

ARTS WAY MANUFACTURING CO INC  
Form 10-Q  
April 14, 2014  
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 February 28, 2014  
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)

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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

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

Number of common shares outstanding as of April 3, 2014: 4,046,552

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**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements****ART’S-WAY MANUFACTURING CO., INC.**

## Condensed Consolidated Balance Sheets

	(Unaudited)	
<b>Assets</b>	<b>February 28, 2014</b>	<b>November 30, 2013</b>
Current assets:		
Cash	\$85,949	\$207,950
Accounts receivable-customers, net of allowance for doubtful accounts of \$29,508 and \$35,474 in 2014 and 2013, respectively	2,410,887	2,999,903
Inventories, net	15,920,713	14,922,525
Deferred taxes	1,228,097	1,228,097
Cost and Profit in Excess of Billings	34,963	42,238
Income taxes receivable	226,304	108,513
Other current assets	623,438	242,146
Total current assets	20,530,351	19,751,372
Property, plant, and equipment, net	12,135,199	11,900,202
Assets held for lease, net	106,364	122,318
Goodwill	993,729	993,729
Total assets	\$33,765,643	\$32,767,621
<b>Liabilities and Stockholders’ Equity</b>		
Current liabilities:		
Line of credit	\$3,802,810	\$3,350,000
Current portion of term debt	1,228,581	1,228,964
Accounts payable	1,056,891	806,207
Customer deposits	1,281,816	147,505
Billings in Excess of Cost and Profit	32,689	17,721
Accrued expenses	1,430,367	1,718,475
Total current liabilities	8,833,154	7,268,872
Long-term liabilities		
Deferred taxes	952,645	952,645
Long Term debt, excluding current portion	5,944,013	6,251,959
Total liabilities	15,729,812	14,473,476
Stockholders’ equity:		

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Undesignated preferred stock - \$0.01 par value. Authorized 500,000 shares in 2014 and 2013; issued and outstanding 0 shares in 2014 and 2013.	-	-
Common stock – \$0.01 par value. Authorized 9,500,000 shares in 2014 and 2013; issued and outstanding 4,046,552 in 2014 and 4,046,552 in 2013	40,466	40,466
Additional paid-in capital	2,616,407	2,616,407
Retained earnings	15,378,958	15,637,272
Total stockholders' equity	18,035,831	18,294,145
Total liabilities and stockholders' equity	\$33,765,643	\$32,767,621

See accompanying notes to condensed consolidated financial statements.

**ART'S-WAY MANUFACTURING CO., INC.**

## Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended	
	<b>February 28, 2014</b>	<b>February 28, 2013</b>
Net sales	\$6,237,336	\$8,415,104
Cost of goods sold	4,896,923	6,045,941
Gross profit	1,340,413	2,369,163
Expenses:		
Engineering	113,539	102,567
Selling	536,149	489,736
General and administrative	985,661	1,064,112
Total expenses	1,635,349	1,656,415
Income (loss) from operations	(294,936 )	712,748
Other income (expense):		
Interest expense	(53,939 )	(89,463 )
Other	5,675	638,142
Total other income (expense)	(48,264 )	548,679
Income (loss) before income taxes	(343,200 )	1,261,427
Tax expense (benefit)	(84,888 )	442,173
Net income (loss)	\$(258,312 )	\$819,254
Net income per share:		
Basic net income (loss) per share	\$(0.06 )	\$0.20
Diluted net income (loss) per share	\$(0.06 )	\$0.20
Weighted average outstanding shares used to compute basic net income per share	4,046,552	4,035,052
Weighted average outstanding shares used to compute diluted net income per share	4,046,552	4,047,134

See accompanying notes to condensed consolidated financial statements.

**ART'S-WAY MANUFACTURING CO., INC.**

## Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended	
	<b>February 28, 2014</b>	<b>February 28, 2013</b>
Cash flows from operations:		
Net income (loss)	\$(258,312 )	\$819,254
Adjustments to reconcile net income to net cash provided by operating activities:		
(Gain) on disposal of property, plant, and equipment	-	(630,028 )
Depreciation expense	212,989	198,753
Bad debt expense (recovery)	(5,966 )	5,018
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	594,980	32,945
Inventories	(998,188 )	201,137
Income taxes receivable	(116,824 )	-
Other current assets	(381,292 )	(19,856 )
Increase (decrease) in:		
Accounts payable	250,684	438,467
Contracts in progress, net	22,243	(536,485 )
Customer deposits	1,134,311	1,779,184
Income taxes payable	-	(457,028 )
Accrued expenses	(288,108 )	(225,755 )
Net cash provided by (used in) operating activities	166,517	1,605,606
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(432,032 )	(144,325 )
Proceeds from sale of Armstrong, IA land and Salem, SD building	-	835,536
Net cash provided by (used in) investing activities	(432,032 )	691,211
Cash flows from financing activities:		
Net change in line of credit	452,810	-
Repayment of term debt	(308,330 )	(272,192 )
Net cash provided by (used in) financing activities	144,480	(272,192 )
Net increase/(decrease) in cash	(121,035 )	2,024,625
Cash at beginning of period	207,950	1,546,609
Cash at end of period	\$86,915	\$3,571,234
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$53,939	\$89,463
Income taxes	32,902	899,200



