DOUGLAS DYNAMICS, INC
Form 10-Q
November 05, 2013
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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 September 30, 2013

OR

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

For the transition period from to .

Commission file number: 001-34728

DOUGLAS DYNAMICS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**134275891** (I.R.S. Employer Identification No.)

7777 North 73rd Street

Milwaukee, Wisconsin 53223

(Address of principal executive offices) (Zip code)

(414) 354-2310

(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 x 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. (Check one):

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

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 shares of registrant s common shares outstanding as of November 5, 2013 was 22,223,454.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Douglas Dynamics, Inc.

Consolidated Balance Sheets

(In thousands except share data)

	September 30, 2013 (unaudited)	December 31, 2012 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 3,975	$ 24,136
Accounts receivable, net	71,269	25,425
Inventories	35,964	30,292
Refundable income taxes paid	4,328	4,870
Deferred income taxes	3,636	3,710
Prepaid and other current assets	1,568	1,149
Total current assets	120,740	89,582
Property, plant, and equipment, net	24,648	19,887
Assets held for sale	1,085	1,732
Goodwill	112,944	107,222
Other intangible assets, net	125,355	116,548
Deferred financing costs, net	2,360	2,794
Other long-term assets	1,193	606
Total assets	$ 388,325	$ 338,371
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 3,781	$ 5,370
Accrued expenses and other current liabilities	13,652	10,329
Short term borrowings	50,000	
Current portion of long-term debt	971	971
Total current liabilities	68,404	16,670
Retiree health benefit obligation	6,568	6,541
Pension obligation	14,367	14,401
Deferred income taxes	37,073	33,805
Deferred compensation	658	756
Long-term debt, less current portion	110,266	110,995
Other long-term liabilities	5,612	1,471
Stockholders equity:		
	222	221

Common Stock, par value $0.01, 200,000,000 shares authorized, 22,223,454 and 22,130,996 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively				
Additional paid-in capital		134,935		133,072
Retained earnings		16,696		27,523
Accumulated other comprehensive loss, net of tax		(6,476)		(7,084)
Total stockholders equity		145,377		153,732
Total liabilities and stockholders equity	$	388,325	$	338,371

See the accompanying notes to consolidated financial statements

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Douglas Dynamics, Inc.

Consolidated Statements of Operations and Comprehensive Income

(In thousands, except share and per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
	(unaudited)		(unaudited)	
Net sales	$ 52,026	$ 37,774	$ 121,323	$ 111,833
Cost of sales	36,982	26,208	83,075	75,387
Gross profit	15,044	11,566	38,248	36,446
Selling, general, and administrative expense	10,733	5,051	22,740	15,388
Intangibles amortization	1,447	1,300	4,142	3,901
Impairment of assets held for sale			647	
Income from operations	2,864	5,215	10,719	17,157
Interest expense, net	(2,130)	(2,080)	(6,190)	(6,304)
Other expense, net	(40)	(44)	(117)	(277)
Income before taxes	694	3,091	4,412	10,576
Income tax expense	91	745	1,304	3,525
Net income	$ 603	$ 2,346	$ 3,108	$ 7,051
Less net income attributable to participating securities	9	19	45	51
Net income attributable to common shareholders	$ 594	$ 2,327	$ 3,063	$ 7,000
Weighted average number of common shares outstanding:				
Basic	22,053,555	21,922,173	22,021,226	21,885,301
Diluted	22,080,037	21,979,015	22,061,713	21,958,473
Earnings per common share:				
Basic	$ 0.03	$ 0.11	$ 0.14	$ 0.32
Diluted	$ 0.02	$ 0.10	$ 0.13	$ 0.31
Cash dividends declared and paid per share	$ 0.21	$ 0.21	$ 0.62	$ 0.62
Comprehensive income	$ 802	$ 2,371	$ 3,716	$ 7,064

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Consolidated Statements of Cash Flows

(in thousands)

