ARTS WAY MANUFACTURING CO INC
Form 10-Q
October 12, 2010

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

FORM 10-Q

(Mark One)

[x] Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended August 31, 2010
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	42-0920725
(State or other jurisdiction of incorporation or organization)	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 x No o

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 o No o

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

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 September 16, 2010: 3,992,182

Art's-Way Manufacturing Co., Inc.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ART'S-WAY MANUFACTURING CO., INC.
Consolidated Balance Sheets

Assets	(Unaudited) August 31, 2010	November 30, 2009
Current assets:		
Cash	$544,612	$387,218
Accounts receivable-customers, net of allowance for doubtful accounts of $155,743 and $194,185 in 2010 and 2009, respectively	3,126,941	2,347,956
Inventories, net	13,978,405	11,928,234
Deferred taxes	847,000	882,000
Cost and Profit in Excess of Billings	125,212	141,778
Other current assets	302,921	1,038,902
Total current assets	18,925,091	16,726,088
Property, plant, and equipment, net	8,068,296	6,638,661
Covenant not to Compete	135,000	180,000
Goodwill	375,000	375,000
Total assets	$27,503,387	$23,919,749
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable to bank	$2,272,000	$2,438,892
Current portion of term debt	603,136	473,341
Accounts payable	1,062,694	439,127
Customer deposits	498,035	249,278
Billings in Excess of Cost and Profit	115,987	28,884
Accrued expenses	1,609,035	791,381
Income taxes payable	548,835	422,205
Total current liabilities	6,709,722	4,843,108
Long-term liabilities		
Deferred taxes	613,000	613,000
Term debt, excluding current portion	6,599,059	5,796,223
Total liabilities	13,921,781	11,252,331
Stockholders' equity:		
Common stock – $0.01 par value. Authorized 5,000,000 shares; issued 3,992,182 and 3,990,352 shares in 2010 and 2009	39,922	39,904
Additional paid-in capital	2,246,750	2,219,286
Retained earnings	11,294,934	10,408,228
Total stockholders' equity	13,581,606	12,667,418
Total liabilities and stockholders' equity	$27,503,387	$23,919,749

See accompanying notes to consolidated financial statements.

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

	Three Months Ended		Year to Date	
	August 31, 2010	August 31, 2009	August 31, 2010	August 31, 2009
Net sales	$10,581,783	$5,600,464	$22,909,802	$19,406,975
Cost of goods sold	8,004,666	4,298,659	17,437,158	15,320,796
Gross profit	2,577,117	1,301,805	5,472,644	4,086,179
Expenses:				
Engineering	102,042	89,316	309,342	248,445
Selling	549,959	436,416	1,476,102	1,249,729
General and administrative	654,234	562,814	2,081,037	1,985,972
Total expenses	1,306,235	1,088,546	3,866,481	3,484,146
Income from operations	1,270,882	213,259	1,606,163	602,033
Other income (expense):				
Interest expense	(121,085)	(122,738)	(310,879)	(389,434)
Other	16,908	8,080	68,869	65,623
Total other income	(104,177)	(114,658)	(242,010)	(323,811)
Income before income taxes	1,166,705	98,601	1,364,153	278,222
Income tax expense	414,903	33,876	477,446	96,984
Net income	$751,802	$64,725	$886,707	$181,238
Net income per share:				
Basic	0.19	0.02	0.22	0.05
Diluted	0.19	0.02	0.22	0.05

See accompanying notes to consolidated financial statements.

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

	Year To Date	
	August 31, 2010	August 31, 2009
Cash flows from operations:		
Net income (loss)	$886,707	$181,238
Adjustments to reconcile net income to		
net cash provided (used) by operating activities:		
Stock based compensation	19,978	87,664
Depreciation expense	491,973	441,229
Amortization expense	45,000	45,000
Deferred income taxes	35,000	(110,000)
Changes in assets and liabilities, net of Roda and M&W acquisitions in 2010:		
(Increase) decrease in:		
Accounts receivable	(778,985)	1,434,276
Inventories	(418,009)	1,241,015
Other current assets	735,981	(80,481)
Income taxes receivable	-	87,000
Increase (decrease) in:		
Accounts payable	623,567	(2,810,847)
Contracts in progress, net	103,669	(37,760)
Customer deposits	248,757	19,215
Income taxes payable	126,630	35,768
Accrued expenses	817,654	(415,078)
Net cash provided by operating activities	2,937,922	118,239
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(1,921,608)	(322,396)
Purchase of assets of Roda	(1,179,001)	-
Purchase of assets of M&W	(453,161)	-
Net cash (used in) investing activities	(3,553,770)	(322,396)
Cash flows from financing activities:		
Net change in line of credit	(166,892)	776,059
Net activity as a result of checks issued in excess of deposits	-	(274,043)
Payments of notes payable to bank	(367,369)	(319,888)
Proceeds from term debt	1,300,000	190,000
Proceeds from the exercise of stock options	7,503	15,440
Net cash provided by financing activities	773,242	387,568
Net increase in cash	157,394	183,411
Cash at beginning of period	387,218	103,450
Cash at end of period	$544,612	$286,861
Supplemental disclosures of cash flow information:		
Cash paid/(received) during the period for:		
Interest	$301,980	$393,252
Income taxes	315,063	95,072

Supplemental schedule of investing activities:		
Roda acquisition:		
Inventories	$1,179,001	$-
Cash paid	$1,179,001	$-
Supplemental schedule of investing activities:		
M&W acquisition:		
Inventories	$453,161	$-
Cash paid	$453,161	$-

See accompanying notes to consolidated financial statements.

