

ARTS WAY MANUFACTURING CO INC
Form 10-Q
October 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended August 31, 2011
- 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 No. 0-5131

ART'S-WAY MANUFACTURING CO., INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or
organization)

42-0920725
(I.R.S. Employer Identification No.)

5556 Highway 9
Armstrong, Iowa 50514
(Address of principal executive offices)

(712) 864-3131
(Registrant's telephone number, including area code)

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

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

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

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

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

Number of common shares outstanding as of August 31, 2011: 4,023,852

Art's-Way Manufacturing Co., Inc.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

ART'S-WAY MANUFACTURING CO., INC.

Condensed Consolidated Balance Sheets

Assets	(Unaudited) August 31, 2011	November 30, 2010
Current assets:		
Cash	\$213,893	\$317,103
Accounts receivable-customers, net of allowance for doubtful accounts of \$67,081 and \$114,834 in 2011 and 2010, respectively	3,345,467	2,493,624
Inventories, net	13,136,600	13,795,816
Deferred taxes	877,113	821,000
Cost and Profit in Excess of Billings	-	256,739
Other current assets	297,962	245,774
Total current assets	17,871,035	17,930,056
Property, plant, and equipment, net	8,278,901	8,038,733
Assets held for lease, net	472,095	313,773
Covenant not to Compete, net	75,000	120,000
Goodwill	375,000	375,000
Total assets	\$27,072,031	\$26,777,562
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable to bank	\$2,475,387	\$2,084,000
Current portion of term debt	638,528	615,294
Accounts payable	698,745	1,008,688
Customer deposits	285,767	440,888
Billings in Excess of Cost and Profit	340,481	41,571
Accrued expenses	1,320,566	1,381,098
Income taxes payable	55,540	594,816
Total current liabilities	5,815,014	6,166,355
Long-term liabilities		
Deferred taxes	739,425	568,000
Term debt, excluding current portion	5,976,073	6,452,750
Total liabilities	12,530,512	13,187,105
Stockholders' equity:		
Common stock – \$0.01 par value. Authorized 5,000,000 shares; issued and outstanding 4,023,852 and 4,008,352 shares in 2011 and 2010	40,238	40,084
Additional paid-in capital	2,453,574	2,328,668
Retained earnings	12,047,707	11,221,705
Total stockholders' equity	14,541,519	13,590,457
Total liabilities and stockholders' equity	\$27,072,031	\$26,777,562

See accompanying notes to unaudited condensed consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended		Nine Months Ended	
	August 31, 2011	August 31, 2010	August 31, 2011	August 31, 2010
Net sales	\$9,252,063	\$10,581,783	\$21,761,551	\$22,909,802
Cost of goods sold	6,544,644	8,004,666	\$16,622,309	\$17,437,158
Gross profit	2,707,419	2,577,117	5,139,242	5,472,644
Expenses:				
Engineering	91,840	102,042	\$330,482	\$309,342
Selling	447,103	549,959	\$1,320,115	\$1,476,102
General and administrative	730,569	654,234	\$2,161,519	\$2,081,037
Total expenses	1,269,512	1,306,235	3,812,116	3,866,481
Income from operations	1,437,907	1,270,882	1,327,126	1,606,163
Other income (expense):				
Interest expense	(120,202)	(121,085)	\$(321,910)	\$(310,879)
Other	46,523	16,908	\$77,821	\$68,869
Total other income (loss)	(73,679)	(104,177)	(244,089)	(242,010)
Income before income taxes	1,364,228	1,166,705	1,083,037	1,364,153
Income tax expense	344,392	414,903	\$257,035	\$477,446
Net income	\$1,019,836	\$751,802	\$826,002	\$886,707
Net income per share:				
Basic	0.25	0.19	0.21	0.22
Diluted	0.25	0.19	0.20	0.22

See accompanying notes to unaudited condensed consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended	
	August 31, 2011	August 31, 2010
Cash flows from operations:		
Net income	\$ 826,002	\$ 886,707
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock based compensation	58,311	19,978
Depreciation expense	560,931	491,973
Amortization expense	45,000	45,000
Deferred income taxes	115,312	35,000
Changes in assets and liabilities, net of Roda acquisition in 2010:		
(Increase) decrease in:		
Accounts receivable	(851,843)	(778,985)
Inventories	659,216	(418,009)
Other current assets	(52,189)	735,981
Increase (decrease) in:		
Accounts payable	(309,943)	623,567
Contracts in progress, net	555,649	103,669
Customer deposits	(155,121)	248,757
Income taxes payable	(539,276)	126,630
Accrued expenses	(60,532)	817,654
Net cash provided by operating activities	851,518	2,937,922
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(730,326)	(1,921,608)
Net change in asset held for lease	(229,095)	-
Purchase of assets of Roda	-	(1,179,001)
Purchase of assets of M&W	-	(453,161)
Net cash (used in) investing activities	(959,421)	(3,553,770)
Cash flows from financing activities:		
Net change in line of credit	391,387	(166,892)
Payments of notes payable to bank	(453,443)	(367,369)
Proceeds from term debt	-	1,300,000
Proceeds from the exercise of stock options	66,749	7,503
Net cash provided by financing activities	4,693	773,242
Net (increase) decrease in cash	(103,210)	157,394
Cash at beginning of period	317,103	387,218
Cash at end of period	\$ 213,893	\$ 544,612
Supplemental disclosures of cash flow information:		
Cash paid/(received) during the period for:		
Interest	\$ 321,921	\$ 301,980
Income taxes	665,203	315,063

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Description of the Company

Unless otherwise specified, as used in this Quarterly Report on Form 10-Q, the terms “we,” “us,” “our,” “Art’s-Way,” and the “Company,” refer to Art’s-Way Manufacturing Co., Inc., a Delaware corporation headquartered in Armstrong, Iowa, and its wholly-owned subsidiaries.