	Nine Months Ended September 30, 2013 (unaudited)	Nine Months Ended September 30, 2012 (unaudited)
Operating activities		
Net income	$ 3,108	$ 7,051
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	6,400	5,998
Amortization of deferred financing costs and debt discount	568	763
Loss recognized on impairment of assets held for sale	647	
Stock-based compensation	2,024	1,700
Provision for losses on accounts receivable	163	208
Deferred income taxes	3,342	3,631
Earnout liability	3,814	
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(45,403)	(36,867)
Inventories	(1,542)	(6,375)
Prepaid and other assets and prepaid income taxes	(423)	(2,145)
Accounts payable	(2,369)	(2,939)
Accrued expenses and other current liabilities	2,177	(5,429)
Deferred compensation	(156)	(156)
Benefit obligations and other long-term liabilities	928	(533)
Net cash used in operating activities	(26,722)	(35,093)
Investing activities		
Capital expenditures	(1,747)	(1,083)
Proceeds from sale of equipment		80
Acquisition of Trynex	(26,734)	
Net cash used in investing activities	(28,481)	(1,003)
Financing activities		
Shares withheld on restricted stock vesting paid for employees taxes	(160)	
Dividends paid	(13,935)	(13,631)
Revolver borrowings	50,000	23,000
Repayment of long-term debt	(863)	(10,863)
Net cash provided by (used in) financing activities	35,042	(1,494)
Change in cash and cash equivalents	(20,161)	(37,590)
Cash and cash equivalents at beginning of period	24,136	39,432
Cash and cash equivalents at end of period	$ 3,975	$ 1,842

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Notes to Unaudited Consolidated Financial Statements

(in thousands except share and per share data)

1. Basis of presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the financial statements and related footnotes included in our 2012 Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission on March 12, 2013.

We operate as a single business unit.

Interim Consolidated Financial Information

The accompanying consolidated balance sheet as of September 30, 2013 and the consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2013 and 2012 and cash flows for the nine months ended September 30, 2013 and 2012 have been prepared by the Company and have not been audited.

The Company is a counterparty to an interest-rate swap agreement to hedge against the potential impact on earnings from increases in market interest rates. Under the interest rate swap agreement, effective as of July 18, 2011 the Company either receives or makes payments on a monthly basis based on the differential between 6.335% and LIBOR plus 4.25% (with a LIBOR floor of 1.5%). The negative fair value of the interest rate swap, net of tax, of ($224) at September 30, 2013 is included in Accumulated other comprehensive loss on the balance sheet. This fair value was determined using Level 2 inputs as defined in Accounting Standards Codification Topic (ASC) 820. The interest rate swap contract on $50,000 notional amount of the term loan expires in December 2014. Additionally, other comprehensive income (loss) includes the net income of the Company plus the Company s adjustments for its defined benefit retirement plans based on the measurement date as of the Company s year-end. For further disclosure, refer to Note 14 to the Unaudited Consolidated Financial Statements.

The Company s business is seasonal and consequently its results of operations and financial condition vary from quarter-to-quarter. Because of this seasonality, the Company s results of operations for any quarter may not be indicative of results of operations that may be achieved for a subsequent quarter or the full year, and may not be similar to results of operations experienced in prior years. The Company attempts to manage the seasonal impact of snowfall on its revenues in part through its pre-season sales program. This pre-season sales program encourages the Company s distributors to re-stock their inventory during the second and third quarters in anticipation of the peak fourth quarter retail sales period by offering favorable pre-season pricing and payment deferral until the fourth quarter. Thus, the Company tends to generate its greatest volume of sales during the second and third quarters. By contrast, its revenue and operating results tend to be lowest during the first quarter, as management believes the Company s end-users prefer to wait until the beginning of a snow season to purchase new equipment and as the Company s distributors sell off inventory and wait for the pre-season sales incentive period to re-stock inventory. Fourth quarter sales vary from year-to-year as they are primarily driven by the level, timing and location of snowfall during the quarter. This is because most of the Company s fourth quarter sales and shipments consist of re-orders by distributors seeking to restock inventory to meet immediate customer needs caused by snowfall during the winter months.

On May 6, 2013, the Company acquired substantially all of the assets of Trynex, Inc. (Trynex). The acquired assets include Trynex s full line of product offerings, including its SnowEx, TurfEx and SweepEx brands, and access to Trynex s network of authorized dealers. All intercompany balances and transactions have been eliminated in consolidation. For further information related to the acquisition, refer to Note 15 to the Unaudited Consolidated Financial Statements.

2. Fair Value

Fair value is the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability s fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Fair value measurements are categorized into one of three levels based on the lowest level of significant input used: Level 1 (unadjusted quoted prices in active markets); Level 2 (observable market inputs available at the measurement date, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data).

