Maturity Date"). On the first day of each January, April, July and October, commencing January 1, 2016, PRW Borrower is required to make a principal payment in the amount of \$160,000 and an interest payment equal to the amount of all interest accrued through the previous day. A final payment of all unpaid principal, interest and any other charges with respect to the 2015 Term Loan shall be due

and payable on the 2015 Loan Maturity Date.

The Company incurred debt issuance costs of approximately \$0.1 million related to the 2015 Term Loan. These costs are recorded as a reduction from short-term or long-term debt based on the time frame in which the fees will be expensed, and as such, amounts to be expensed within twelve months shall be classified against short-term debt. The costs are being amortized to interest expense using the effective interest method over the contractual term of the loan.

The full \$16.0 million was drawn at closing and the 2015 Term Loan can be used to fund acquisitions, capital projects and other general corporate purposes. As of September 30, 2018, \$14.2 million in principal was outstanding on the 2015 Term Loan, and unamortized loan fees were \$0.1 million.

Table of Contents

(ii) On June 29, 2017, Double Canyon Vineyards, LLC (the “DCV Borrower” and, individually and collectively with the PRW Borrower, “Borrower”), a wholly-owned subsidiary of Crimson, entered into a senior secured term loan agreement (the “2017 Term Loan”) with the Lender for an aggregate principal amount of \$10.0 million. Amounts outstanding under the 2017 Term Loan bear a fixed interest rate of 5.39% per annum.

The 2017 Term Loan will mature on July 1, 2037 (the “2017 Loan Maturity Date”). On the first day of each January, April, July and October, commencing October 1, 2017, DCV Borrower is required to make a principal payment in the amount of \$125,000 and an interest payment equal to the amount of all interest accrued through the previous day. A final payment of all unpaid principal, interest and any other charges with respect to the 2017 Term Loan shall be due and payable on the 2017 Loan Maturity Date.

The Company incurred debt issuance costs of approximately \$0.1 million related to the 2017 Term Loan. These costs were recorded using the same treatment as described for the 2015 Term Loan debt issuance costs.

The full \$10.0 million was drawn at closing and the 2017 Term Loan can be used to fund acquisitions, capital projects and other general corporate purposes. As of September 30, 2018, \$9.5 million in principal was outstanding on the 2017 Term Loan, and unamortized loan fees were \$0.1 million.

Borrower’s obligations under the 2015 Term Loan and 2017 Term Loan are guaranteed by the Company. All obligations of Borrower under the 2015 Term Loan and 2017 Term Loan are collateralized by certain real property of the Company. Borrower’s covenants include the maintenance of a specified debt service coverage ratio and certain customary affirmative and negative covenants, including limitations on the incurrence of additional indebtedness; limitations on distributions to shareholders; and restrictions on certain investments, sale of assets and merging or consolidating with other entities.

The Company was in compliance with all debt covenants as of September 30, 2018.

A summary of debt maturities as of September 30, 2018 is as follows (in thousands):

Principal due the remainder of 2018	\$285
Principal due in 2019	1,140
Principal due in 2020	1,140
Principal due in 2021	1,140
Principal due in 2022	1,140
Principal due thereafter	18,895
Total	\$23,740

10. Stockholders’ Equity

In March 2018, the Company commenced a share repurchase program (the “2018 Repurchase Program”) that provided for the repurchase of up to \$2.0 million of outstanding common stock. Under the 2018 Repurchase Program, any repurchased shares are constructively retired. During the three months ended September 30, 2018, the Company repurchased 156,000 shares at an original repurchase price of \$1.4 million under the 2018 Repurchase Program. Through the nine months ended September 30, 2018 and through November 2, 2018, the Company had repurchased a total of 217,377 shares under the 2018 Repurchase Program at an original repurchase price of \$2.0 million and therefore the 2018 Repurchase Program was completed.

11. Income Taxes

Consolidated income tax expense for the three and nine months ended September 30, 2018 and 2017 were determined based upon the Company’s estimated consolidated annual effective income tax rates for the years ending December 31, 2018 and 2017 respectively.

The Company's effective tax rates for the third quarter ended September 30, 2018 and 2017 were 28.5% and 20.5%, respectively. The Company's effective tax rates for the nine months ended September 30, 2018 and 2017 were 28.7% and 40.7% respectively. As a result of the Tax Cuts and Jobs Act (Public Law 115-97), the Company revised its estimated annual effective tax rate to reflect the change in the U.S. federal statutory tax rate from 34% to 21%. The difference between the consolidated effective income tax rate and the U.S. federal statutory rate for the nine months ended September 30, 2018 is primarily attributable to state income taxes and permanent items, which primarily consisted of meals and entertainment.