We began operations as a farm equipment manufacturer in 1956. Since that time, we have become a major worldwide manufacturer of agricultural equipment. Our principal manufacturing plant is located in Armstrong, Iowa.

We have organized our business into three operating segments. Management separately evaluates the financial results of each segment because each is a strategic business unit offering different products and requiring different technology and marketing strategies. Art’s-Way Manufacturing Co., Inc. manufactures farm equipment under its own and private labels. Art’s-Way Manufacturing Co., Inc. has two wholly-owned operating subsidiaries. Art’s-Way Vessels, Inc. (“Art’s-Way Vessels”) manufactures pressure vessels and Art’s-Way Scientific, Inc. (“Art’s-Way Scientific”) manufactures modular buildings for various uses, commonly animal containment and research laboratories. For detailed financial information relating to segment reporting, see Note 14, “Segment Information.”

(2) Summary of Significant Account Policies

Statement Presentation

The foregoing condensed consolidated financial statements of the Company are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the fiscal year ended November 30, 2010. The results of operations for the three and nine months ended August 31, 2011 are not necessarily indicative of the results for the fiscal year ending November 30, 2011.

(3) Net Income Per Share of Common Stock

Basic net income per common share has been computed on the basis of the weighted average number of common shares outstanding. Diluted net income per share has been computed on the basis of the weighted average number of common shares outstanding plus equivalent shares assuming exercise of stock options.

Basic and diluted earnings per common share have been computed based on the following as of August 31, 2011 and August 31, 2010:

	For the three months ended	
	August 31, 2011	August 31, 2010
Basic:		
Numerator, net income	\$ 1,019,836	\$ 751,802
Denominator: Average number of common shares outstanding	4,019,874	3,992,182
Basic earnings per common share	\$ 0.25	\$ 0.19
Diluted:		
Numerator, net income	\$ 1,019,836	\$ 751,802

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Denominator: Average number		
of common shares outstanding	4,019,874	3,992,182
Effect of dilutive stock options	22,261	11,584
	4,042,135	4,003,766
Diluted earnings per common share	\$ 0.25	\$ 0.19

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	For the nine months ended	
	August 31, 2011	August 31, 2010
Basic:		
Numerator, net income	\$ 826,002	\$ 886,707
Denominator: Average number of common shares outstanding	4,016,039	3,991,381
Basic earnings per common share	\$ 0.21	\$ 0.22
Diluted:		
Numerator, net income	\$ 826,002	\$ 886,707
Denominator: Average number of common shares outstanding	4,016,039	3,991,381
Effect of dilutive stock options	33,667	9,482
	4,049,706	4,000,863
Diluted earnings per common share	\$ 0.20	\$ 0.22

(4) Stock Based Compensation

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant vesting period. We estimate the fair value of each stock-based award on the measurement date using the Black-Scholes option valuation model which incorporates assumptions as to stock price volatility, the expected life of the options, risk-free interest rate, and dividend yield.

(5) Inventory

Major classes of inventory are:

	August 31, 2011	November 30, 2010
Raw materials	\$ 8,287,096	\$ 8,269,852
Work in process	258,572	776,083
Finished goods	6,925,513	6,565,964
	\$ 15,471,181	\$ 15,611,899
Less: Reserves	(2,334,581)	(1,816,083)
	\$ 13,136,600	\$ 13,795,816

(6) Accrued Expenses

Major components of accrued expenses are:

	August 31, 2011	November 30, 2010
Salaries, wages, and commissions	\$ 525,220	\$ 661,200
Accrued warranty expense	250,783	180,549
Other	544,563	539,349
	\$ 1,320,566	\$ 1,381,098

(7) Product Warranty

The Company offers warranties of various lengths to its customers depending on the specific product and terms of the customer purchase agreement. The average length of the warranty period is one year from the date of purchase. The Company's warranties require it to repair or replace defective products during the warranty period at no cost to the customer. The Company records a liability for estimated costs that may be incurred under its warranties. The costs are estimated based on historical experience and any specific warranty issues that have been identified. Although historical warranty costs have been within expectations, there can be no assurance that future warranty costs will not exceed historical amounts. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the balance as necessary. The accrued warranty balance is included in accrued expenses as shown in note 6.

Changes in the Company's product warranty liability for the three and nine months ended August 31, 2011 and 2010 are as follows:

	For the three months ended	
	August 31, 2011	August 31, 2010
Balance, beginning	\$ 199,395	\$ 148,412
Settlements made in cash or in-kind	(123,457)	(51,842)
Warranties issued	174,844	218,180
Balance, ending	\$ 250,783	\$ 314,750

	For the nine months ended	
	August 31, 2011	August 31, 2010
Balance, beginning	\$ 180,549	\$ 96,370
Settlements made in cash or in-kind	(315,621)	(237,516)
Warranties issued	385,856	455,896
Balance, ending	\$ 250,784	\$ 314,750

