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ARTS WAY MANUFACTURING CO INC  
Form 10KSB  
February 28, 2006

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

FORM 10-KSB

(Mark one)

Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended November 30, 2005

Transition report under 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.  
(Name of Small Business Issuer In Its Charter)

DELAWARE

42-0920725

\_\_\_\_\_  
(State or Other Jurisdiction of  
Incorporation or Organization)

\_\_\_\_\_  
(I.R.S. Employee Identification No.)

5556 Highway 9  
Armstrong, Iowa

50514

\_\_\_\_\_  
(Address of Principal  
Executive Offices)

\_\_\_\_\_  
(Zip Code)

(712) 864-3131

(Issuer's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common stock \$.01 par value

Check whether the issuer is not required to file reports pursuant to Section 13 on 15(d) of the Exchange Act.

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this form 10-KSB.

Indicate by check mark whether the registrant is a shell company ( as

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defined in Rule 12b-2 of the Exchange Act). Yes  No

State issuer's revenues, for its most recent fiscal year: \$14,618,904.

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity as of a specified date written the past 60 days: \$12,564,326. As of February 10, 2006.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practical date: As of February 3, 2006, there were 1,963,176 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Definitive Proxy Statement for the registrant's 2006 Annual Meeting of Stockholders to be filed within 120 days of November 30, 2005, are incorporated by reference into Part III of this Form 10-KSB.

Transitional Small Business Issuer Forecast (check one): Yes  No

### Art's-Way Manufacturing Co., Inc. and Subsidiary Index to Annual Report on Form 10-KSB

|   | Page      |
|---|-----------|
| Part I  |           |
| Item 1 - Description of Business  | 4 thru 6  |
| Item 2 - Description of Property  | 6         |
| Item 3 - Legal Proceedings  | 7         |
| Item 4 - Submission of Matters to a Vote of<br>Security Holders                                     | 7         |
| Part II   |           |
| Item 5 - Market for Common Equity and Related<br>Stockholder Matters                                | 8         |
| Item 6 - Management's Discussion and Analysis or<br>Plan of Operation                               | 9 thru 14 |
| Item 7 - Financial Statements   | 14        |
| Item 8 - Changes in and Disagreements with<br>Accountants on Accounting and<br>Financial Disclosure | 15        |
| Item 8A - Controls and Procedures   | 15        |
| Item 8B - Other Information   | 15        |
| Part III  |           |
| Item 9 - Directors and Executive Officers of<br>the Registrant                                      | 16        |
| Item 10 - Executive Compensation  | 16        |

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|  |    |
|--|----|
| Item 11 - Security Ownership of Certain Beneficial Owners and Management And Related Stockholder Markets | 16 |
| Item 12 - Certain Relationships and Related Transactions   | 16 |
| Item 13 - Exhibits   | 16 |
| Item 14 - Principal Accountant Fees & Services   | 16 |

### PART I

#### Item 1. Description of Business

##### (a) Business Development

Art's-Way Manufacturing Co., Inc. began operations as a farm equipment manufacturer in 1956. Our manufacturing plant is located in Armstrong, Iowa.

On July 28, 2003, we purchased the assets of Obeco, Inc., a manufacturer of steel truck bodies located in Cherokee, Iowa, and changed the name to Cherokee Truck Bodies, Inc. The purchase included all inventory, intellectual materials, machinery, tooling, fixtures and the company name. We also acquired the real estate loan in the amount of \$165,725.

In May 2004, we moved the Cherokee Truck Bodies operation from Cherokee Iowa, to the facility in Armstrong. The move reduced overhead significantly and enables us to focus on sales growth.

In August 2004, we delivered our new 6812 Sugar Beet Harvester. Sales were strong, as we introduced the industry's only 12 row harvester. End users were excited about the overall performance. In 2006 we will again bring an updated model to market to enhance customer satisfaction.

In November 2004, we launched a second new product offering, our 5165 Grinder Mixer, with faster cycle times and increased capacity. Sales exceeded our expectations.

We continue to focus our efforts in research and design. In 2005 we saw sales of our feed processing equipment double, with the November 2004 introduction of our new model 5165 Grinder Mixer. The sugar beet industry is still excited about our model 6812 which we continue to enhance with each new model year.

During the 2005 beet harvesting season we field tested a new single pass defoliator; we project that this product will be in production and in the field for the 2006 beet harvest. We also tested a new exportable beet harvester. The export unit is designed off of our model 6812 but down sized to fit in a cargo container for shipping.