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The following table presents financial assets and liabilities measured at fair value on a recurring basis and discloses the fair value of long-term debt:

	Fair Value at September 30, 2013	Fair Value at December 31, 2012
Assets:		
Other long-term assets (a)	$ 1,076	$ 491
Total Assets	$ 1,076	$ 491
Liabilities:		
Long term debt (b)	$ 111,237	$ 110,566
Other long-term liabilities-		
Earnout - Trynex (c)	3,587	
Interest rate swaps (d)	350	544
Total Liabilities	$ 115,174	$ 111,110

(a) Included in other assets is the cash surrender value of insurance policies on various individuals that are associated with the Company. The carrying amounts of these insurance policies approximates their fair value.

(b) The fair value of the Company s long-term debt, including current maturities, is estimated using discounted cash flows based on the Company s current incremental borrowing rates for similar types of borrowing arrangements, which is a Level 2 input for all periods presented. Meanwhile, long-term debt is recorded at carrying amount, net of discount, as disclosed on the face of the balance sheet.

(c) Included in other long term liabilities is an obligation for a portion of the potential earn out incurred in conjunction with the acquisition of substantially all of Trynex s assets. The carrying amount of the earn out approximates its fair value. Fair value is based upon Level 3 inputs of a monte carlo simulation analysis using key inputs of forecasted future sales and financial performance as well as a growth rate reduced by the market required rate of return. See reconciliation of liability included below:

	September 30, 2013
Beginning Balance	$
Additions	3,587
Adjustments to fair value	
Ening balance	$ 3,587

(d) Valuation models are calibrated to initial trade price. Subsequent valuations are based on observable inputs to the valuation model (e.g. interest rates and credit spreads). Model inputs are changed only when corroborated by market data. A credit risk adjustment is made on each swap using observable market credit spreads. Thus, inputs used to determine fair value of the interest rate swap are Level 2 inputs.

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3. Inventories

Inventories consist of the following:

	September 30, 2013	December 31, 2012
Finished goods and work-in-process	$ 32,351	$ 29,119
Raw material and supplies	3,613	1,173
	$ 35,964	$ 30,292

4. Property, plant and equipment

Property, plant and equipment are summarized as follows:

	September 30, 2013	December 31, 2012
Land	$ 1,160	$ 960
Land improvements	2,677	1,768
Buildings	15,852	12,852
Machinery and equipment	25,717	24,286
Furniture and fixtures	8,222	7,465
Mobile equipment and other	1,267	1,138
Construction-in-process	740	351
Total property, plant and equipment	55,635	48,820
Less accumulated depreciation	(30,987)	(28,933)
Net property, plant and equipment	$ 24,648	$ 19,887

5. Long-Term Debt

Long-term debt is summarized below:

	September 30, 2013	December 31, 2012
Term Loan, net of debt discount of $813 and $946 at September 30,	$ 111,237	$ 111,966

2013 and December 31, 2012, respectively				
Less current maturities		971		971
	$	110,266	$	110,995

The Company s senior credit facilities consist of a $125,000 term loan facility and an $80,000 revolving credit facility with a group of banks. The agreement for the term loan (the Term Loan Credit Agreement) provides for a senior secured term loan facility in the aggregate principal amount of $125,000 and generally bears interest at (at the Company s election) either (i) 3.25% per annum plus the greatest of (a) the Prime Rate (as defined in the Term Loan Credit Agreement) in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) 1.00% plus the greater of (1) the London Interbank Offered Rate for a one month interest period multiplied by the Statutory Reserve Rate (as defined in the Term Loan Credit Agreement) and (2) 1.50% or (ii) 4.25% per annum plus the greater of (a) the London Interbank Offered Rate for the applicable interest period multiplied by the Statutory Reserve Rate and (b) 1.50%. The revolving credit facility provides that the Company has the option to select whether borrowings will bear interest at either (i) 1.75% per annum plus the London Interbank Offered Rate for the applicable interest period multiplied by the Statutory Reserve Rate or (ii) 1.25% per annum plus the greatest of (a) the Prime Rate in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) the London Interbank Offered Rate for a one month interest period multiplied by the Statutory Reserve Rate plus 1%. The maturity date for the Company s revolving credit facility is April 17, 2017, and the Company s term loan amortizes in nominal amounts quarterly with the balance payable on April 18, 2018.

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The term loan was issued at a $1,250 discount which is being amortized over the term of the term loan.

At September 30, 2013, the Company had $50,000 in outstanding borrowings on the revolving credit facility and remaining borrowing availability of $24,288.