(8) Loan and Credit Agreements

The Company has a \$6,000,000 revolving line of credit with West Bank (the "Line of Credit") which was scheduled to mature on April 30, 2011. Effective March 31, 2011, the Company renewed the Line of Credit and extended the maturity date to April 30, 2012. The Line of Credit is renewable annually with advances funding the Company's working capital and letter of credit needs. The interest rate is West Bank's prime interest rate, adjusted daily, with a minimum rate of 4.00%. As of August 31, 2011, the interest rate was the minimum of 4.00%. Monthly interest-only payments are required and the unpaid principal is due on the maturity date. As of August 31, 2011 and November 30, 2010, the Company had borrowed \$2,475,387 and \$2,084,000, respectively, against the Line of Credit. The available amounts remaining on the Line of Credit were \$3,524,613 and \$3,916,000 on August 31, 2011 and November 30, 2010, respectively. The borrowing base limits advances from the Line of Credit to 60% of accounts receivable less than 90 days, 60% of finished goods inventory, 50% of raw material inventory and work-in-process inventory, plus 40% of Net Book Value of Fixed Assets as calculated at each month-end. The Company's obligations under the Line of Credit are evidenced by a Business Loan Agreement effective March 31, 2011 (the "Business Loan Agreement"), a Change in Terms Agreement effective March 31, 2011, and certain other ancillary documents.

On June 7, 2007, the Company obtained a term loan from West Bank in the amount of \$4,100,000. The loan, which had an outstanding principal balance of \$2,889,843 as of August 31, 2011, matures on May 1, 2013 and bears fixed interest at 5.75%. Monthly principal and interest payments in the amount of \$42,500 are required, with a final payment of principal and accrued interest in the amount of \$2,300,391 due on May 1, 2013.

The Company obtained two additional loans from West Bank in 2007 for the purpose of financing the construction of the Company's new facilities in Monona and Dubuque. On October 9, 2007, the Company obtained a loan for \$1,330,000, which has a maturity date of May 1, 2013 and bears interest at a fixed interest rate of 5.75%. Monthly payments of \$11,000 are required for principal and interest, with a final payment of accrued interest and principal in the amount of \$1,005,905 due on May 1, 2013. On August 31, 2011, the outstanding principal balance on this loan was \$1,118,956.

On November 30, 2007, the Company obtained a \$1,500,000 construction loan to finance construction of the Dubuque, Iowa facility, which has a maturity date of May 1, 2013 and bears interest at a fixed interest rate of 5.75%. Payments of \$12,550 are due monthly for principal and interest, with a final accrued interest and principal payment in the amount of \$1,144,539 due on May 1, 2013. On August 31, 2011 the outstanding principal balance on this loan was \$1,272,547.

Each of the Company's loans from West Bank are governed by the Business Loan Agreement, which requires the Company to comply with certain financial and reporting covenants. The Company must provide monthly internally prepared financial reports, year-end audited financial statements, annual compliance certificates, and notice upon certain events, such as a change in executive or management personnel. The Company must maintain a minimum debt service coverage ratio of 1.5, a maximum debt to tangible net worth ratio of 1.25, and a minimum tangible net worth of \$12,000,000, each as measured at the Company's fiscal year-end. Further, the Company must obtain West Bank's prior written consent for any investment in, acquisition of, or guaranty relating to another business or entity. The loans are secured by a first position security interest on the assets of the Company and its subsidiaries, including but not limited to, inventories, accounts receivable, machinery, equipment and real estate, in accordance with the Business Loan Agreement and Commercial Guaranties executed by the Company's subsidiaries. The Company and its subsidiaries were also required to execute Agreements to Provide Insurance that set forth the insurance requirements for the collateral.

If the Company or either of its subsidiaries (as guarantors) commits an event of default under the Business Loan Agreement and fails or is unable to cure that default, the interest rate on the Line of Credit would increase by 2.0%. In addition, West Bank may cease advances under the Line of Credit and has the option of causing all outstanding indebtedness to become immediately due and payable. Events of default include, without limitation: (i) becoming insolvent or subject to bankruptcy proceedings; (ii) defaulting on any obligations to West Bank; (iii) defaulting on any obligations to third parties that would materially affect the ability to perform obligations owed to West Bank; (iv) suffering a material adverse change in financial condition or the value of any collateral; (v) experiencing a change in ownership of twenty-five percent or more of outstanding common stock; and (vi) making false statements to West Bank.

The Company was in compliance with all covenants under the Business Loan Agreement as measured on November 30, 2010. Although compliance with the financial ratio covenants is measured only on an annual basis, the Company internally evaluates such ratios on a quarterly basis. As of August 31, 2011, the Company was in compliance with all financial ratio covenants under the Business Loan Agreement. The next measurement date is November 30, 2011.

On June 1, 2009, Art's-Way Scientific received funds from two \$95,000 promissory notes in connection with an agreement signed August 7, 2007 between Art's-Way Scientific and the Iowa Department of Economic Development. The first \$95,000 promissory note is a 0% interest loan requiring 60 monthly payments of \$1,583.33, with a final payment due July 1, 2014. The outstanding principal balance on this note was \$53,833 as of August 31, 2011. The second \$95,000 promissory note, which had an outstanding principal balance of \$95,000 as of August 31, 2011, is a forgivable loan subject to certain contract obligations. These obligations include maintaining Art's-Way Scientific's principal place of business in Iowa, complying with certain tax and insurance requirements, and creating 16 full-time positions and retaining 21 full-time positions in Iowa, which must be maintained for a two-year period.

Art's-Way Manufacturing Co., Inc. has provided a guarantee in connection with these loans to Art's-Way Scientific.