In October 2005 we purchased certain assets of Vessel Systems Inc., a manufacturer of pressurized tanks and vessels, located in Dubuque, Iowa. We purchased the inventory, fixed assets and accounts receivable for the purchase price of \$844,284, paid in cash. We will operate this new business through our wholly-owned subsidiary, Art's-Way Vessels, Inc.

##### (b) Business of Issuer

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We manufacture specialized farm machinery under our own and private labels, steel truck bodies under the label of Cherokee Truck Bodies and now pressure vessels through our wholly owned subsidiary of Art's-Way Vessels, Inc.

Equipment manufactured by the Company under our own label includes: portable & stationary animal feed processing equipment and related attachments used to mill and mix feed grains into custom animal feed rations; a high bulk mixing wagon to mix animal feeds containing silage, hay and grain; a line of stalk shredders; sugar beet and potato harvesting equipment; and a line of land maintenance equipment, edible bean equipment, moldboard plows and grain drill equipment.

Private label manufacturing of farm equipment accounted for 15% and 13% of total sales for the years ended November 30, 2005 and 2004, respectively.

Art's-Way labeled products are sold by farm equipment dealers throughout the United States. There is no contractual relationship with these dealers to distribute our products, and dealers may sell a competitor's product line.

Automotive and other dealers throughout the United States sell Cherokee Truck Bodies labeled products.

Art's-Way Vessels, Inc. sells pressurized vessels, both code and non-code. Vessels can range from 3 feet in length up to 40 feet. The diameter can be between 18 inches to 8 feet. These vessels are sold to manufacturing facilities that will use the vessel as a component part of their end product.

Raw materials, for both Art's-Way Manufacturing and Art's-Way Vessels, Inc., in all aspects of our business are acquired from domestic and foreign sources and normally are readily available.

We maintain manufacturing rights on several products covering unique aspects of design and have trademarks covering product identification. We pay royalties for use of certain manufacturing rights. Our material royalty agreement is with CNH. The agreement with CNH will run through September 2006 on moldboard plows. In our opinion, our trademarks and licenses are of value in securing and retaining business.

Sales of our agricultural products are seasonal; however, we have tried to decrease this impact of seasonality through the development of mowers, shredders and beet harvesting machinery coupled with private labeled products, as the peak periods for these different products occur at different times. Similar to other manufacturers in the farm equipment industry, we are affected by factors peculiar to the farm equipment field, including items such as fluctuations in farm income resulting from the change in commodity prices, crop damage caused by weather and insects, government farm programs and other unpredictable variables such as interest rates.

Sales of truck bodies are somewhat seasonal, being affected by the cold months of winter when sales tend to decrease.

We believe that pressure vessel sales do not tend to be seasonal.

We have an OEM supplier agreement with CNH (Case New Holland). Under the OEM agreement we have agreed to supply CNH's requirements for certain feed processing and service parts under CNH's label. The agreement has

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no minimum requirements and can be cancelled upon certain conditions. For the years ended November 30, 2005 and 2004, sales under the CNH label aggregated approximately 8% of total sales.

Our feed processing products, including private labeled units, compete with similar products of many other manufacturers. We estimated that there are more than 15 competitors producing similar products although total market statistics are not available. We believe that our products are competitively priced with greater diversity than most competitor product lines. Beet harvesting equipment is manufactured by three companies that have a significant impact on the market. We estimate our share of the domestic market is estimated to be about 35%. Other products such as mowers, shredders and grain drills are manufactured by approximately 20 other companies. We believe our products are competitively priced with above average quality and performance, in a market where price, product performance and quality are principal elements.

Another important part of our business is after market service parts that are available to keep our branded and OEM produced equipment operating to the satisfaction of the end user.

The backlog of orders booked in February 2006, was approximately \$7,158,000. Art's-Way Vessels, Inc. had a backlog of \$2,303,000, and Art's-Way Manufacturing had a backlog of \$4,855,000. Art's-Way Manufacturing had approximately \$4,707,000 in backlog a year ago. Overall we are looking forward to another strong year.

We currently do no business with any local, state or federal government agencies.

We are engaged in research and development work on a continual basis to improve the present products and create new products. In 2004 research and development costs were down \$407,000 as we moved from prototype into production. In 2005 we invested heavily in research and development, \$285,000 compared to only \$10,000 in 2004. For further information please see Part II, Item 6, Results of Operations. We worked with an outside engineering firm to develop a new exportable beet harvester.

Art's-Way Vessels, Inc. produces custom tanks and vessels that are manufactured to customer blue prints. Art's-Way Vessels, Inc. incurred no research and development costs in 2005.