Table of Contents

The Company does not have any amounts in its condensed consolidated balance sheets for unrecognized tax benefits related to uncertain tax positions at September 30, 2018.

12. Business Segment Information

The Company has identified two operating segments which are reportable segments for financial statement reporting purposes, Wholesale net sales and Direct to Consumer net sales, based upon their different distribution channels, margins and selling strategies. Wholesale net sales include all sales through a third party where prices are given at a wholesale rate, whereas Direct to Consumer net sales include retail sales in the tasting room, remote sites and on-site events, wine club net sales and other sales made directly to the consumer without the use of an intermediary.

The two segments reflect how the Company's operations are evaluated by senior management and the structure of its internal financial reporting. The Company evaluates performance based on the gross profit of the respective business segments. Selling expenses that can be directly attributable to the segment are allocated accordingly. However, centralized selling expenses and general and administrative expenses are not allocated between operating segments. Therefore, net income information for the respective segments is not available. Based on the nature of the Company's business, revenue generating assets are utilized across segments. Therefore, discrete financial information related to segment assets and other balance sheet data is not available and that information continues to be aggregated.

The following table outlines the net sales, cost of sales, gross profit, directly attributable selling expenses and operating income for the Company's reportable segments for the three and nine months ended September 30, 2018 and 2017, and also includes a reconciliation of consolidated income (loss) from operations. Other/Non-allocable net sales and gross profit include bulk wine and grape sales, event fees and retail sales. Other/Non-allocable expenses include centralized corporate expenses not specific to an identified reporting segment. Sales figures are net of related excise taxes.

(in thousands)	Three Months Ended September 30,							
	Wholesale		Direct to Consumer		Other/Non-Allocable		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
Net sales	\$7,777	\$6,480	\$6,397	\$5,319	\$2,646	\$1,706	\$16,820	\$13,505
Cost of sales	4,557	3,903	1,964	1,552	2,559	1,594	9,080	7,049
Gross profit	3,220	2,577	4,433	3,767	87	112	7,740	6,456
Operating expenses:								
Sales and marketing	1,537	1,358	1,672	1,512	996	938	4,205	3,808
General and administrative	—	—	—	—	2,752	2,604	2,752	2,604
Total operating expenses	1,537	1,358	1,672	1,512	3,748	3,542	6,957	6,412
Net (gain) loss on disposal of property and equipment	—	—	—	—	(11)	196	(11)	196
Restructuring costs	—	—	—	—	70	—	70	—
Income (loss) from operations	\$1,683	\$1,219	\$2,761	\$2,255	\$(3,720)	\$(3,626)	\$724	\$(152)
(in thousands)	Nine Months Ended September 30,							
	Wholesale		Direct to Consumer		Other/Non-Allocable		Total	
	2018	2017	2018	2017	2018	2017	2018	2017
Net sales	\$25,223	\$23,308	\$17,527	\$16,450	\$4,581	\$3,603	\$47,331	\$43,361
Cost of sales	14,536	13,067	5,616	4,981	4,466	3,129	24,618	21,177
Gross profit	10,687	10,241	11,911	11,469	115	474	22,713	22,184

Edgar Filing: Crimson Wine Group, Ltd - Form 10-Q

Operating expenses:								
Sales and marketing	4,702	4,468	4,798	4,710	2,756	2,482	12,256	11,660
General and administrative	—	—	—	—	8,081	7,829	8,081	7,829
Total operating expenses	4,702	4,468	4,798	4,710	10,837	10,311	20,337	19,489
Net loss on disposal of property and equipment	—	—	—	—	94	195	94	195
Restructuring costs	—	—	—	—	662	—	662	—
Income (loss) from operations	\$5,985	\$5,773	\$7,113	\$6,759	\$(11,478)	\$(10,032)	\$1,620	\$2,500

Table of Contents

13. Commitments and Contingencies

Litigation

The Company and its subsidiaries may become parties to legal proceedings that are considered to be either ordinary, routine litigation incidental to their business or not significant to the Company's consolidated financial position or liquidity. Other than as described below, the Company does not believe that there is any other pending litigation that could have a significant adverse impact on its consolidated financial position, liquidity or results of operations.

On May 17, 2017, a former employee filed a class action complaint in the Superior Court of California, County of Napa against one of the Company's subsidiaries, Pine Ridge Vineyards, alleging various wage and labor violations. On February 5, 2018, the Company settled this class action complaint at mediation for \$0.4 million, which was recorded in the consolidated financial statements for the year ended December 31, 2017. The settlement does not contain any admission of liability, wrongdoing, or responsibility by any of the parties. The court granted final approval of the settlement amount and final payments will be issued in the fourth quarter of 2018.