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On May 1, 2010, the Company obtained a loan to finance the purchase of an additional facility located in West Union, Iowa to be used as a distribution center, warehouse facility, and manufacturing plant for certain products under the Art's-Way brand. The funds for this loan were made available by the Iowa Finance Authority by the issuance of tax exempt bonds. This loan had an original principal amount of \$1,300,000 and bears fixed interest at 3.5%. The payments required on this loan began July 1, 2010 and will continue until June 1, 2020. The terms of the loan require monthly payments of \$12,891.68 for principal and interest. As of August 31, 2011, the outstanding principal balance on this loan was \$1,171,422.

This loan from the Iowa Finance Authority, which has been assigned to The First National Bank of West Union, is governed by a Manufacturing Facility Revenue Note dated May 28, 2010 and a Loan Agreement dated May 1, 2010 ("the IFA Loan Agreement"), which requires the Company to provide quarterly internally prepared financial reports and year-end audited financial statements and to maintain a minimum debt service coverage ratio of 1.5, which is measured at November 30 of each year. Among other covenants, the IFA Loan Agreement also requires the Company to maintain proper insurance on, and maintain in good repair, the West Union Facility, and continue to conduct business and remain duly qualified to do business in the State of Iowa. The loan is secured by a mortgage on the Company's West Union Facility, pursuant to a Mortgage, Security Agreement, Assignment of Leases and Rents and Fixture Financing Statement dated May 1, 2010 between the Company and The First National Bank of West Union (the "West Union Mortgage").

If the Company fails to make a required payment or perform any other covenant under the IFA Loan Agreement or the West Union Mortgage, becomes subject to bankruptcy or insolvency proceedings, defaults in payment on any of our other loan obligations in excess of \$100,000, or if there is a determination that any of the Company's representations made in the IFA Loan Agreement or related documents are materially false, the Company will be deemed to have committed an event of default under the IFA Loan Agreement. If the Company does not cure the event of default within the time specified by the IFA Loan Agreement, the lender may cause the entire amount of the loan to be immediately due and payable and take any other action that it is permitted to take at law or in equity to enforce the Company's performance.

On September 15, 2010, the company obtained a zero-interest loan from the West Union Community Development Corporation in the amount of \$13,000. Annual principal payments of \$4,333.33 are due September 1 of 2011, 2012, and 2013.

A summary of the Company's term debt is as follows:

	August 31, 2011	November 30, 2010
West Bank loan payable in monthly installments of \$42,500 including interest at 5.75%, due May 1, 2013	2,889,843	\$ 3,140,229
West Bank loan payable in monthly installments of \$11,000 including interest at 5.75%, due May 1, 2013	1,118,956	1,167,970
West Bank loan payable in monthly installments of \$12,550 including interest at 5.75%, due May 1, 2013	1,272,547	1,328,642
Iowa Finance Authority loan payable in monthly installments of \$12,892 including interest at 3.5%, due June 1, 2020	1,171,422	1,255,120

IDED loan payable in monthly installments of \$1,583 including interest at 0%, due July 1, 2014.	53,833	68,083
IDED loan payable in monthly installments of \$0 including interest at 0%, due July 1, 2014	95,000	95,000
West Union Community Development Corporation loan payable in annual installments of \$4,333 including interest at 0% due September 1, 2013	13,000	13,000
Total term debt	6,614,601	7,068,044
Less current portion of term debt	638,528	615,294
Term debt, excluding current portion	5,976,073	\$ 6,452,750

(9) Recently Issued Accounting Pronouncements

Fair Value Measurements

In September 2006, the Financial Accounting Standards Board (“FASB”) issued a statement that defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure about fair value measurements. The statement does not require any new fair value measurements, but for some entities, the application of the statement will change current practice. This statement was adopted by the Company without a material impact on the financial statements. In January 2010, the FASB issued an update to amend existing disclosure requirements. The update requires new disclosures for significant transfers between Levels 1 and 2 in the fair value hierarchy and separate disclosures for purchases, sales, issuances, and settlements in the reconciliation of activity for Level 3 fair value measurements. This update also clarifies the existing fair value disclosures regarding the level of disaggregation and the valuation techniques and inputs used to measure fair value. The update is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures on purchases, sales, issuances, and settlements in the roll forward of activity for Level 3 fair value measurements. Those disclosures are effective for interim and annual periods beginning after December 15, 2010. The Company has determined that there was no significant impact to the financial statements as a result of the adoption of these standards.

Goodwill Impairment Testing

In December 2010, the FASB issued standards on testing goodwill and other intangible assets impairment which is a two-step test. When a goodwill impairment test is performed (either on an annual or interim basis), an entity must assess whether the carrying amount of a reporting unit exceeds its fair value (Step 1). If it does, an entity must perform an additional test to determine whether goodwill has been impaired and to calculate the amount of that impairment (Step 2). The objective of this Update is to address questions about entities with reporting units with zero or negative carrying amounts because some entities concluded that Step 1 of the test is passed in those circumstances because the fair value of their reporting unit will generally be greater than zero. The amendment will affect all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010, with no early adoption permitted. The Company has a year end of November 30th and this standard is not yet adopted. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

In September 2011, the FASB issued standards to address concerns about the cost and complexity of performing the first step of the two-step goodwill impairment test required under Topic 350, Intangibles-Goodwill and Other. The objective of this Update is to simplify how entities, both public and nonpublic, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