The Company s senior credit facilities include certain negative and operating covenants, including restrictions on its ability to pay dividends, and other customary covenants, representations and warranties and events of default. The senior credit facilities entered into and recorded by the Company s subsidiaries significantly restrict its subsidiaries from paying dividends and otherwise transferring assets to Douglas Dynamics, Inc. The terms of the Company s revolving credit facility specifically restrict subsidiaries from paying dividends if a minimum availability under the revolving credit facility is not maintained, and both senior credit facilities restrict subsidiaries from paying dividends above certain levels or at all if an event of default has occurred. These restrictions would affect the Company indirectly since the Company relies principally on distributions from its subsidiaries to have funds available for the payment of dividends. In addition, the Company s revolving credit facility includes a requirement that, subject to certain exceptions, capital expenditures may not exceed $10,000 in any calendar year and, if certain minimum availability under the revolving credit facility is not maintained, that the Company comply with a monthly minimum fixed charge coverage ratio test of 1.0:1.0. Compliance with the fixed charge coverage ratio test is subject to certain cure rights under the Company s revolving credit facility. At September 30, 2013, the Company was in compliance with the respective covenants. The credit facilities are collateralized by substantially all assets of the Company.

In accordance with the senior credit facilities, the Company is required to make additional principal prepayments over the above scheduled payments under certain conditions. This includes, in the case of the term loan facility, 100% of the net cash proceeds of certain asset sales, certain insurance or condemnation events, certain debt issuances, and, within 150 days of the end of the fiscal year, 50% of excess cash flow, as defined, including a deduction for certain distributions (which percentage is reduced to 25% or 0% upon the achievement of certain leverage ratio thresholds), for any fiscal year. Excess cash flow is defined in the senior credit facilities as consolidated adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) plus a working capital adjustment less the sum of repayments of debt and capital expenditures subject to certain adjustments, interest and taxes paid in cash, management fees and certain restricted payments (including dividends or distributions). Working capital adjustment is defined in the senior credit facilities as the change in working capital, defined as current assets excluding cash and cash equivalents less current liabilities excluding current portion of long term debt. As of September 30, 2013, the Company was not required to make an excess cash flow payment.

Each of the senior secured facilities includes a hedge provision, which required the Company to enter into an interest rate hedge commencing 90 days after the closing date. The hedging provision requires the Company to hedge the interest rate on at least 25% of the aggregate outstanding principal amount of the term loans. The purpose of the interest rate swap is to reduce the Company s exposure to interest rate volatility. Effective June 20, 2011, the Company entered into an interest rate swap agreement with a notional amount of $50,000. The interest rate swap negative fair value at September 30, 2013 of $350 is included in other long-term liabilities on the Consolidated Balance Sheet. The Company has counterparty credit risk resulting from the interest rate swap, which it monitors on an on-going basis. This risk lies with one global financial institution. Under the interest rate swap agreement, effective as of July 18, 2011, the Company either receives or makes payments on a monthly basis based on the differential between 6.335% and LIBOR plus 4.25% (with a LIBOR floor of 1.5%). The interest rate swap contract on the term loan expires in December 2014.

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other liabilities are summarized as follows:

	September 30, 2013	December 31, 2012
Payroll and related costs	$ 2,948	$ 1,429
Employee benefits	3,122	2,731
Accrued warranty	3,881	3,628
Other	3,701	2,541
	$ 13,652	$ 10,329

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7. Warranty Liability

The Company accrues for estimated warranty costs as sales are recognized and periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. The Company s warranties generally provide, with respect to its snow and ice control equipment, that all material and workmanship will be free from defect for a period of two years after the date of purchase by the end-user, and with respect to its parts and accessories purchased separately, that such parts and accessories will be free from defect for a period of one year after the date of purchase by the end-user. Certain snowplows only provide for a one year warranty. The Company determines the amount of the estimated warranty costs (and its corresponding warranty reserve) based on the Company s prior five years of warranty history utilizing a formula driven by historical warranty expense and applying management s judgment. The Company adjusts its historical warranty costs to take into account unique factors such as the introduction of new products into the marketplace that do not provide a historical warranty record to assess. The warranty reserve is included in Accrued Expenses and Other Current Liabilities in the accompanying consolidated balance sheets.