See accompanying notes to condensed consolidated financial statements.

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## 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 four 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. Our agricultural products segment (“Manufacturing”) manufactures farm equipment under the Art’s-Way Manufacturing label and private labels. Our pressurized vessels segment (“Vessels”) manufactures pressurized vessels. Our modular buildings segment (“Scientific”) manufactures modular buildings for various uses, commonly animal containment and research laboratories and our tools segment (“Metals”) manufactures steel cutting tools and inserts. For detailed financial information relating to segment reporting, see Note 12, “Segment Information.”

On June 25, 2013, the Company acquired the fixed assets, raw material inventory, work-in-progress inventory and select finished goods inventory of Agro Trend, a division of Rojac Industries, Inc. of Clifford, Ontario, Canada. Agro Trend distributes agricultural equipment and manufactures commercial snow blowers and agricultural trailers. Most of the existing Agro Trend operational team was retained to continue the manufacture of snow blowers and trailers. The acquired assets and operations are reported with our agricultural products segment. For specific financial information related to the acquisition, see Note 10, “Acquisitions.”

On September 30, 2013, the Company acquired the assets of Ohio Metal Working Products Company in Canton, Ohio consisting of inventory, equipment, real property, and intangible assets. Ohio Metal Working Products Company is a domestic manufacturer and distributor of standard single point brazed carbide tipped tools as well as PCD (polycrystalline diamond) and CBN (cubic boron nitride) inserts and tools. The existing Ohio Metal Working Products Company operational team was retained to continue the manufacturing of the carbide, PCD, and CBN tipped tools and inserts. The acquired assets and operations are reported in our tools segment for financial reporting purposes. For specific financial information related to the acquisition, see Note 10, “Acquisitions.”

**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, 2013. The results of operations for the three months ended February 28, 2014 are not necessarily indicative of the results for the fiscal year ending November 30, 2014.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the three months ended February 28, 2014. Actual results could differ from those estimates.

**3) Net Income (Loss) Per Share of Common Stock**

Basic net income (loss) per common share has been computed on the basis of the weighted average number of common shares outstanding. Diluted net income (loss) 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. Potential shares of common stock that have an anti-dilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted EPS.

Basic and diluted earnings (loss) per common share have been computed based on the following as of February 28, 2014 and February 28, 2013:

	<b>For the three months ended</b>	
	<b>February 28, 2014</b>	<b>February 28, 2013</b>
Basic:		
Numerator: net income (loss)	\$(258,312 )	\$819,254
Denominator: average number of common shares outstanding	4,046,552	4,035,052
Basic earnings (loss) per common share	\$(0.06 )	\$0.20
Diluted:		
Numerator: net income (loss)	\$(258,312 )	\$819,254
Average number of common shares outstanding	4,046,552	4,035,052
Effect of dilutive stock options	0	12,082
Denominator: dilutive average number of common shares outstanding	4,046,552	4,047,134
Diluted earnings (loss) per common share	\$(0.06 )	\$0.20

**4) Inventory**

Major classes of inventory are:

<b>February 28, 2014</b>	<b>November 30, 2013</b>
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Raw materials	\$ 11,506,097	\$ 10,322,014
Work in process	385,816	511,016
Finished goods	7,352,606	7,305,301
	\$ 19,244,519	\$ 18,138,331
Less: Reserves	(3,323,806 )	(3,215,806 )
	\$ 15,920,713	\$ 14,922,525

**5) Accrued Expenses**

Major components of accrued expenses are:

	<b>February 28, 2014</b>	<b>November 30, 2013</b>
Salaries, wages, and commissions	\$618,198	\$836,200
Accrued warranty expense	153,455	220,719
Other	658,714	661,556
	<b>\$1,430,367</b>	<b>\$1,718,475</b>

**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. The accrued warranty balance is included in accrued expenses as shown in Note 5.