Disclosure of Supplementary Pro Forma Information for Business Combinations

In December 2010, the FASB issued standards which state that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. The amendments in this Update clarify the acquisition date that should be used for reporting the pro forma financial information disclosures when comparative financial statements are presented. The amendments also improve the usefulness of the pro forma revenue and earnings disclosures by requiring a description of the nature and amount of material, nonrecurring pro forma adjustments that are directly attributable to the business combination(s). The amendments in this Update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The Company has a year end of November 30th and this standard is not yet adopted. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

Fair Value Measurement Update

In May 2011, the FASB issued ASU No. 2011-04, “Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs” that amends the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and disclosing information about fair value measurements. The amendments in this update achieve the objective of developing common fair value measurement and disclosure requirements, as well as improving consistency and understandability. Some of the requirements clarify the FASB’s intent about the application of existing fair value measurement requirements while other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this ASU are effective prospectively for interim and annual periods beginning after December 15, 2011, with no early adoption permitted. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

Comprehensive Income

In June 2011, the FASB issued ASU NO. 2011-05, “Presentation of Comprehensive Income” that improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statements of changes in stockholders’ equity. The amendments in this standard require that all non-owner changes in stockholders’ equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from other comprehensive income (“OCI”) to net income, in both net income and OCI. The standard does not change the current option for presenting components of OCI gross or net of the effect of income taxes, provided that such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, the standard does not affect the calculation or reporting of earnings per share. For public entities, the amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively, with early adoption permitted. We do not expect the adoption of this standard to have a material impact on our consolidated financial statements.

(10) Equity Incentive Plan

On January 27, 2011, the Board of Directors of the Company authorized and approved the Art’s-Way Manufacturing Co., Inc. 2011 Equity Incentive Plan (the “2011 Plan”), subject to approval by the stockholders on or before January 27, 2012. The 2011 Plan was approved by the stockholders on April 28, 2011. It replaced the Employee Stock Option Plan and the Directors’ Stock Option Plan (collectively, the “Prior Plans”), and no further stock options will be awarded

under the Prior Plans. Awards to directors and executive officers under the 2011 Plan will be governed by the forms of agreement approved by the Board of Directors.

The 2011 Plan permits the plan administrator to award nonqualified stock options, incentive stock options, restricted stock awards, restricted stock units, performance awards, and stock appreciation rights to employees (including officers), directors, and consultants. The Board of Directors has approved a director compensation policy pursuant to which non-employee directors are automatically granted non-qualified stock options to purchase 2,000 shares of common stock annually or initially upon their election to the Board, which are fully vested.

Stock options granted prior to January 27, 2011 are governed by the applicable Prior Plan and the forms of agreement adopted thereunder.

(11) 2010 Acquisitions

Effective January 19, 2010, the Company acquired certain assets related to the manure spreader product line of Roda Mfg., Inc. The acquisition-date fair value of the total consideration transferred was approximately \$1,159,000. The operating results of the acquired business are reflected in the Company's consolidated statement of operations from the acquisition date forward. The amount of revenue attributable to the Roda Mfg. product line was \$273,000 and \$834,000 for the quarter and the nine month period ended August 31, 2011. The amount of revenue from all product lines for the combined entity as of the period ended August 31, 2011 was \$21,761,551 compared with \$22,909,802 as of August 31, 2010. The amounts of expenses for the individual product lines are not separately identifiable as the production and related accounting are integrated. Prior information is not available for the product line. The acquisition was made to continue the Company's growth strategy and diversify its product offerings inside the agricultural industry. The purchase price was determined based on an arms-length negotiated value. The transaction is being accounted for under the acquisition method of accounting, with the purchase price allocated to the individual assets acquired.

In addition, effective June 11, 2010, the Company acquired certain assets related to the baler product line of M&W, a subsidiary of the Alamo Group. The acquisition-date fair value of the total consideration transferred was approximately \$427,000. The operating results of the acquired business are reflected in the Company's consolidated statement of operations from the acquisition date forward. The amount of revenue attributable to the M&W baler product line was \$129,000 and \$195,000 for the quarter and nine month period ended August 31, 2011. The amount of revenue for the combined entity as of period ended August 31, 2011 was \$21,761,551 compared with \$22,909,802 as of August 31, 2010. The amounts of expenses for individual product lines are not separately identifiable as the production and related accounting are integrated. Prior information is not available for the product line. The acquisition was made to continue the Company's growth strategy and diversify its product offerings inside the agricultural industry. The purchase price was determined based on an arms-length negotiated value. The transaction is being accounted for under the acquisition method of accounting, with the purchase price allocated to the individual assets acquired.

(12) Disclosures About the Fair Value of Financial Instruments

The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties. At August 31, 2011, and November 30, 2010, the carrying amount approximated fair value for cash, accounts receivable, accounts payable, notes payable to bank, and other current and long-term liabilities. The carrying amounts approximate fair value because of the short maturity of these instruments. The fair value of the Company's installment term loans payable also approximate recorded value because the interest rates charged under the loan terms are not substantially different than current interest rates.

(13) Related Party Transactions

The financial statements of Art's-Way Manufacturing, Inc. include a sale by our Vessels division to Adamson Global Technology in the amount of \$17,000 and \$250,000 during the nine months ended August 31, 2011 and 2010, respectively. Adamson Global Technology is wholly-owned and operated by J. Ward McConnell, Jr., the Executive Chairman of the Board of Directors.

(14) Segment Information

There are three reportable segments: agricultural products, pressurized vessels and modular buildings. The agricultural products segment fabricates and sells farming products as well as replacement parts for these products in the United States and worldwide. The pressurized vessel segment produces pressurized tanks. The modular building segment produces modular buildings for animal containment and various laboratory uses.