We are subject to various federal, state and local laws and regulations pertaining to environmental protection and the discharge of materials into the environment. In 2005 we completed the installation of a new powder coat paint system. We are also in the process of installing a different paint system for our whole goods. These new paint systems will significantly improve the quality of our paint, in terms of luster, hardness and longevity. The paint systems will be located in a new location within the plant, as we redesign our workflow to optimize productivity. We have obtained the proper permits that allow us to change the paint systems and remain in compliance with all applicable laws and regulations.

During the year ended November 30, 2005, we had peak employment of 97 full-time and 19 part-time employees, of which 90 were factory and production employees, 5 were engineers and engineering draftsman, 17 were administrative employees, and 4 were in sales and sales management. Employee levels fluctuate based upon the seasonality of the product line.

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### Item 2. Description of Property

Our existing executive offices, production and warehousing facilities in Armstrong are built of hollow clay block/concrete and contain approximately 240,000 square feet of usable space. Most of these facilities were constructed after 1965 and are in good condition. We own approximately 127 acres of land west of Armstrong, which includes the factory and inventory storage space. We currently lease excess land to third parties for farming.

The facility in Dubuque is a leased building. The building was constructed in 2004 and is in excellent condition.

### Item 3. Legal Proceedings

We are from time to time a party to various legal actions arising in the normal course of business. We believe that there are no threatened or pending proceedings against us that if determined adversely, would have a material adverse effect on our business or financial position.

### Item 4. Submission of Matters to a Vote of Security Holders

Not Applicable.

## PART II

### Item 5. Market for Common Equity and Related Stockholder Matters.

#### (a) Market Information

|                | Per Common Stock Bid Prices by Quarter |       |                   |       |
|----------------|--|-------|-------------------|-------|
|                | Year ended                             |       | Year ended        |       |
|                | November 30, 2005                      |       | November 30, 2004 |       |
|                | High                                   | Low   | High              | Low   |
| First Quarter  | 8.790                                  | 5.50  | 5.360             | 4.530 |
| Second Quarter | 11.500                                 | 5.110 | 5.600             | 4.990 |
| Third Quarter  | 9.050                                  | 5.110 | 5.360             | 4.620 |
| Fourth Quarter | 5.950                                  | 4.500 | 6.240             | 4.290 |

Our common stock trades on The NASDAQ Small Cap Stock Market under the symbol "ARTW." The range of closing bid prices shown above, are as reported by NASDAQ. The quotations shown reflect inter-dealer prices, without retail mark-up, mark-down, or commission and may not necessarily represent actual transactions.

#### (b) Holders

There were approximately 461 stockholders of our common stock as of February 6, 2006.

#### (c) Dividends

On October 27, 2005 our Board of Directors declared a dividend of \$0.05 per share to be paid on November 30, 2005 to stockholders of record as of November 15, 2005. The loan covenants that restricted the payment of dividends were waived by our lenders. While we anticipate that this dividend will be the first in our ongoing plan of future annual dividend payments, the declaration of and the amount of any future dividends will be governed by our financial position at that time, and may again require the waiver of loan covenants by our lenders.

#### (d) Security Authorization for Issuance Under Equity Compensation Plans.

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|  | Number of securities<br>to be issued upon<br>exercise of<br>outstanding options,<br>warrants and rights | Weighted-average<br>exercise price of<br>Outstanding<br>options,<br>Warrants and rights | Number of securities<br>remaining available<br>for future issuance<br>under equity<br>compensation plans<br>(excluding<br>securities reflected<br>in columns (a)) |
|--|---|---|---|
| Equity compensation<br>plans approved<br>by security holders     | (a) 25,000  | (b) \$3.22  | (c) 5,000   |
| Equity compensation<br>plans not approved<br>by security holders | -   |   | -   |
| <b>Total</b>   | <b>25,000</b>   |   | <b>5,000</b>  |

### Item 6. Management's Discussion and Analysis or Plan of Operation

The following discussion of our consolidated financial condition and results of operations should be read in conjunction with the financial statements and the related notes thereto included elsewhere in this Form 10-KSB. The matters discussed herein contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended, which involve risks and uncertainties. All statements other than statements of historical information provided herein may be deemed to be forward-looking statements. Without limiting the foregoing the words "believes", "anticipates", "plans", "expects" and similar expressions are intended to identify forward-looking statements. Factors that could cause actual results to differ materially from those in the forward-looking statements include our degree of financial leverage, the factors described in Item 1 of this Form 10-KSB, risks associated with acquisitions and in the integration thereof, risks associated with supplier/OEM agreements, dependence upon the farm economy and the impact of competitive services and pricing, as well as other risks referenced from time to time in our filings with the SEC. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis, judgment, belief or expectation only as of the date hereof. We undertake no obligation to publicly revise these forward-looking statements to reflect events or circumstances that arise after the date hereof.