Other

In October 2017, significant wildfires broke out in Napa, Sonoma, and surrounding counties in Northern California. Operations at two of the Company's properties, Pine Ridge Vineyards and Seghesio Family Vineyards, were temporarily impacted due to these wildfires and then resumed shortly thereafter. At the time of the wildfires, both properties had already harvested substantially all of their 2017 estate grapes. Certain inventory on hand was impacted by power losses and smoke damage which was covered under existing insurance policies. Through the nine month period ended September 30, 2018 the Company recognized \$1.1 million in insurance proceeds. Proceeds of \$0.6 million were offset against inventory losses and \$0.5 million was included in other income, net. All of the \$1.1 million received in insurance proceeds were included in Net cash provided by operating activities on the Condensed Consolidated Statement of Cash Flows.

Table of Contents

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

Statements included in this Report may contain forward-looking statements. See "Cautionary Statement for Forward-Looking Information" below. The following should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") and the Company's audited consolidated financial statements for the year ended December 31, 2017 included in the Company's Annual Report on Form 10-K as filed with the SEC (the "2017 Report").

Quantities or results referred to as "current quarter" and "current nine-month period" refer to the three and nine months ended September 30, 2018, respectively.

Cautionary Statement for Forward-Looking Information

This MD&A and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The unaudited interim condensed consolidated financial statements, that include results of Crimson Wine Group, Ltd. and all of its subsidiaries further collectively known as "we", "Crimson", "our", "us", or "the Company", have been prepared in accordance with GAAP for interim financial information and with the general instruction for quarterly reports filed on Form 10-Q and Article 8 of Regulation S-X. All statements, other than statements of historical fact, regarding our strategy, future operations, financial position, prospects, plans, opportunities, and objectives constitute "forward-looking statements." The words "may," "will," "expect," "plan," "anticipate," "believe," "estimate," "potential," or "continue" and similar types of expressions identify such statements, although not all forward-looking statements contain these identifying words. These statements are based upon information that is currently available to us and our management's current expectations speak only as of the date hereof and are subject to risks and uncertainties. We expressly disclaim any obligation, except as required by federal securities laws, or undertaking to update or revise any forward-looking statements contained herein to reflect any change or expectations with regard thereto or to reflect any change in events, conditions, or circumstances on which any such forward-looking statements are based, in whole or in part. Our actual results may differ materially from the results discussed in or implied by such forward-looking statements.

Risks that could cause actual results to differ materially from any results projected, forecasted, estimated or budgeted or that may materially and adversely affect our actual results include, but are not limited to, those discussed in Part I, Item 1A. Risk Factors in the 2017 Report. Readers should carefully review the risk factors described in the 2017 Report and in other documents that the Company files from time to time with the SEC.

Overview of Business

The Company generates revenues from sales of wine to wholesalers and direct to consumers, sales of bulk wine and grapes, special event fees, tasting fees and retail sales.

Our wines are primarily sold to wholesale distributors, who then sell to retailers and restaurants. As permitted under federal and local regulations, we have also been placing increased emphasis on generating revenue from direct sales to consumers which occur through wine clubs, at the wineries' tasting rooms and through the internet and direct outreach to customers. Direct sales to consumers are more profitable for the Company as we are able to sell our products at a price closer to retail prices rather than the wholesale price sold to distributors. From time to time, we may sell grapes or bulk wine, because the wine does not meet the quality standards for the Company's products, market conditions have changed resulting in reduced demand for certain products, or because the Company may have produced more of a particular varietal than it can use. When these sales occur, they may result in a loss.

Cost of sales includes grape and bulk wine costs, whether purchased or produced from the Company's controlled vineyards, crush costs, winemaking and processing costs, bottling, packaging, warehousing and shipping and handling costs. For the Company controlled vineyard produced grapes, grape costs include annual farming labor costs, harvest costs and depreciation of vineyard assets. For wines that age longer than one year, winemaking and processing costs continue to be incurred and capitalized to the cost of wine, which can range from 3 to 36 months. Reductions to the carrying value of inventories are also included in costs of sales.

At September 30, 2018, wine inventory includes approximately 0.9 million cases of bottled and bulk wine in various stages of the aging process. Cased wine is expected to be sold over the next 12 to 36 months and generally before the release date of the next vintage.