The accounting policies applied to determine the segment information are the same as those described in the summary of significant accounting policies. Management evaluates the performance of each segment based on profit or loss from operations before income taxes, exclusive of nonrecurring gains and losses.

Approximate financial information with respect to the reportable segments is as follows.

	Three Months Ended August 31, 2011			
	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	\$7,771,000	\$403,000	\$1,078,000	\$9,252,000
Income from operations	1,358,000	(11,000)	91,000	1,438,000
Income before tax	1,351,000	(65,000)	78,000	1,364,000
Total Assets	20,527,000	2,843,000	3,658,000	27,028,000
Capital expenditures	207,000	2,000	87,000	296,000
Depreciation & Amortization	123,000	26,000	54,000	203,000

	Three Months Ended August 31, 2010			
	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	\$7,725,000	\$502,000	\$2,355,000	\$10,582,000
Income from operations	1,092,000	(116,000)	295,000	1,271,000
Income before tax	1,062,000	(171,000)	276,000	1,167,000
Total Assets	20,367,000	3,139,000	3,997,000	27,503,000
Capital expenditures	101,000	21,000	9,000	131,000
Depreciation & Amortization	135,000	27,000	26,000	188,000

	Nine Months Ended August 31, 2011			
	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	\$18,091,000	\$1,368,000	\$2,302,000	\$21,761,000

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Income from operations	1,830,000	(332,000)	(171,000)	1,327,000
Income before tax	1,804,000	(500,000)	(221,000)	1,083,000
Total Assets	20,527,000	2,843,000	3,658,000	27,028,000
Capital expenditures	473,000	89,000	397,000	959,000
Depreciation & Amortization	375,000	78,000	152,000	605,000

	Nine Months Ended August 31, 2010			
	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	\$15,927,000	\$1,245,000	\$5,738,000	\$22,910,000
Income from operations	1,287,000	(344,000)	663,000	1,606,000
Income before tax	1,271,000	(514,000)	607,000	1,364,000
Total Assets	20,367,000	3,139,000	3,997,000	27,503,000
Capital expenditures	1,839,000	37,000	46,000	1,922,000
Depreciation & Amortization	382,000	79,000	76,000	537,000

(15) Income Tax Provision

During the quarter ended August 31, 2011 we completed our fiscal year ending November 30, 2010 tax filings for both Federal and State Taxing Authorities. We calculated a tax provision reduction for the year ending November 30, 2010. The tax provision reduction was recognized during the quarter ended August 31, 2011 and brought our effective tax rate down during the quarter and year to date ending August 31, 2011, to 25.2% and 23.7%, respectively. The tax provision effective tax rate for the comparative quarter and year to date ending August 31, 2010 was 35.6% and 35.0%, respectively. The tax provision benefit was due to taking advantage of additional tax deductions and credits for the fiscal year ended November 30, 2010.

(16) Subsequent Event

Management evaluated all activity of the Company and concluded that no subsequent events have occurred that would require recognition in the consolidated financial statements or disclosure in the notes to the consolidated financial statements.

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

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of Part I of this report and the audited consolidated financial statements and related notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended November 30, 2010. Some of the statements in this report may contain forward-looking statements that reflect our current view on future events, future business, industry and other conditions, our future performance, and our plans and expectations for future operations and actions. In some cases you can identify forward-looking statements by the use of words such as "may," "should," "anticipate," "believe," "expect," "plan," "future," "intend," "could," "estimate," "predict," "hope," "potential," "continue," these terms or other similar expressions. Many of these forward-looking statements are located in this report under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" but they may appear in other sections as well. Forward-looking statements in this report generally relate to: (i) the anticipated benefits from hiring a Production Manager for our pressurized vessels segment; (ii) our belief that demand for our modular buildings will increase if economic conditions improve; (iii) the expected response to our modular buildings from customers who do not depend on government funding and customers pursuing leasing alternatives, and our intent to continue to grow that segment; (iv) the anticipated benefits of our efforts to improve our disclosure controls and procedures and remediate the material weakness in our internal control over financial reporting; (v) our order backlog; and (vi) our beliefs regarding the sufficiency of working capital and our continued ability to renew or obtain financing on reasonable terms when necessary.

You should read this report thoroughly with the understanding that our actual results may differ materially from those set forth in the forward-looking statements for many reasons, including events beyond our control and assumptions that prove to be inaccurate or unfounded. We cannot provide any assurance with respect to our future performance or results. Our actual results or actions could and likely will differ materially from those anticipated in the forward-looking statements for many reasons, including but not limited to: (i) delays in or obstacles to our ability to successfully improve our disclosure controls and procedures and remediate the material weakness in our internal control over financial reporting; (ii) the impact of tightening credit markets on our ability to continue to obtain financing on reasonable terms; (iii) our ability to continue to meet debt obligations; (iv) the effect of general economic conditions on the demand for our products and the cost of our supplies and materials; (v) unforeseen costs or delays in implementing production of new products; (vi) unexpected effects from changes to our production schedule; (vii) an inability to retain new customers for our modular buildings; and (viii) other factors described from time to time in our reports to the SEC. We do not intend to update the forward-looking statements contained in this report other than as required by law. We caution you not to put undue reliance on any forward-looking statements, which speak only as of the date of this report. You should read this report and the documents that we reference in this report and have filed as exhibits completely and with the understanding that our actual future results may be materially different from what we currently expect. We qualify all of our forward-looking statements by these cautionary statements.