The following is a rollforward of the Company s warranty liability:

	Three months ended		Nine months ended	
	September 30, 2013	**September 30, 2012**	**September 30, 2013**	**September 30, 2012**
Balance at the beginning of the period	$ 3,568	$ 3,965	$ 3,628	$ 4,188
Establish warranty provision for Trynex			600	
Warranty provision	375	293	1,018	1,066
Claims paid/settlements	(62)	(85)	(1,365)	(1,081)
Balance at the end of the period	$ 3,881	$ 4,173	$ 3,881	$ 4,173

8. Employee Retirement Plans

The components of net periodic pension cost consist of the following:

	Three months ended		Nine months ended	
	September 30, 2013	**September 30, 2012**	**September 30, 2013**	**September 30, 2012**
Component of net periodic pension cost:				
Service cost	$ 62	$ 67	$ 185	$ 201
Interest cost	362	370	1,087	1,110
Expected return on plan assets	(352)	(318)	(1,057)	(954)

Amortization of net loss	302	192	905	576
Net periodic pension cost	$ 374	$ 311	$ 1,120	$ 933

The Company estimates its total required minimum contributions to its pension plans in 2013 will be $828. Through September 30, 2013, the Company has made $584 of cash contributions to the pension plans versus $2,014 through the same period in 2012.

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Components of net periodic other postretirement benefit cost consist of the following:

	Three months ended		Nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Components of net periodic other postretirement benefit cost				
Service cost	$ 63	$ 70	$ 188	$ 210
Interest cost	61	90	184	270
Amortization of net gain	(43)	(4)	(129)	(12)
Net periodic other postretirement benefit cost	$ 81	$ 156	$ 243	$ 468

9. Earnings per Share

Basic earnings per share of common stock is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed by dividing net income by the weighted average number of common shares and common stock equivalents related to the assumed exercise of stock options, using the two-class method. Stock options for which the exercise price exceeds the average fair value have an anti-dilutive effect on earnings per share and are excluded from the calculation.

As restricted shares and restricted stock units both participate in dividends, in accordance with ASC 260, the Company has calculated earnings per share pursuant to the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends.

	Three months ended		Nine months ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
Basic earnings per common share				
Net income	$ 603	$ 2,346	$ 3,108	$ 7,051
Less income allocated to participating securities	9	19	45	51
Net income allocated to common shareholders	$ 594	$ 2,327	$ 3,063	$ 7,000
Weighted average common shares outstanding	22,053,555	21,922,173	22,021,226	21,885,301
	$ 0.03	$ 0.11	$ 0.14	$ 0.32

Earnings per common share assuming dilution								
Net income	$	603	$	2,346	$	3,108	$	7,051
Less income allocated to participating securities		9		19		45		51
Net income allocated to common shareholders	$	594	$	2,327	$	3,063	$	7,000
Weighted average common shares outstanding		22,053,555		21,922,173		22,021,226		21,885,301
Incremental shares applicable to stock based compensation		26,482		56,842		40,487		73,172
Weighted average common shares assuming dilution		22,080,037		21,979,015		22,061,713		21,958,473
	$	0.02	$	0.10	$	0.13	$	0.31

10. Employee Stock Plans

Amended and Restated 2004 Stock Incentive Plan

As of September 30, 2013, 37,240 shares of common stock are reserved for issuance upon the exercise of outstanding options under the Company s Amended and Restated 2004 Stock Incentive Plan (the A&R 2004 Plan). All outstanding options are fully vested. All options expire 10 years from the date of grant. No further awards are permitted to be issued under the A&R 2004 Plan.

There were no stock options exercised with respect to the Company s stock under the A&R 2004 Plan for either the three or nine months ended September 30, 2013.

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2010 Stock Incentive Plan

In May 2010, the Company s Board of Directors and stockholders adopted the 2010 Stock Incentive Plan (the 2010 Plan). The 2010 Plan provides for the issuance of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock awards and restricted stock units, any of which may be performance-based, and for incentive bonuses, which may be paid in cash or stock or a combination of both, to eligible employees, officers, non-employee directors and other service providers to the Company and its subsidiaries. A maximum of 2,130,000 shares of common stock may be issued pursuant to all awards under the 2010 Plan.

Restricted Stock Share Awards

A summary of restricted stock activity for the nine months ended September 30, 2013 is as follows:

	Shares (In thousands)		Weighted Average Grant Date Fair value	Weighted Average Remaining Contractual Term
Unvested at December 31, 2012	208,823	$	12.63	1.94 years
Granted	44,022	$	14.78	2.25 years
Vested	(82,942)	$	12.97	
Cancelled and forfeited				
Unvested at September 30, 2013	169,903	$	13.03	1.59 years
Expected to vest in the future at September 30, 2013	163,786	$	13.03	1.59 years

The fair value of the Company s restricted stock awards is the closing stock price on the date of grant. The Company recognized $264 and $832 of compensation expense related to restricted stock awards granted for the three and nine months ended September 30, 2013, respectively. The unrecognized compensation expense calculated under the fair value method for shares expected to vest as of September 30, 2013 was approximately $1,483 and is expected to be recognized over a weighted average period of 1.59 years.