Changes in the Company's product warranty liability for the three months ended February 28, 2014 and February 28, 2013 are as follows:

	<b>For the three months ended</b>	
	<b>February 28, 2014</b>	<b>February 28, 2013</b>
Balance, beginning	\$220,719	\$ 578,864
Settlements made in cash or in-kind	(151,577)	(168,689 )
Warranties issued	84,313	165,155
Balance, ending	<b>\$153,455</b>	<b>\$ 575,330</b>

**7) Loan and Credit Agreements**

On May 1, 2013, the Company began to move all banking arrangements previously held through West Bank to U.S. Bank. The relationship with U.S. Bank now includes an \$8,000,000 revolving line of credit (the "Line of Credit") which is scheduled to mature on May 1, 2014. The Line of Credit is renewable annually with advances funding the Company's working capital needs and is secured by real property and fixed asset collateral. The interest rate is U.S. Bank's prime interest rate, adjusted each time that the Federal prime rate changes, with a minimum rate of 3.50%. As of February 28, 2014, the interest rate was the minimum of 3.50%. Monthly interest-only payments are required and the unpaid principal is due on the maturity date. As of February 28, 2014, the Company had a principal balance of \$3,802,810 outstanding against the Line of Credit. The Line of Credit states that the borrowing base will be an amount equal to the sum of 75% of accounts receivable (discounted for aged accounts and customer balances exceeding 20% of aggregate receivables), plus 50% of inventory (this component cannot exceed \$6,000,000 and only includes finished goods and raw materials deemed to be in good condition and not obsolete), less any outstanding loan balance of the Line of Credit, and less undrawn amounts of outstanding letters of credit issued by U.S. Bank or any affiliate. The Company's obligations under the Line of Credit are evidenced by a Revolving Credit Note effective May 1, 2013, a Revolving Credit Agreement dated May 1, 2013 and certain other ancillary documents.

In addition to the Line of Credit, on May 1, 2013, the Company refinanced all outstanding West Bank term loans with U.S. Bank. The West Bank long-term debt, which had outstanding principal balances of \$4,342,000 at a fixed interest rate of 4.75% and \$1,749,000 at a fixed interest rate of 4.50%, was paid off with four U.S. Bank loans totaling \$6,319,000 at a fixed interest rate of 2.98% (the "2013 U.S. Bank Term Loans"). As detailed in the Company's long-term debt summary below, monthly principal and interest payments in the aggregate amount of \$93,850 are required, with final payments of principal and accrued interest on the four loans, in the aggregate amount of \$1,372,000, due on May 1, 2018.

As a result of paying off the West Bank loans, the Company incurred \$130,000 worth of prepayment penalties which were financed by the U.S. Bank loans. The penalties were booked to fixed costs on the income statement for the quarter ended May 31, 2013. Closing costs amounted to \$9,000 and will be amortized over the life of the loans.

Except for the U.S. Bank UHC Loan (as defined below), each of the Company's term loans from U.S. Bank is governed by a Term Note and a Term Loan Agreement. Each Term Loan Agreement and the Revolving Credit Agreement require the Company to provide monthly internally prepared financial reports, year-end audited financial statements, and a monthly aging of accounts receivable. The Company, as of the end of each fiscal quarter, must maintain a debt to tangible net worth ratio of not more than 1.5 to 1.0 and a fixed charge coverage ratio of at least 1.15 to 1.00. 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, machinery, equipment and real estate, in accordance with the Business Security Agreements entered into by the Company and its subsidiaries and the Pledge Agreements entered into by the subsidiaries. Additionally, the Company has mortgaged certain real property in favor of U.S. Bank to secure the new loans, as documented by the Mortgage, Security Agreement and Assignment of Rents between U.S. Bank and the Company and its subsidiaries.

If the Company or its subsidiaries (as guarantors pursuant to continuing guaranties) commits an event of default under the Term Loan Agreements, Business Security Agreements, Pledge Agreements or Revolving Credit Agreement and fails or is unable to cure that default, the interest rate on each of the loans and Line of Credit could increase by 5.0% per annum and U.S. Bank can immediately terminate its obligation, if any, to make additional loans to the Company. In addition, U.S. Bank may collect any and all money due or to become due and shall have all other rights and remedies for default provided by the Uniform Commercial Code, as well as any other applicable law and the various loan agreements, including, without limitation, the right to repossess, render unusable and/or dispose of the collateral without judicial process.