Table of Contents

Seasonality

As discussed in the 2017 Report, the wine industry in general historically experiences seasonal fluctuations in revenues and net income. The Company typically has lower sales and net income during the first quarter and higher sales and net income during the fourth quarter due to seasonal holiday buying as well as wine club shipment timing. We anticipate similar trends in the future.

Restructuring

During the first quarter of 2018, the Company committed to various restructuring activities including the termination of a vineyard operating lease agreement in Oregon and certain departmental reorganizations.

Restructuring charges of \$0.7 million incurred in the first nine months of 2018 consisted of \$0.4 million of asset impairment charges associated with leasehold improvements under the terminated operating lease agreement, \$0.2 million employee related costs, and \$0.1 million of other restructuring costs associated with departmental reorganization activities. The fair value of impaired leasehold improvements were determined using the undiscounted cash flows expected to result from the use and eventual disposition of the assets. The Company expects to incur an additional \$0.7 million in other restructuring charges in the fourth quarter of 2018, and it may incur additional charges in future periods should additional restructuring activities be rolled out. The Company will continue to assess the need for additional restructuring activities during 2018 and expects the restructuring program to be completed by the end of the fourth quarter of 2018.

Results of Operations

Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

Net Sales

(in thousands, except percentages)	Three Months Ended September 30,			
	2018	2017	Increase (Decrease)	% change
Wholesale	\$7,777	\$6,480	\$ 1,297	20%
Direct to Consumer	6,397	5,319	1,078	20%
Other	2,646	1,706	940	55%
Total net sales	\$16,820	\$13,505	\$ 3,315	25%

Wholesale net sales increased \$1.3 million, or 20%, in the current quarter as compared to the same period in 2017. The increase was primarily driven by domestic volume increases of 19% and export volume increases of 48% related to successful sales campaigns and a shift in product mix to higher priced brands.

Direct to Consumer net sales increased \$1.1 million, or 20%, in the current quarter as compared to the same period in 2017. The increase was primarily driven by an increase in wine club net sales compared to the prior year which was impacted by shipment delays due to hurricanes.

Other net sales include bulk wine, grape sales, event fees and retail sales and increased \$0.9 million or 55% in the current quarter as compared to the same period in 2017 primarily due more tons of grapes and gallons of bulk wine sold in the current quarter.

Table of Contents

Gross Profit

(in thousands, except percentages)	Three Months Ended September 30,			
	2018	2017	Increase (Decrease)	% change
Wholesale	\$3,220	\$2,577	\$ 643	25%
Wholesale gross margin percentage	41	% 40	%	
Direct to Consumer	4,433	3,767	666	18%
Direct to Consumer gross margin percentage	69	% 71	%	
Other	87	112	(25)	(22)%
Total gross profit	\$7,740	\$6,456	\$ 1,284	20%
Total gross margin percentage	46	% 48	%	

Wholesale gross profit increased \$0.6 million, or 25%, in the current quarter as compared to the same period in 2017 primarily driven by higher sales volume. Gross margin percentage, which is defined as gross profit as a percentage of net sales, improved slightly due to product mix and decreased price support.

Direct to Consumer gross profit increased \$0.7 million or 18% in the current quarter as compared to the same period in 2017, driven primarily by an increase in wine club net sales shipments. Shipments in the prior year were delayed due to hurricanes. Gross margin percentage decreased slightly due to a shift in product mix to vintages with higher winegrowing costs.

Other gross profit includes bulk wine, grape sales, event fees and non-wine retail sales and decreased in the current quarter as compared to the same period in 2017. The decrease in gross profit is primarily driven by higher average costs related to bulk wine sales compared to the same period in 2017.

Operating Expenses

(in thousands, except percentages)	Three Months Ended September 30,			
	2018	2017	Increase (Decrease)	% change
Sales and marketing	\$4,205	\$3,808	\$ 397	10%
General and administrative	2,752	2,604	148	6%
Total operating expenses	\$6,957	\$6,412	\$ 545	8%

Sales and marketing expenses increased \$0.4 million, or 10%, in the current quarter as compared to the same period in 2017. The increase was primarily driven by compensation related expenses and consulting and marketing costs related to planned strategic marketing initiatives.

General and administrative expenses increased \$0.1 million or 6% in the current quarter as compared to the same period in 2017 primarily due to consulting fees.