Performance Share Unit Awards

The Company granted performance share units as performance based awards under the 2010 Plan in the first quarter of 2013 that are subject to performance conditions. Upon meeting the prescribed performance conditions, in the first quarter of the year subsequent to grant, employees will be issued restricted stock units (RSUs) that will be subject to vesting over the two years following the end of the performance period. In accordance with ASC 718, such awards are being expensed over the vesting period from the date of grant through the requisite service period, based upon the most probable outcome. The fair value per share of the awards is the closing stock price on the date of grant, which was $14.40. The Company recognized $230 and $410 of compensation expense related to the awards in the three and nine months ended September 30, 2013, respectively. The unrecognized compensation expense calculated under the fair value method for shares that were, as of September 30, 2013, expected to be earned through the requisite service period was approximately $613 and is expected to be recognized through 2016.

Restricted Stock Unit Awards

RSUs are granted to both non-employee directors and management. Prior to 2013, RSUs were only issued to directors, however, in 2013, the Company changed the timing and form of management s annual stock grants. For both management and non-employee directors, RSUs carry dividend equivalent rights but do not carry voting rights. Each RSU represents the right to receive one share of the Company s common stock and is subject to time based vesting restrictions. Participants are not required to pay any consideration to the Company at either the time of grant of a RSU or upon vesting.

The Company s compensation committee approved a retirement provision for RSUs issued to management. The retirement provision provides that members of management who either (1) are age 65 or older or (2) have at least ten years of service and are at least age 55 will continue to vest in unvested RSUs upon retirement. As the retirement provision does not qualify as a substantive service condition, the Company incurred $261 in additional expense in the first quarter of 2013 as a result of accelerated stock based compensation expense for employees who meet the thresholds of the retirement provision. The Company s nominating and governance committee approved a retirement provision for the RSUs issued to non-employee directors that accelerates the vesting of such RSUs upon retirement. Such awards are fully expensed immediately upon grant in accordance with ASC 718, as the retirement provision eliminates substantive service conditions associated with the awards.

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A summary of RSU activity for the nine months ended September 30, 2013 is as follows:

	Shares (In thousands)		Weighted Average Grant Date Fair value	Weighted Average Remaining Contractual Term
Unvested at December 31, 2012	26,046	$	14.73	0.72 years
Granted	70,324	$	14.52	1.01 years
Vested	(53,022)	$	14.68	
Cancelled and forfeited				
Unvested at September 30, 2013	43,348	$	14.46	1.81 years
Expected to vest in the future at September 30, 2013	41,721	$	14.46	1.81 years

The Company recognized $70 and $782 of compensation expense related to the RSU awards in the three and nine months ended September 30, 2013, respectively. The unrecognized compensation expense, net of expected forfeitures, calculated under the fair value method for shares that were, as of September 30, 2013, expected to be earned through the requisite service period was approximately $427 and is expected to be recognized through 2016.

Vested director RSUs are settled by the delivery to the participant or a designated brokerage firm of one share of common stock per vested RSU as soon as reasonably practicable following a termination of service of the participant that constitutes a separation from service, and in all events no later than the end of the calendar year in which such termination of service occurs or, if later, two and one-half months after such termination of service. Vested management RSUs are settled by the delivery to the participant or a designated brokerage firm of one share of common stock per vested RSU as soon as reasonably practicable following vesting.

11. Commitments and Contingencies

In the ordinary course of business, the Company is engaged in various litigation including product liability and intellectual property disputes. However, the Company does not believe that any pending litigation will have a material adverse effect on its consolidated financial position. In addition, the Company is not currently a party to any environmental-related claims or legal matters.

12. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The largest item affecting deferred taxes is the difference between book and tax amortization of goodwill and other intangibles amortization. The Company estimates that the annual effective tax rate for 2013 will be approximately 38%. The Company s effective tax rate was 13.1% and 24.1% for the three months ended September 30, 2013 and 2012,

respectively. The effective tax rate for the three months ended September 30, 2013 was lower than corresponding period in 2012 due to changes triggered by the TrynEx acquisition, including changes in apportionment of certain discrete period items among various taxing jurisdictions.
The Company s effective tax rate for the nine months ended September 30, 2013 and 2012 was 29.6% and 33.3%, respectively The effective rate for the nine months ended September 30, 2013 was lower than the corresponding period in 2012 due to tax benefits related to the inability to utilize a 2012 federal research and development credit until 2013 due to delayed legislation. In addition, the effective tax rate for the nine months ended September 30, 2012 incorporated state valuation allowance adjustments that did not recur in 2013.