The Company was in compliance with all covenants under the Term Loan Agreements and the Revolving Credit Agreement as measured on February 28, 2014, other than its covenant to maintain a fixed charge coverage ratio of at least 1.15 to 1.00. The fixed charge coverage ratio is based on a rolling 12 month calculation and measures the Company's ability to cover fixed expenses such as loan payments, tax payments, rental payments, and dividends. The net loss from operations was the main reason for the non-compliance result as of February 28, 2014. US Bank has issued a waiver forgiving the non-compliance for the first quarter and no event of default occurred. The next measurement date is May 31, 2014.

On May 10, 2012, the Company obtained \$880,000 in long-term debt from U.S. Bank issued to acquire the building and property of Universal Harvester Co., Inc. located in Ames, Iowa (the "U.S. Bank UHC Loan"). The maturity date of this loan is May 10, 2017, with a final payment of principal and accrued interest in the amount of \$283,500 due May 10, 2017. This loan is secured by a mortgage on the building and property acquired from Universal Harvester Co., Inc. in Ames, Iowa, pursuant to a Mortgage, Security Agreement and Assignment of Rents between the Company and U.S. Bank, dated May 10, 2012. On May 1, 2013, the U.S. Bank UHC Loan and the Mortgage were amended to extend the mortgage to secure the 2013 U.S. Bank Term Loans in addition to the U.S. Bank UHC Loan.



If the Company or its subsidiaries (as guarantors) commits an event of default under the agreement governing the U.S. Bank UHC Loan and fails or is unable to cure during any applicable cure periods, the lender may cause the entire amount of the loan to be immediately due and payable, may foreclose on the property, or may increase the interest rate to a rate of 5.00% per annum, plus the interest rate otherwise payable under the U.S. Bank UHC Loan.

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 an interest rate of 3.5%. On February 1, 2013, the interest rate was decreased to 2.75%. The other terms of the loan remain unchanged.

This loan from the Iowa Finance Authority, which has been assigned to The First National Bank of West Union (n/k/a Bank 1<sup>st</sup>), is governed by a Manufacturing Facility Revenue Note dated May 28, 2010 as amended February 1, 2013 and a Loan Agreement dated May 1, 2010 and a First Amendment to Loan Agreement dated February 1, 2013 (collectively, “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 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 commits an event of default under the IFA Loan Agreement and 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 lawfully permitted to take or in equity to enforce the Company’s performance.

The Company was in compliance with all covenants under the IFA Loan Agreement as measured on November 30, 2013. The next measurement date is November 30, 2014.

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

	<b>February 28, 2014</b>	<b>November 30, 2013</b>
U.S. Bank loan payable in monthly installments of \$42,500 including interest at 2.98%, due May 1, 2018	\$ 2,002,993	\$ 2,114,675
U.S. Bank loan payable in monthly installments of \$11,000 including interest at 2.98%, due May 1, 2018	929,718	955,507
U.S. Bank loan payable in monthly installments of \$12,550 including interest at 2.98%, due May 1, 2018	1,055,890	1,085,350
U.S. Bank loan payable in monthly installments of \$27,800 including interest at 2.98%, due May 1, 2018	1,623,070	1,693,752
U.S. Bank loan payable in monthly installments of \$11,700 including interest at 3.15%, due May 10, 2017	678,218	707,719

Iowa Finance Authority loan payable in monthly installments of \$12,500 including interest at 2.75%, due June 1, 2020	873,022	904,662
IDED loan payable in monthly installments of \$2,437 including interest at 6%, due June 1, 2014	7,241	14,375
IDED loan payable in monthly installments of \$813 including interest at 0%, due June 1, 2014	2,442	4,883
Total term debt	\$ 7,172,594	\$ 7,480,923
Less current portion of term debt	1,228,581	1,228,964
Term debt, excluding current portion	\$ 5,944,013	\$ 6,251,959

**8) Recently Issued Accounting Pronouncements**

Comprehensive Income

In June 2011, the FASB issued ASU ' equity. The amendments in this standard require(Accounting Standards Update) No. 2011-05, "Presentation of Comprehensive Income" requiring 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. In December 2011, the FASB issued ASU No. 2011-12 which stated that the new presentation requirements presented in No. 2011-05 about reclassifications of items out of accumulated other comprehensive income would be difficult for preparers and may add unnecessary complexity to financial statements. Update 2011-12 allowed the Board time to confirm whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the Board considered the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05.