Other Income (Expense)

(in thousands, except percentages)	Three Months Ended September 30,			
	2018	2017	Increase (Decrease)	% change
Interest (expense), net	\$(333)	\$(276)	\$ 57	21%
Other income, net	636	169	467	276%
Total other income (expense)	\$303	\$(107)	\$ 410	383%

Edgar Filing: Crimson Wine Group, Ltd - Form 10-Q

Interest expense, net increased less than \$0.1 million, or 21%, in the current quarter compared to the same period in 2017. The increase was primarily driven by capitalized interest related to the buildout of the Washington Winemaking Facility which offset interest expense in the prior year.

Other income increased \$0.5 million or 276% in the current quarter as compared to the same period in 2017. The increase was primarily driven by insurance proceeds from the October 2017 wildfires.

18

Table of Contents

Income Tax Provision

The Company's effective tax rates for the three months ended September 30, 2018 and 2017 were 28.5% and 20.6%, respectively. As a result of the Tax Cuts and Jobs Act (Public Law 115-97), the Company revised its estimated annual effective tax rate to reflect the change in the U.S. federal statutory tax rate from 34% to 21%. The difference between the consolidated effective income tax rate and the U.S. federal statutory rate for the three months ended September 30, 2018 was primarily attributable to state income taxes and the effect of certain permanent differences, which primarily consisted of meals and entertainment.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

Net Sales

(in thousands, except percentages)	Nine Months Ended September 30,			
	2018	2017	Increase (Decrease)	% change
Wholesale	\$25,223	\$23,308	\$ 1,915	8%
Direct to Consumer	17,527	16,450	1,077	7%
Other	4,581	3,603	978	27%
Total net sales	\$47,331	\$43,361	\$ 3,970	9%

Wholesale net sales increased \$1.9 million, or 8%, in the current nine-month period as compared to the same period in 2017. The increase was primarily driven by export volume increases of 47% and price increases, partially offset by increased price support. The increase in export volume was primarily attributable to successful sales campaigns.

Direct to Consumer net sales increased \$1.1 million or 7% in the current nine-month period as compared to the same period in 2017 primarily due to an increase in wine club shipments of higher priced varietals. Shipments in the prior year were also delayed to the fourth quarter due to hurricanes.

Other net sales include bulk wine and grape sales, event fees and retail sales and increased \$1.0 million, or 27%, in the current nine-month period as compared to the same period in 2017. The increase was primarily driven by more tons of grapes and more gallons of bulk wine sold in the current year.

Gross Profit

(in thousands, except percentages)	Nine Months Ended September 30,			
	2018	2017	Increase (Decrease)	% change
Wholesale	\$10,687	\$10,241	\$ 446	4%
Wholesale gross margin percentage	42	% 44	%	
Direct to Consumer	11,911	11,469	442	4%
Direct to Consumer gross margin percentage	68	% 70	%	
Other	115	474	(359)	(76)%
Total gross profit	\$22,713	\$22,184	\$ 529	2%
Total gross margin percentage	48	% 51	%	

Wholesale gross profit increased \$0.4 million, or 4%, in the current nine-month period as compared to the same period in 2017 due to an increase in volume of cases sold. Gross margin percentage decreased in the current nine-month period related to a shift in product mix to vintages with higher winegrowing costs.

Direct to Consumer gross profit increased \$0.4 million, or 4%, in the current nine-month period as compared to the same period in 2017. Gross margin percentage decreased in the current nine-month period, driven by the same shift in product mix to vintages with higher winegrowing costs as wholesale.

Table of Contents

Other gross profit includes bulk wine and grape sales, event fees and non-wine retail sales which reflected an overall decrease of \$0.4 million, or 76%, in the current nine-month period as compared to the same period in 2017. The overall decrease was primarily driven by increase in cost of wine included in tastings from newer vintage wines with higher winegrowing costs.

Operating Expenses

	Nine Months Ended September 30,			
(in thousands, except percentages)	2018	2017	Increase (Decrease)	% change
Sales and marketing	\$12,256	\$11,660	\$ 596	5%
General and administrative	8,081	7,829	252	3%
Total operating expenses	\$20,337	\$19,489	\$ 848	4%

Sales and marketing expenses increased \$0.6 million, or 5%, in the current nine-month period as compared to the same period in 2017. The increase was primarily driven by increased compensation, consulting and marketing costs related to planned strategic marketing initiatives and increased travel related costs.

General and administrative expenses increased \$0.3 million, or 3%, in the current nine-month period as compared to the same period in 2017. The increase was primarily driven by increased legal and professional fees.