Critical Accounting Policies

Our critical accounting policies involving the more significant judgments and assumptions used in the preparation of the financial statements as of August 31, 2011 have remained unchanged from November 30, 2010. These policies include revenue recognition, inventory valuation, income taxes and stock-based compensation. Disclosure of these critical accounting policies is incorporated by reference from Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended November 30, 2010.

Results of Operations

Net Sales and Cost of Sales

Our consolidated corporate sales for the three- and nine-month periods ended August 31, 2011 were \$9,252,000 and \$21,761,000, respectively, compared to \$10,582,000 and \$22,910,000 during the same respective periods in 2010, a decrease of \$1,330,000, or 12.6% for the quarter and a decrease of \$1,148,000 or 5.0% year-to-date. The sales decreases were due to reduced sales at our modular building segments.

Consolidated gross profit margin for the third fiscal quarter of 2011 was 29.3% compared to 24.4% during the third fiscal quarter of 2010. Year-to-date gross margin was 23.6% in fiscal year 2011, compared to 23.9% in fiscal year 2010. The increase in gross margin for the quarter was due to Manufacturing, Vessels, and Scientific gross margin improving from 27.8% to 30.7%, -5.0% to 16.7% and 19.4% to 23.9%, respectively. The impact of increases brought the consolidated gross margin up by approximately 5.0%. The decrease in gross margin for the year-to-date was primarily due to Scientific gross margin decreasing from 20.6% during 2010 to 15.6% during 2011. The impact of this decrease brought the consolidated gross margin down by approximately 0.3%.

Our third fiscal quarter sales at Manufacturing were \$7,771,000, compared to \$7,725,000 during the same period of 2010, an increase of \$46,000, or 0.6%. Year-to-date sales were up to \$18,091,000, from \$15,927,000 as of August 31, 2010, an increase of \$2,164,000, or 13.6%. Gross margin for the quarter ended August 31, 2011 was 30.7% compared to 27.8% for the same period in 2010. The increase in margin during Q3 2011 vs. 2010 was due to the product mix. The year-to-date gross margin was 26.9% compared to 27.3% as of August 31, 2010. The year-to-date margin decrease is attributable to higher steel costs that impacted the margin on sales from prior year whole goods sales orders.

Our third fiscal quarter sales at Vessels were \$403,000, compared to \$502,000 for the same period in 2010, a decrease of \$99,000, or 19.7%. Year-to-date sales were \$1,368,000, compared to \$1,245,000 for the nine-month period ending August 31, 2010, an increase of \$123,000, or 9.9%. We hired a Production Manager on February 17, 2011. He has been with us for two quarters during which time he has improved our overall shop flow and cleanliness, and has improved our ability to track cost and revenue on a per-job basis. While we have not seen an immediate financial impact, we are pleased with both the physical and procedural changes that have been made in the factory and believe that the addition of this individual will prove to be beneficial. Over time, we anticipate manufacturing costs will decline and that margins will subsequently increase. Gross margin for the quarter ended August 31, 2011 was 16.7% compared to -5.0% for the same period in 2010. Year-to-date gross margin was -6.0% compared to -4.4% as of August 31, 2010.

Our third fiscal quarter sales in 2011 at Scientific were \$1,078,000, compared to \$2,355,000 for the same period in fiscal 2010, a decrease of \$1,277,000, or 54.2%. Year-to-date sales were \$2,302,000 in fiscal 2011 compared to \$5,738,000 for the same period in 2010, a decrease of \$3,436,000, or 59.9%. We believe the modular buildings sales have been sluggish and erratic due to general economic conditions. Many of Scientific's customers are government entities or universities that are experiencing budget cuts. A majority of these customers applied for federal grant money, but did not receive the necessary award amounts to proceed with the projects as quoted. We are now working with those customers who either are scaling their projects back or looking at leasing to meet their funding requirements. We currently have three leased facilities and are building more with the expectation of leasing. We also intend to more heavily focus our sales activities on entities that do not rely on governmental funding. Our backlog in Scientific remains lower when compared to last year but continues to climb and we continue our focus on growing this segment. Gross margin for the quarter ended August 31, 2011 was 23.9% compared to 19.4% for the same period in 2010. Year-to-date gross margin was 15.6% compared to 20.6% as of August 31, 2010, which was attributable to the lower sales volume.

Expenses

Our third fiscal quarter consolidated selling expenses were \$447,000 compared to \$550,000 for the same period in 2010. Year-to-date selling expenses were \$1,320,000 in 2011 compared to \$1,476,000 for the same period in 2010. The decrease was primarily due to reductions in trade show and literature expenditures. Selling expenses as a percentage of sales were 4.8% and 6.1% for the three- and nine-month periods ending August 31, 2011, compared to 5.2% and 6.4% for the same respective periods in 2010.

Consolidated engineering expenses were \$92,000 for the three months ended August 31, 2011, compared to \$102,000 for the same period in 2010. Year-to-date engineering expenses were \$330,000 for fiscal 2011 compared to \$309,000 in fiscal 2010. Engineering expenses as a percentage of sales were 1.0% and 1.5% for the three- and nine-month periods ending August 31, 2011, compared to 1.0% and 1.3% for the same respective periods in 2010.