13. Impairment of Assets Held For Sale

During the first quarter of 2013, the Company lowered the asking price for its assets held for sale. The Company recorded assets held for sale on its balance sheet in conjunction with the closure of the Johnson City, Tennessee location in 2010. The land and building have been held for sale since the closure. In an effort to stimulate sales activity, the Company lowered the listed sale price which caused the Company to reassess the fair value of the assets held for sale. The Company valued the fair value of the assets held for sale based upon Level 2 market price inputs for similar assets. The Company used comparable properties sold and held for sale in the Johnson City, TN industrial real estate market to determine an appropriate fair value. Consequently, the Company incurred a $647 loss recognized on the impairment of assets held for sale and is included in Impairment of assets held for sale on the Consolidated Statements of Operations and Comprehensive Income.

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14. Changes in Accumulated Other Comprehensive Loss by Component

Changes to accumulated other comprehensive loss by component for the nine months ended September 30, 2013 are as follows:

	(dollars in thousands)			
	Unrealized Net Loss on Interest Rate Swap	Retiree Health Benefit Obligation	Pension Obligation	Total
Balance at December 31, 2012	$ (344)	$ 1,063	$ (7,803)	$ (7,084)
Other comprehensive earnings (loss) before reclassifications	(20)			(20)
Amounts reclassified from accumulated other comprehensive loss: (1)	140	(81)	569	628
Balance at September 30, 2013	$ (224)	$ 982	$ (7,234)	$ (6,476)

(1) Amounts reclassified from accumulated other comprehensive loss:	
Amortization of Other Postretirement Benefit items:	
Actuarial gains	(129)
Tax expense	48
Reclassification net of tax	$ (81)
Amortization of pension items:	
Actuarial losses	$ 905
Tax benefit	(336)
Reclassification net of tax	$ 569
Realized losses on interest rate swaps reclassified to interest expense	222
Tax benefit	(82)
Reclassification net of tax	$ 140

15. Acquisition

On May 6, 2013, the Company acquired substantially all of the assets of Trynex for the purpose of expanding its current market presence in the snow and ice segment. Total consideration paid was $26,734 including an estimated working capital adjustment. The acquisition was financed with $28,000 of revolver borrowings under the Company s credit facility discussed in Note 5. The Company incurred $1,180 of transaction expenses related to this acquisition that are included in selling, general and administrative expense in the Consolidated Statements of Operations and Comprehensive Income.

The Trynex purchase agreement includes contingent consideration in the form of an earnout capped at $7,000. Under the earnout the former owners of Trynex are entitled to receive payments contingent upon the revenue growth and financial performance of the acquired business for the years 2014, 2015 and 2016. On August 5, 2013, the purchase agreement was amended to remove the requirement that the former owners of Trynex remain employed in the 2014 and 2015 performance periods, resulting in recognition of the fair value of the contingent consideration for 2014 and 2015 of $3,587 during the three months ended September 30, 2013. The requirement of continued employment remains in place for the 2016 performance period.

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The following table summarizes the preliminary allocation of the purchase price paid to the fair value of the net assets acquired as of the acquisition date:

Accounts receivable		604
Inventories		4,130
Other current assets		29
Property and equipment		5,272
Goodwill		5,722
Intangible assets		12,960
Accounts payable and other liabilities		(1,983)
Total	$	26,734

The goodwill for the acquisition is a result of acquiring and retaining the existing workforces and expected synergies from integrating the operations into the Company. Due to the limited amount of time since the acquisition of substantially all of the assets of Trynex, the initial purchase price allocation is preliminary as of September 30, 2013 as the Company has not completed its analysis of the fair value of inventories, property and equipment, intangible assets and income tax liabilities. The Company expects to be able to deduct amortization of goodwill for income tax purposes over a fifteen-year period.

The acquisition was accounted for under the purchase method, and accordingly, the results of operations are included in the Company s financial statements from the date of acquisition. From the date of acquisition through September 30, 2013, the Trynex assets contributed $5,072 of revenues and ($4,596) of pre-tax operating losses, including $4,369 of certain purchase accounting expenses, related to the Company.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes which are included in Item 1 of this Quarterly Report on Form 10-Q, as well as the information contained in our Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission.