Other Income (Expense)

	Nine Months Ended September 30,			
(in thousands, except percentages)	2018	2017	Increase (Decrease)	% change
Interest (expense), net	\$(843)	\$(516)	\$ 327	63%
Other income, net	713	445	268	60%
Total other (expense) income	\$(130)	\$(71)	\$ 59	83%

Interest expense increased \$0.3 million, or 63%, in the current nine-month period as compared to the same period in 2017. The increase was primarily driven by interest incurred on the 2017 Term Loan entered into during the second quarter of 2017, partially offset by lower capitalized interest related to the buildout of the Washington Winemaking Facility and a higher patronage dividend received in the current period.

Other income increased \$0.3 million, or 60%, in the current nine-month period as compared to the same period in 2017. The increase was primarily driven by a \$0.5 million gain on insurance proceeds from the October 2017 wildfires. The gains were partially offset by losses in apples which were reclassified along with the associated land held for sale as the Company does not plan to continue harvesting and selling apples after the 2018 season.

Income Tax Provision

The Company's effective tax rates for the nine months ended September 30, 2018 and 2017 were 28.7% and 40.7%, respectively. As a result of the Tax Cuts and Jobs Act (Public Law 115-97), the Company revised its estimated annual effective tax rate to reflect the change in the U.S. federal statutory tax rate from 34% to 21%. The difference between the consolidated effective income tax rate and the U.S. federal statutory rate for the nine months of 2018 and the same period in 2017 was primarily attributable to state income taxes and the effect of certain permanent differences, which primarily consisted of meals and entertainment.

Liquidity and Capital Resources

Table of Contents

General

The Company's principal sources of liquidity are its available cash and cash equivalents, investments in available for sale securities, funds generated from operations and bank borrowings. The Company's primary cash needs are to fund working capital requirements and capital expenditures.

Revolving Credit Facility

In March 2013, Crimson and its subsidiaries entered into a \$60.0 million revolving credit facility (the "2013 Revolving Credit Facility") with American AgCredit, FLCA, as agent for the lenders identified in the 2013 Revolving Credit Facility, comprised of a revolving loan facility (the "Revolving Loan") and a term revolving loan facility (the "Term Revolving Loan"), which together are secured by substantially all of Crimson's assets. In March 2018, Crimson and its subsidiaries entered into the second amendment to the 2013 Revolving Credit Facility with American AgCredit, FLCA (the "Second Amendment"). The Second Amendment modified certain provisions of the 2013 Revolving Credit Facility, including, among other things, extending the Revolving Loan and Term Revolving Loan termination dates to March 31, 2023, extending the Term Revolving Loan conversion date to March 31, 2023 and extending the Term Revolving Loan maturity date to March 31, 2033.

The Revolving Loan is for up to \$10.0 million of availability in the aggregate for a five year term, and the Term Revolving Loan is for up to \$50.0 million in the aggregate for a fifteen year term. All obligations of Crimson under the 2013 Revolving Credit Facility are collateralized by certain real property, including vineyards and certain winery facilities of Crimson, accounts receivable, inventory and intangible assets. In addition to unused line fees ranging from 0.15% to 0.25%, rates for the borrowings are priced based on a performance grid tied to certain financial ratios and the London Interbank Offered Rate. The 2013 Revolving Credit Facility can be used to fund acquisitions, capital projects and other general corporate purposes. Covenants include the maintenance of specified debt and equity ratios, limitations on the incurrence of additional indebtedness, limitations on dividends and other distributions to shareholders and restrictions on certain mergers, consolidations and sales of assets. No amounts have been borrowed under the revolving credit facility to date.

Term Loans

Term loans consist of the following:

(i) On November 10, 2015, Pine Ridge Winery, LLC ("PRW Borrower"), a wholly-owned subsidiary of Crimson, entered into a senior secured term loan agreement (the "2015 Term Loan") with American AgCredit, FLCA ("Lender") for an aggregate principal amount of \$16.0 million. Amounts outstanding under the 2015 Term Loan bear a fixed interest rate of 5.24% per annum.

The 2015 Term Loan will mature on October 1, 2040 (the "2015 Loan Maturity Date"). On the first day of each January, April, July and October, commencing January 1, 2016, PRW Borrower is required to make a principal payment in the amount of \$160,000 and an interest payment equal to the amount of all interest accrued through the previous day. A final payment of all unpaid principal, interest and any other charges with respect to the 2015 Term Loan shall be due and payable on the 2015 Loan Maturity Date.

The full \$16.0 million was drawn at closing and the 2015 Term Loan can be used to fund acquisitions, capital projects and other general corporate purposes. As of September 30, 2018, \$14.2 million in principal was outstanding on the 2015 Term Loan, and unamortized loan fees were \$0.1 million.