In February 2013, the FASB issued ASU No. 2013-02. After reviewing the presentation requirements about the effect of reclassification adjustments out of accumulated other comprehensive income on each line item of net income that were deferred by Update 2011-12, the FASB decided to not move forward with the requirement. Instead, the FASB decided that the reporting as described above is to be completed in one location, either on the face of the financial statements or in the notes. The Company has completed the adoption of this standard and the standard does not have a material impact on our consolidated financial statements.

### Presentation of an Unrecognized Tax Benefit

In July 2013, the FASB issued ASU No. 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" that clarifies how an unrecognized tax benefit should be presented in the financial statements when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists; as a reduction to a deferred tax asset or as a liability. The amendments are meant to eliminate the diversity that exists in the financial statement presentation of the unrecognized tax benefits. The amendments in this ASU do not require new recurring disclosures and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. The effective date for the Company will be fiscal year beginning December 1, 2014. The Company currently has no unrecognized tax benefits that are impacted by the amendment and the Company does not expect this standard to have a material impact on our consolidated financial statements.

### **9) Equity Incentive Plan and Stock Based Compensation**

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"). 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.

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. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses historical option exercise and termination data

to estimate the expected term the options are expected to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield is calculated using historical dividend amounts and the stock price at the option issuance date. We did not incur any stock-based compensation expense during the quarter ended February 28, 2014.

## 10) Acquisitions

On June 25, 2013, the Company acquired the fixed assets, raw material inventory, work-in-process inventory, and select finished good inventory of Agro Trend, a division of Rojac Industries, Inc. of Clifford, Ontario, Canada. A new entity was formed, Art's Way Manufacturing International, LTD ("International"), which is included in the agricultural products segment for financial reporting purposes. International will lease the facility in Clifford, Ontario and is continuing manufacturing, marketing and sales from the Canadian location. The amount paid in U.S. dollars for the acquisition of assets totaled \$311,000 (\$88,000 in fixed assets and \$223,000 in inventory). The operating results of the acquired business are reflected in the Company's consolidated statement of operations from the acquisition date forward. The acquisition was made to continue the Company's growth strategy and diversify its product offerings inside the agricultural industry.

The acquisition also includes a consignment arrangement regarding \$600,000 of select finished good inventory. As part of the arrangement, International agreed to use reasonable efforts to sell the inventory including providing a sales and marketing plan with projections within 60 days of the closing date and meeting with the consignor quarterly to discuss progress. Once a month, International will pay the consignor an amount equal to the cost base of the inventory sold that month. As of February 28, 2014, International had sold \$343,000 of the consigned inventory.

The financial books of the operation are kept in the functional currency of Canadian dollars and the financial statements are converted to U.S. Dollars for consolidation. When consolidating the financial results of the Company into U.S. Dollars for reporting purposes, the Company uses the All-Current translation method. The All-Current method requires the balance sheet assets and liabilities be translated to U.S. Dollars at the exchange rate as of quarter end. Owner's equity is translated at historical exchange rates and retained earnings are translated at an average exchange rate for the period. Additionally, revenue and expenses are translated at average exchange rates for the periods presented. The resulting cumulative translation adjustment is carried on the balance sheet and distributed among various balance sheet accounts. The Company monitors the amount of the adjustment and considers it to be immaterial.

On September 30, 2013, the Company acquired the assets of Ohio Metal Working Products Company in Canton, Ohio consisting of inventory, equipment, real property, and intangible assets. A new entity was formed, Ohio Metal Working Products/Art's-Way, Inc. ("Metals"). A new segment called Tools was created for financial reporting purposes. Ohio Metal Working Products/Art's-Way, Inc. is a domestic manufacturer and distributor of standard single point brazed carbide tipped tools as well as PCD (polycrystalline diamond) and CBN (cubic boron nitride) inserts and tools. The amount paid for the acquisition totaled approximately \$3,172,000 (\$1,142,000 in inventory, \$1,200,000 in land and building, \$868,000 in fixed assets, and a reduction for assumed vacation liability of \$38,000). The Company has a year to review and assess the purchase price allocation. Upon completion of the review, adjustments will be made if necessary. The acquisition was financed by accessing the line of credit available through U.S. Bank. The acquired assets are not subject to a security interest. We expect to obtain permanent financing for the acquisition in the future. The operating results of the acquired business are reflected in the Company's consolidated statement of operations from the acquisition date forward. The acquisition was made to continue the Company's growth strategy and diversify

its product offerings.

**11) 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 February 28, 2014, and November 30, 2013, 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.