Notes to 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 th “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 13, “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, 2009. The results of operations for the three and nine months ended August 31, 2010 are not necessarily indicative of the results for the fiscal year ending November 30, 2010.

(3) Income Per Share

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.

Notes to Consolidated Financial Statements

Basic and diluted earnings per common share have been computed based on the following as of August 31, 2010 and August 31, 2009:

	For the three months ended	
	August 31, 2010	August 31, 2009
Basic:		
Numerator, net income	$751,802	$64,725
Denominator: Average number		
of common shares		
Outstanding	3,992,182	3,990,352
Basic earnings per		
common share	$0.19	$0.02
Diluted:		
Numerator, net income	$751,802	$64,725
Denominator: Average number		
of common shares outstanding	3,992,182	3,990,352
Effect of dilutive stock options	11,584	9,598
	4,003,766	3,999,950
Diluted earnings per		
common share	$0.19	$0.02

	For the nine months ended	
	August 31, 2010	August 31, 2009
Basic:		
Numerator, net income	$886,707	$181,238
Denominator: Average number		
of common shares	3,991,381	3,987,856
Outstanding		
Basic earnings per		
common share	$0.22	$0.05
Diluted:		
Numerator, net income	$886,707	$181,238
Denominator: Average number		
of common shares outstanding	3,991,381	3,987,856
Effect of dilutive stock options	9,482	1,767
	4,000,863	3,989,623
Diluted earnings per		
common share	$0.22	$0.05

Notes to Consolidated Financial Statements

(4) Inventory

Major classes of inventory are:

	August 31, 2010	November 30, 2009
Raw materials	$8,361,107	$9,209,873
Work in process	427,945	258,621
Finished goods	7,166,335	4,060,163
	$15,955,388	$13,528,657
Less: Reserves	(1,976,983)	(1,600,423)
	$13,978,405	$11,928,234

(5) Accrued Expenses

Major components of accrued expenses are:

	August 31, 2010	November 30, 2009
Salaries, wages, and commissions	$872,672	$425,133
Accrued warranty expense	314,750	96,370
Other	421,613	269,878
	$1,609,035	$791,381

(6) 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.

Notes to Consolidated Financial Statements

Changes in the Company's product warranty liability for the three and nine months ended August 31, 2010 and August 31, 2009 are as follows:

	For the three months ended	
	August 31, 2010	August 31, 2009
Balance, beginning	$148,412	$259,899
Settlements made in cash or in-kind	(51,842)	(137,506)
Warranties accrued	218,180	77,050
Balance, ending	$314,750	$199,443

	For the nine months ended	
	August 31, 2010	August 31, 2009
Balance, beginning	$96,370	$327,413
Settlements made in cash or in-kind	(237,516)	(361,771)
Warranties accrued	455,896	233,801
Balance, ending	$314,750	$199,443

(7) Loan and Credit Agreements

The Company has a $6,000,000 revolving line of credit with West Bank (the "Line of Credit") which matures April 30, 2011. 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, 2010, the interest rate was the minimum of 4.0%. Monthly interest-only payments are required and the unpaid principal is due on the maturity date. As of August 31, 2010 and November 30, 2009, the Company had borrowed $2,272,000 and $2,438,892, respectively, against the Line of Credit. The available amounts remaining on the Line of Credit were $3,728,000 and $3,561,108 on August 31, 2010 and November 30, 2009, respectively. The borrowing base limits advances from the Line of Credit to 60% of accounts receivable less than 90 days, plus 60% of finished goods inventory, plus 50% of raw material inventory and work-in-process inventory, as calculated at each month-end. The Company's obligations under the Line of Credit are evidenced by a Commitment Letter dated April 27, 2010 (the "Commitment Letter"), a Promissory Note dated June 8, 2009, as updated by the Commitment Letter, 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 $3,221,306 as of August 31, 2010, 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 $2,304,789 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 $1,007,294 due on May 1, 2013. On August 31, 2010, the outstanding principal balance on this loan was $1,183,842.

Notes to Consolidated Financial Statements

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 $1,114,714 due on May 1, 2013. On August 31, 2010 the outstanding principal balance on this loan was $1,346,807.

Each of the Company's loans from West Bank are governed by a Business Loan Agreement dated June 8, 2009 (the "Business Loan Agreement"), as modified by the Commitment Letter, which requires the Company to comply with certain financial and reporting covenants. The Company must provide monthly internally prepared financial reports, including accounts receivable aging schedules and borrowing base and compliance certificates, and year-end audited financial statements. The Company must maintain a minimum debt service coverage ratio of 1.5, a maximum debt to tangible net worth ration 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 capital expenditures that exceed $500,000 annually. 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. The Company and its subsidiaries were 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, 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; and (v) making false statements to West Bank.

The Company was in compliance with all covenants under the Business Loan Agreement as measured on November 30, 2009. 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, 2010, the Company was in compliance with all financial ratio covenants under the Business Loan Agreement. The next measurement date is November 30, 2010.

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 $72,833 as of August 31, 2010. The second $95,000 promissory note, which had an outstanding principal balance of $95,000 as of August 31, 2010, 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.

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 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, 2010, the outstanding principal balance on this loan was $1,282,407.

Notes to Consolidated Financial Statements

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 to 1.0, which will be measured at November 30 of each year, beginning November 30, 2010. 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.

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

	August 31, 2010	November 30, 2009
West Bank loan payable in monthly installments of $42,500 including interest at 5.75%, due May 1, 2013	$3,221,306	$3,457,625
West Bank loan payable in monthly installments of $11,000 including interest at 5.75%, due May 1, 2013	1,183,842	1,230,104