(ii) On June 29, 2017, Double Canyon Vineyards, LLC (the “DCV Borrower” and, individually and collectively with the PRW Borrower, “Borrower”), a wholly-owned subsidiary of Crimson, entered into a senior secured term loan agreement (the “2017 Term Loan”) with the Lender for an aggregate principal amount of \$10.0 million. Amounts outstanding under the 2017 Term Loan bear a fixed interest rate of 5.39% per annum.

The 2017 Term Loan will mature on July 1, 2037 (the “2017 Loan Maturity Date”). On the first day of each January, April, July and October, commencing October 1, 2017, DCV Borrower is required to make a principal payment in the amount of \$125,000 and an interest payment equal to the amount of all interest accrued through the previous day. A final payment of all unpaid principal, interest and any other charges with respect to the 2017 Term Loan shall be due and payable on the 2017 Loan Maturity Date.

The full \$10.0 million was drawn at closing and the 2017 Term Loan can be used to fund acquisitions, capital projects and other general corporate purposes. As of September 30, 2018, \$9.5 million in principal was outstanding on the 2017 Term Loan, and unamortized loan fees were \$0.1 million.

Table of Contents

Borrower's obligations under the 2015 Term Loan and 2017 Term Loan are guaranteed by the Company. All obligations of Borrower under the 2015 Term Loan and 2017 Term Loan are collateralized by certain real property of the Company. Borrower's covenants include the maintenance of a specified debt service coverage ratio and certain customary affirmative and negative covenants, including limitations on the incurrence of additional indebtedness; limitations on distributions to shareholders; and restrictions on certain investments, sale of assets and merging or consolidating with other entities.

Consolidated Statements of Cash Flows

The following table summarizes our cash flow activities for the nine months ended September 30, 2018 and 2017 (in thousands):

Cash provided by (used in):	2018	2017
Operating activities	\$5,672	\$3,980
Investing activities	713	(9,949)
Financing activities	(3,042)	9,065

Cash provided by operating activities

Net cash provided by operating activities was \$5.7 million for the nine months ended September 30, 2018, consisting primarily of \$1.0 million of net income adjusted for non-cash items such as \$6.7 million of depreciation and amortization and \$0.7 million of restructuring charges, partially offset by \$3.0 million of net cash outflow related to changes in operating assets and liabilities. The change in operating assets and liabilities was primarily due to an increase in accounts receivable including \$1.1 million in insurance proceeds and inventory partially offset by an increase in accounts payable and expense accruals. The decrease in accounts payable and expense accruals was primarily due to grower payments made in the current period for the 2017 harvest.

Net cash provided by operating activities was \$4.0 million for the nine months ended September 30, 2017, consisting primarily of \$1.4 million of net income adjusted for non-cash items such as \$6.4 million of depreciation and amortization, and \$0.2 million of loss related to disposals of property and equipment, partially offset by \$4.2 million of net cash outflow related to changes in operating assets and liabilities. The change in operating assets and liabilities was primarily due to an increase in inventory, partially offset by an increase in accounts payable and accrued liabilities, and customer deposits.

Cash provided by (used in) investing activities

Net cash provided by investing activities was \$0.7 million for the nine months ended September 30, 2018, consisting primarily of net redemptions of available for sale investments of \$5.3 million, partially offset by capital expenditures of \$4.6 million.

Net cash used in investing activities was \$9.9 million for the nine months ended September 30, 2017, consisting primarily of capital expenditures of \$12.0 million, partially offset by net redemptions of available for sale investments of \$2.0 million. Capital expenditures of \$12.0 million include \$7.0 million of costs related to the buildout of the Washington Winemaking Facility and other planned purchases associated with ongoing business activities.

Cash (used in) provided by financing activities

Net cash used in financing activities for the nine months ended September 30, 2018 was \$3.0 million, which reflects the repurchase of shares of our common stock at a repurchase price of \$2.0 million, principal payments on our term loans of \$0.9 million and contingent consideration payments of \$0.1 million associated with the Seven Hills Winery

acquisition.

Net cash provided by financing activities for the nine months ended September 30, 2017 was \$9.1 million, which reflects proceeds of \$10.0 million from the issuance of the 2017 Term Loan, partially offset by principal payments on our 2015 Term Loan of \$0.5 million and contingent consideration payments of \$0.4 million associated with the Seven Hills Winery acquisition.

Share Repurchases

In March 2018, the Company commenced a share repurchase program (the “2018 Repurchase Program”) that provided for the repurchase of up to \$2.0 million of outstanding common stock. Under the 2018 Repurchase Program, any repurchased shares are constructively retired. During the three months ended September 30, 2018, there were 156,000 shares at an original repurchase price of \$1.4 million repurchased under the plan. Through November 2, 2018, the Company has repurchased 217,377 shares at an original repurchase price of \$2.0 million, and therefore the 2018 Repurchase Program was completed.