**12) Segment Information**

There are four reportable segments: agricultural products, pressurized vessels, modular buildings and tools. The agricultural products segment fabricates and sells farming products as well as related equipment and replacement parts for these products in the United States and worldwide. The pressurized vessels segment produces and services pressurized tanks. The modular buildings segment manufactures and installs modular buildings for animal containment and various laboratory uses. The tools segment manufactures steel cutting tools and inserts.

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 and Year-to-Date Ended February 28, 2014

	Agricultural Products	Pressurized Vessels	Modular Buildings	Tools	Consolidated
Net Sales from external customers	\$4,441,000	\$424,000	\$461,000	\$911,000	\$6,237,000
Income (loss) from operations	(203,000 )	(31,000 )	(127,000 )	66,000	(295,000 )
Income (loss) before taxes	(240,000 )	(40,000 )	(129,000 )	66,000	(343,000 )
Total Assets	25,019,000	2,687,000	2,572,000	3,488,000	33,766,000
Capital expenditures	412,000	11,000	0	9,000	432,000
Depreciation & Amortization	120,000	27,000	37,000	29,000	213,000

Three Months and Year-to-Date Ended February 28, 2013

Agricultural Products	Pressurized	Modular	Tools	Consolidated
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		Vessels	Buildings		
Net Sales from external customers	\$7,004,000	\$394,000	\$1,017,000	\$ 0	\$8,415,000
Income (loss) from operations	561,000	(123,000 )	275,000	0	713,000
Income (loss) before taxes	1,176,000	(176,000 )	261,000	0	1,261,000
Total Assets	26,697,000	2,707,000	3,328,000	0	32,732,000
Capital expenditures	139,000	4,000	1,000	0	144,000
Depreciation & Amortization	151,000	26,000	22,000	0	199,000

### 13) Subsequent Event

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

## **Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

### **Forward-Looking Statements**

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, 2013. 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,” or 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) our order backlog; (ii) our beliefs regarding the sufficiency of working capital and our continued ability to renew or obtain financing on reasonable terms when necessary; (iii) expected future sales, expenses and operating results; (iv) growth strategy and expected benefits from acquisitions; (v) our ability to capture additional sales and retain repeat customers in Vessels and Scientific; (vi) the impact of recently issued accounting pronouncements; (vii) our expectations concerning our primary capital needs; and (viii) the cyclical nature of the agricultural market and our expectations regarding the strength of certain agricultural markets.

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) the impact of tightening credit markets on our ability to continue to obtain financing on reasonable terms; (ii) our ability to continue to meet debt obligations and comply with financial covenants; (iii) obstacles related to integration of acquired product lines and businesses; (iv) the effect of general economic conditions on the demand for our products and the cost of our supplies and materials; (v) fluctuations in seasonal demand and our production cycle; and (vi) 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 February 28, 2014 have remained unchanged from November 30, 2013. These policies include revenue recognition, inventory valuation, and income taxes. 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, 2013.

## **Results of Operations**

### *Net Sales and Cost of Sales*

Our consolidated corporate sales for the three-month period ended February 28, 2014 were \$6,237,000 compared to \$8,415,000 during the same respective period in 2013, a \$2,178,000, or 25.9%, decrease for the quarter and year-to-date. The agricultural products segment (“Manufacturing”) had a three-month sales decrease of \$2,563,000. The modular buildings segment (“Scientific”) had a three-month sales decrease of \$556,000. The pressurized vessels segment (“Vessels”) had a three-month sales increase of \$30,000. The tools segment (“Metals”) three-month incremental sales amounted to \$911,000.

Consolidated gross profit margin for the first fiscal quarter and year-to-date of 2014 was 21.5% compared to 28.2% during the first fiscal quarter and year-to-date of 2013.

Our fiscal quarter and year-to-date sales at Manufacturing were \$4,441,000, compared to \$7,004,000 during the same period of 2013, a decrease of \$2,563,000, or (36.6%). The year over year decrease in revenue was due to several factors. The colder than average winter had a negative impact on our available labor hours in both quantitative and qualitative terms. While the loss of man hours hurt productivity, the effect on process flow was also disruptive. At the same time this was occurring, fixed overhead remained constant and variable overhead such as energy, etc. increased. As such, there was more overhead to be absorbed and less output to absorb it. While demand is off significantly for sugar beet harvesters, the demand for products serving the dairy and livestock markets is very robust, providing both a significant backlog to fulfill and reason to be optimistic about the rest of the year. In addition, while we were training many new employees to meet the robust dairy and livestock product demand, we took steps to ensure that quality would not suffer. This had the effect of constraining output. Manufacturing's gross margin for the quarter ended February 28, 2014 was 21.7%, compared to 28.0% for the same period in 2013. The gross margin decrease was due to the factors described above.