Consolidated administrative expenses for the three months ended August 31, 2011 were \$731,000 compared to \$654,000 for the same period in 2010. Year-to-date administrative expenses were \$2,162,000 compared to \$2,081,000 in 2010. The year to date increase is due to additional cost incurred to complete a R&D tax credit study and non-litigation legal costs. Administrative expenses as a percentage of sales were 7.9% and 9.9% for the three- and nine-month periods ending August 31, 2011, compared to 6.2% and 9.1% for the same respective periods in 2010.

Net Income

The changes to net income were primarily attributable to the decrease in consolidated sales for the three and nine month periods, offset by a decrease in consolidated expenses and lower tax expense in 2011 due to recognition of a tax provision reduction during the quarter ended August 31, 2011.

Order Backlog

The consolidated order backlog as of August 31, 2011 was \$2,851,000 compared to \$4,823,000 as of August 31, 2010. Manufacturing's order backlog was \$1,843,000 as of August 31, 2011, compared to \$2,884,000 in fiscal 2010. The backlog for Vessels was \$434,000 as of August 31, 2011, compared to \$655,000 in fiscal 2010. The backlog for Scientific was \$ 574,000 as of August 31, 2011, compared to \$1,334,000 in fiscal 2010. Our order backlog is not necessarily indicative of future revenue to be generated from such orders due to the possibility of order cancellations and dealer discount arrangements we may enter into from time to time.

Liquidity and Capital Resources

Our main sources of funds for the nine months ended August 31, 2011 have been cash from operations of approximately \$851,000, as well as proceeds from customer deposits for Manufacturing and borrowings on our line of credit. These funds supported our working capital requirements and capital expenditures for the period.

We have a \$6,000,000 revolving line of credit with West Bank, pursuant to which we had borrowed \$2,475,000 and \$2,084,000 as of August 31, 2011 and November 30, 2010, respectively. The revolving line of credit was renewed effective March 31, 2011. In addition, we have three term loans from West Bank, which had outstanding principal balances of approximately \$2,890,000, \$1,119,000 and \$1,273,000 as of August 31, 2011, respectively. We have also received funds pursuant to two promissory notes from the Iowa Department of Economic Development. These notes had outstanding principal balances of approximately \$95,000 and \$54,000 as of August 31, 2011, respectively. In May 2010, the Iowa Finance Authority extended us a loan to finance the purchase of a facility. As of August 31, 2011, the outstanding principal balance on this loan was approximately \$1,171,000. In September 2010, we obtained an interest-free \$13,000 loan from the West Union Community Development Corporation, which requires annual principal payments of \$4,333 on September 1 of 2011, 2012, and 2013.

Our loans require us to comply with various covenants, including maintaining certain financial ratios. We were in compliance with all financial ratio covenants as of November 30, 2010, our last measurement date.

For additional information about our financing activities, please refer to note 8 to the audited consolidated financial statements and the discussion entitled "Liquidity and Capital Resources," each contained in our Annual Report on Form 10-K for the fiscal year ended November 30, 2010, as well as note 8 to the unaudited consolidated financial statements included in Part I, Item 1 of this Quarterly Report.

We believe that our current financing arrangements provide sufficient cash to finance operations for the next 12 months. We expect to continue to rely on cash from financing activities to supplement our cash flows from operations in order to meet our liquidity and capital expenditure needs in the near future. We expect to continue to be able to procure financing upon reasonable terms.

Off Balance Sheet Arrangements

None.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The person serving as our principal executive officer and principal financial officer evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) and Rule 15d-15(e), as of the end of the period subject to this Report. Based on this evaluation, the person serving as our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were not effective to provide reasonable assurance that information required to be disclosed by us in the periodic and current reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the periods specified by the Securities and Exchange Commission's rules and forms. As a result of the material weakness relating to inventory accounting that existed at the end of our fiscal year, which was previously disclosed in Item 9A of our 2010 Annual Report on Form 10-K, the person serving as our principle executive officer and principal financial officer concluded that our disclosure controls and procedures did not ensure that the information required to be disclosed in the reports that we file or submit under the Exchange Act was collected and communicated to our management, including the person serving as our principal executive officer and principal financial officer, in a manner to allow timely decisions regarding required disclosures.

Changes to Internal Control over Financial Reporting

We are undertaking efforts to remediate the material weakness identified in our 2010 Annual Report 10-K. During the third fiscal quarter, we continued to enhance and implement additional, meaningful inventory control procedures. We believe that we have trained the staff on inventory transactions. These procedural changes, additional analysis and assessment, and ownership by manufacturing employees and our enforcement of these policies and procedures allow us to continue to monitor these controls.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

We are currently not a party to any material pending legal proceedings.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved.)

Item 5. Other Information.

None.

Item 6. Exhibits.

See “Exhibit Index” on page 19 of this report.

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.

ART'S-WAY MANUFACTURING CO., INC.

Date: October 14, 2011

By: /s/ Carrie L. Majeski
Carrie L. Majeski
President, Chief Executive Officer and
Principal Financial Officer

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Art's-Way Manufacturing Co., Inc.
Exhibit Index
Form 10-Q for the Quarterly Period Ending August 31, 2011

Exhibit No.	Description
31.1	Certificate pursuant to 17 CFR 13a-14(a) – filed herewith
32.1	Certificate pursuant to 18 U.S.C. Section 1350 – filed herewith
101*	The following materials from this report, formatted in XBRL (Extensible Business Reporting Language), are filed herewith: (i) condensed consolidated balance sheets, (ii) condensed consolidated statement of operations, (iii) condensed consolidated statements of cash flows, and (iv) the notes to the condensed financial statements.

* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.