Table of Contents

Commitments & Contingencies

There have been no significant changes to our contractual obligations table as disclosed in the 2017 Report.

Off-Balance Sheet Financing Arrangements

None.

Critical Accounting Policies and Estimates

Except as disclosed in Note 1 and Note 2 of this Form 10-Q, there have been no material changes to the critical accounting policies and estimates previously disclosed in the 2017 Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Crimson does not currently have any exposure to financial market risk. Sales to international customers are denominated in U.S. dollars; therefore, Crimson is not exposed to market risk related to changes in foreign currency exchange rates. As discussed above under Liquidity and Capital Resources, Crimson has a revolving credit facility and two term loans. The revolving credit facility had no outstanding balance as of September 30, 2018, and bears interest at floating rates on borrowings. The term loans had \$23.7 million outstanding at September 30, 2018 and are fixed-rate debt and therefore are not subject to fluctuations in market interest rates.

Item 4. Controls and Procedures.

The Company's management evaluated, with the participation of the Company's principal executive and principal financial officers, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of September 30, 2018. Based on their evaluation, the Company's principal executive and principal financial officers concluded that the Company's disclosure controls and procedures were effective as of September 30, 2018.

There has been no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the Company's fiscal quarter ended September 30, 2018, that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Beginning January 1, 2018, we implemented internal controls to ensure we have adequately evaluated our contracts and properly assessed the impact of the new accounting standard related to revenue recognition to facilitate adoption on that date. We do not expect significant changes to our internal control over financial reporting due to the adoption of the new standard.

Table of Contents

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, Crimson may be involved in legal proceedings in the ordinary course of its business. Other than as described below, Crimson is not currently involved in any legal or administrative proceedings individually or together that it believes are likely to have a significant adverse effect on its business, results of operations or financial condition.

On May 17, 2017, a former employee filed a class action complaint in the Superior Court of California, County of Napa against one of the Company’s subsidiaries, Pine Ridge Vineyards, alleging various wage and labor violations. On February 5, 2018, the Company settled this class action complaint at mediation for \$0.4 million, which was recorded in the consolidated financial statements for the year ended December 31, 2017. The settlement does not contain any admission of liability, wrongdoing, or responsibility by any of the parties. The court granted final approval of the settlement amount and final payments will be issued in the fourth quarter of 2018.

Item 1A. Risk Factors.

In addition to the other information set forth in this Report, you should carefully consider the factors discussed in Part I, “Item 1A. Risk Factors” in our 2017 Report, which could materially affect our business, results of operations or financial condition. The risks described in our 2017 Report are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may eventually prove to materially adversely affect our business, results of operations or financial condition.

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

Share repurchase activity under the Company’s share repurchase program, on a trade date basis, for the three months ended September 30, 2018 was as follows:

Fiscal Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Approximate Dollar Value of Shares that May Yet Be Purchased Under Publicly Announced Plan (millions)
July 1-31, 2018	56,422	\$ 9.28	56,422	\$ 0.9
August 1-31, 2018	70,198	9.20	126,620	0.3
September 1-30, 2018	29,380	9.11	156,000	—
Total	156,000			

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

24

Table of Contents

Item 6. Exhibits.

- 2.1* Separation Agreement, dated February 1, 2013, between Crimson Wine Group, Ltd. and Leucadia National Corporation (incorporated by reference to Exhibit 2.1 to Form 8-K filed on February 25, 2013).
 - 3.1* Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to Form 8-K filed on February 25, 2013).
 - 3.2* Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to Form 8-K filed on February 25, 2013).
 - 31.1** Certification of President and Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 - 31.2** Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
 - 32.1** Certification of Principal Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
 - 32.2** Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101** Unaudited financial statements from the Quarterly Report on Form 10-Q of Crimson Wine Group, Ltd. for the quarter ended September 30, 2018, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets; (ii) the Condensed Consolidated Statements of Operations; (iii) the Condensed Consolidated Statements of Comprehensive Income (iv) the Condensed Consolidated Statements of Cash Flows; and (v) the Notes to Unaudited Interim Condensed Consolidated Financial Statements.

* Incorporated by reference

** Filed herewith

Table of Contents

SIGNATURES

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

CRIMSON WINE GROUP, LTD.
(Registrant)

Date: November 7, 2018 By: /s/ Karen L. Diepholz
Karen L. Diepholz
Chief Financial Officer