Our first fiscal quarter and year-to-date sales at Vessels were \$424,000, compared to \$394,000 for the same period in 2013, an increase of \$30,000, or 7.6%. Gross margin for the quarter ended February 28, 2014 was 8.6% compared to (12.5%) for the same period in 2013. Additional sales have been the main contributor to the improved margins.

Our first fiscal quarter and year-to-date sales at Scientific were \$461,000, compared to \$1,017,000 for the same period in fiscal 2013, a decrease of \$556,000, or (54.7%). The decrease was primarily attributable to the 2013 first quarter finalization of an approximately \$7 million fabrication and delivery contract executed in January 2012 and an approximately \$1.7 million installation contract executed in April 2012. Scientific was hired to design, fabricate, and install twenty-four modular units over the course of approximately one year for one of the world's leading research and teaching institutions. Scientific uses percent complete accounting to calculate revenue and gross margins for all contracts. Gross margin for the quarter ended February 28, 2014 was 13.5% compared to 44.9% for the same period in 2013. The margin reported in first fiscal quarter 2013 was a result of the finalization of costs as compared to estimates on the major projects described above and did not reflect normal operating margin for the business. The lower margin for first fiscal quarter 2014 is primarily attributable to the lower revenue relative to steady overhead costs.

Our first fiscal quarter and year-to-date sales at Metals were \$911,000. Gross margin for the quarter ended February 28, 2014 was 30.6%.

### *Expenses*

Our first fiscal quarter and year-to-date consolidated selling expenses were \$536,000 compared to \$490,000 for the same period in 2013. The increase was primarily due to the incremental expenses associated with the Ohio Metals acquisition. Selling expenses as a percentage of sales were 8.6% for the three-month period ended February 28, 2014, compared to 5.8% for the same respective period in 2013.

Consolidated engineering expenses were \$114,000 for the three months ended February 28, 2014, compared to \$103,000 for the same period in 2013. The increase was primarily due to the hiring of engineering staff at the Armstrong, Iowa facility. Engineering expenses as a percentage of sales were 1.8% for the three-month period ended February 28, 2014, compared to 1.2% for the same respective period in 2013.

Consolidated administrative expenses for the three months ended February 28, 2014 were \$986,000 compared to \$1,064,000 for the same period in 2013. The decrease is primarily due to the reduction of bonus accruals offset by the incremental expenses associated with the Ohio Metals acquisition. Administrative expenses as a percentage of sales were 15.8% for the three-month period ended February 28, 2014, compared to 12.6% for the same respective period in 2013.

*Gain/Loss-Asset Disposal*

The Company had been leasing approximately 88 acres of excess land to third parties for farming. In December of 2012, we sold this excess land as 3 separate tracts. Tract 1 was farmland northwest of the Armstrong Manufacturing plant located at 5556 Highway 9 in Armstrong, Iowa. Tract 2 was farmland north of railroad tracks that run on the north side of the Armstrong Manufacturing plant located at 5556 Highway 9 in Armstrong, Iowa. Tract 3 was pasture land east of the Armstrong Manufacturing plant located at 5556 Highway 9 in Armstrong, Iowa. The net gain on the sale of the three parcels totaled \$639,000.

To better utilize our production facilities, our auger production was moved from our Salem, South Dakota facility to our West Union, Iowa production facility in July 2011. The Salem, South Dakota facility was sold in December 2012. An impairment of \$95,000 was recognized in fiscal year 2012 on the production facility due to the Company's carrying value exceeding the bid price. A net loss of \$9,000 was recognized in December 2012, which consisted of the closing costs associated with the sale.

The net gain on the sale of the Salem, South Dakota facility and the three tracts of land in Iowa totaled \$630,000. The gain was recognized in the three-month period ended February 28, 2013.

*Net Income*

Consolidated net loss was (\$258,000) for the three-month period ended February 28, 2014, compared to a net income of \$819,000 for the same respective period in 2013. The decrease is attributable to the 2013 first quarter sale of land described previously and the first quarter 2014 decrease in revenue at Scientific and Manufacturing, offset by higher revenue from Vessels and our new Metals entity.