In this Quarterly Report on Form 10-Q, unless the context indicates otherwise: Douglas Dynamics, the Company, we, our, or us refer to Douglas Dynamics, Inc.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These statements include information relating to future events, product demand, the payment of dividends, future financial performance, strategies, expectations, competitive environment, regulation and availability of financial resources. These statements are often identified by use of words such as anticipate, believe, intend, estimate, expect, continue, should, could, may, plan, project, predict, will and similar expressions and include references to assumptions and relate to our future prospects, developments and business strategies. Such statements involve known and unknown risks, uncertainties and other factors that could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to: (i) weather conditions, particularly lack of or reduced levels of snowfall and timing of such snowfall; (ii) a significant decline in economic conditions; (iii) our inability to maintain good relationships with our distributors; (iv) lack of available or favorable financing options for our end-users or distributors; (v) increases in the price of steel or other materials necessary for the production of our products that cannot be passed on to our distributors; (vi) increases in the price of fuel; (vii) the inability of our suppliers to meet our volume or quality requirements; (viii) inaccuracies in our estimates of future demand for our products; (ix) our inability to protect or continue to build our intellectual property portfolio; (x) the effects of laws and regulations and their interpretations on our business and financial condition; (xi) our inability to develop new products or improve upon existing products in response to end-user needs; (xii) losses due

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to lawsuits arising out of personal injuries associated with our products; (xiii) factors that could impact the future declaration and payment of dividends; (xiv) our inability to compete effectively against our competitors; (xv) our inability to achieve the projected financial performance with the Trynex assets; and (xvi) unexpected costs or liabilities related to the acquisition of the Trynex assets, as well as those discussed in the sections entitled Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q, if any, or in our most recent Annual Report on Form 10-K. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. In addition, the forward-looking statements in this Quarterly Report on Form 10-Q speak only as of the date hereof and we undertake no obligation, except as required by law, to update or release any revisions to any forward-looking statement, even if new information becomes available in the future.

Results of Operations

Overview

During the three months ended September 30, 2013 and 2012, we sold 13,434 and 9,518 units of snow and ice control equipment, respectively, and during the nine months ended September 30, 2013 and 2012 we sold 29,684 and 27,618 units of snow and ice control equipment, respectively. The following table shows our sales of snow and ice control equipment and related parts and accessories as a percentage of net sales for the three and nine months ended September 30, 2013 and 2012.

	Three months ended		**Nine months ended**	
	September 30, 2013	**September 30, 2012**	**September 30, 2013**	**September 30, 2012**
Equipment	91%	91%	86%	89%
Parts and accessories	9%	9%	14%	11%

The following table sets forth, for the three and nine months ended September 30, 2013 and 2012, the consolidated statements of operations of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the table below and throughout this Management s Discussion and Analysis of Financial Condition and Results of Operations, consolidated statements of operations data for the three and nine months ended September 30, 2013 and 2012 have been derived from our unaudited consolidated financial statements. The information contained in the table below should be read in conjunction with our unaudited consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q.

	Three Months Ended		**Nine Months Ended**	
	September 30, 2013	**September 30, 2012**	**September 30, 2013**	**September 30, 2012**
	(unaudited) (in thousands)		**(unaudited) (in thousands)**	
Net sales	$ 52,026	$ 37,774	$ 121,323	$ 111,833
Cost of sales	36,982	26,208	83,075	75,387
Gross profit	15,044	11,566	38,248	36,446
Selling, general, and administrative expense	10,733	5,051	22,740	15,388

Intangibles amortization		1,447		1,300		4,142		3,901
Impairment of assets held for sale						647		
Income from operations		2,864		5,215		10,719		17,157
Interest expense, net		(2,130)		(2,080)		(6,190)		(6,304)
Other expense, net		(40)		(44)		(117)		(277)
Income before taxes		694		3,091		4,412		10,576
Income tax expense		91		745		1,304		3,525
Net income	$	603	$	2,346	$	3,108	$	7,051

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The following table sets forth for the three and nine months ended September 30, 2013 and 2012, the percentage of certain items in our consolidated statement of operations, relative to net sales:

	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
	(unaudited)		(unaudited)	
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	71.1%	69.4%	68.5%	67.4%
Gross profit	28.9%	30.6%	31.5%	32.6%
Selling, general, and administrative expense	20.6%	13.4%	18.8%	13.8%
Intangibles amortization	2.8%	3.4%	3.4%	3.5%
Impairment of assets held for sale	0.0%	0.0%	0.5%	0.0%
Income from operations	5.5%	13.8%	8.8%	15.3%
Interest expense, net	(4.1)%			