*Order Backlog*

The consolidated order backlog net of discounts as of March 31, 2014 was \$10,378,000 compared to \$9,603,000 as of March 31, 2013. The increase is primarily due to the demand attributable to the Tools segment and demand for our agricultural equipment offset by lower demand in the beet harvester line at Manufacturing. The agricultural products segment order backlog was \$8,946,000 as of March 31, 2014, compared to \$8,729,000 in fiscal 2013. The backlog for the pressurized vessels segment was \$563,000 as of March 31, 2014, compared to \$765,000 in fiscal 2013. The backlog for the modular buildings segment was \$378,000 as of March 31, 2013, compared to \$109,000 in fiscal 2013. The backlog for the tools segment was \$491,000 as of March 31, 2014. 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 primary sources of funds for the three months ended February 28, 2014 were proceeds from the U.S. Bank Line of Credit and customer deposits; we expect our primary capital needs to relate to costs of production. We have an \$8,000,000 revolving Line of Credit with U.S. Bank, which, as of February 28, 2014, had an outstanding principal balance of \$3,802,810. We drew on this Line of Credit to finance our purchase of Ohio Metal in September 2013, as discussed in Note 10 to the unaudited condensed consolidated financial statements in Part I, Item 1 of this report. The Line of Credit is renewable annually and is scheduled to mature on May 1, 2014.

For additional information about our financing activities, please refer to Note 9 to the audited consolidated financial statements and to the discussion entitled "Liquidity and Capital Resources," each contained in our Annual Report on Form 10-K for the fiscal year ended November 30, 2013, as well as Note 7 to the unaudited condensed consolidated financial statements included in Part I, Item 1 of this Report.



We believe that our current financing arrangements provide sufficient cash to finance operations for the next twelve 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 3. Quantitative and Qualitative Disclosures About Market Risk.**

As a smaller reporting company, we are not required to provide disclosure pursuant to this item.

#### **Item 4. Controls and Procedures.**

##### **Evaluation of Disclosure Controls and Procedures**

The person serving as our principal executive officer and principal financial officer has 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 effective and 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.

## **Changes to Internal Control over Financial Reporting**

There were no changes in our internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

## **PART II – OTHER INFORMATION**

### **Item 1. Legal Proceedings.**

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

### **Item 1A. Risk Factors.**

As a smaller reporting company, we are not required to provide disclosure pursuant to this item.

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

None.

### **Item 3. Defaults Upon Senior Securities.**

None.



**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

On January 31, 2014, the Board of Directors of the Company, upon a recommendation by the Compensation and Stock Option Committee, approved compensation arrangements for fiscal 2014. The arrangements approved by the Board of Directors included annual retainers of \$267,750 and \$89,250 for the Company's Chairman of the Board and Vice Chairman of the Board, respectively, and a base salary of \$157,000 for the Company's Chief Executive Officer, as described in the Company's proxy statement filed with the Securities and Exchange Commission on Schedule 14A on March 25, 2014.

In addition, the Board of Directors of the Company set the maximum cash incentives and objectives for the incentive compensation pool for fiscal year 2014. This pool provides incentive compensation for the Company's Chairman of the Board, Vice Chairman of the Board, Chief Executive Officer, and certain other key employees. Under the approved incentive arrangements, the foregoing individuals will be eligible for maximum cash incentives as follows: Chairman of the Board, \$201,000; Vice Chairman of the Board, \$58,500; and Chief Executive Officer, \$102,700. Each individual has the potential to earn specified levels of incentive compensation, up to the established maximum amounts, upon achievement of growth objectives. The relevant objectives for fiscal year 2014 pertaining to the Chairman and Vice Chairman are earnings per share, increased sales and profit outside of the Company's Manufacturing segment, and capital improvements. The relevant objectives for fiscal year 2014 pertaining to the Chief Executive Officer are related to earnings per share, productivity, on time deliveries and increased sales and profit outside of the Company's Manufacturing segment, timely financial reporting and staff development. These objectives, and the target incentive compensation thresholds and gradations, are based on an analysis of market data conducted by the Compensation and Stock Option Committee, along with consideration of the Company's circumstances and opportunities. They reflect the belief of the Board of Directors and Compensation and Stock Option Committee that defined annual incentives should be closely aligned with financial performance and opportunities for long-term growth.

**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: April 14, 2014 By: /s/ Carrie L. Majeski  
Carrie L. Majeski  
President, Chief Executive Officer and interim  
Chief Financial Officer

**Art's-Way Manufacturing Co., Inc.**

**Exhibit Index**

**Form 10-Q for the Quarterly Period Ended February 28, 2014**

**Exhibit**

<b>No.</b>	<b>Description</b>
31.1	Certificate of Chief Executive Officer and interim Chief Financial Officer pursuant to 17 CFR 13a-14(a) – filed herewith.
32.1	Certificate of Chief Executive Officer and interim Chief Financial Officer 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 consolidated financial statements.