#### Management's Discussion and Analysis of Financial Condition and Results of Operations

##### Critical Accounting Policies

We have identified the following accounting policies as critical to our operations.

**Revenue Recognition** - Revenue is recognized when risk of ownership and title pass to the buyer, generally upon the shipment of the product. In very limited circumstances, and only upon a written customer agreement, we recognize revenue upon the production and invoicing of the products.

**Inventory Valuation** - Inventories are stated at the lower of cost or market, and cost is determined using the first-in, first-out (FIFO) method. Management monitors the carrying value of inventories using inventory control and review processes that include, but are not limited

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to, sales forecast review, inventory status reports, and inventory reduction programs. We record inventory write downs to market based on expected usage information for raw materials and historical selling trends for finished goods. Write downs of inventory create a new cost basis. Additional write downs may be necessary if the assumptions made by management do not occur. We classified inventories not expected to be consumed in our manufacturing process or our parts fulfillment business within our normal operating cycle as a non-current asset in the accompanying balance sheets.

**Income Taxes** - Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating losses. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is entirely dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

### Results of Operations

Twelve months ended November 30, 2005 compared to the twelve months ended November 30, 2004

Our consolidated revenue of \$14,619,000 for 2005 represents a 14.3% increase when compared to \$12,784,000 for 2004. Art's-Way Vessels, Inc., had revenues of \$358,000, for the period from its acquisition on October 4, 2005 through November 2005. Art's-Way Manufacturing had revenues totaling \$14,261,000. Art's-Way Manufacturing's branded products increased by \$1,099,000 while OEM sales increased by \$378,000. Gross profit as a percent of sales was 30% for 2005 compared to 28% for 2004. The agricultural markets we serve are generally forecasted to remain constant in 2006, yet we anticipate that our sales and profits before tax for 2006 will increase slightly as we bring new or improved products to market.

Operating expenses in 2005 increased \$210,000 from 2004. Art's-Way Vessels, Inc. represents 123,000 of that increase, while Art's-Way Manufacturing represents \$87,000 of the total. As a percent of sales, operating expenses were 19% and 20%, respectively, when comparing 2005 and 2004.

Engineering expenses for Art's-Way Manufacturing increased by \$294,000. This was due to the increase in new product development expenses of \$275,000, for our new export beet harvester and new defoliator. We also engineered a new domestic defoliator. We increased our engineering staff by one degreed engineer and an additional part-time drafter. We also purchased new engineering software. We believe that by investing in our engineering department and research and development we are investing in the future of our company. We believe that by developing new products and updating our current products we will secure and better our position in our markets and allow the company to grow sales.



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Selling expenses for Art's-Way Manufacturing decreased \$54,000 from 2005 to 2004. Approximately \$24,000 of that decrease was due to a reduction in commission expense as the Cherokee Truck Bodies sales decreased. In 2004 commissions were up due to increased payments to a sales rep that helped to design the model 6812 harvester. That cost of approximately \$18,000 went away in 2005. The decrease in commissions accounted for 78% of the decrease. In 2004 we also incurred the costs for design and formulation of manuals for the new model 6812, and this accounted for 20% of the cost reduction.

General and administrative expenses decreased by \$30,000. The addition of Art's-Way Vessels, Inc. resulted in an increase of \$123,000. Art's-Way Manufacturing accounted for a decrease of \$153,000. In 2004 we moved the Cherokee Truck Bodies operation from Cherokee, Iowa to Armstrong and as a result of the move we incurred costs totaling \$59,000. In 2005 our legal fees decreased \$30,000 as we settled two suits in early 2005. Like many other businesses, we struggle with the ever rising costs of health insurance, and our overall health insurance costs increased over 20% in 2005. We chose to hold the amount that the company contributed at a constant and passed the cost of the increase on to our employees. As a result some of our employees elected to drop the coverage, resulting in a decrease in our group insurance costs of \$28,000. During 2005 our general and administrative depreciation expense also decreased approximately \$13,000. The remainder of the decrease comes from numerous other small decreases.

Art's-Way Manufacturing experienced a 28% increase in interest and other expenses in 2005 compared to 2004. Interest expense was up 45%, compared to 2004, due to higher average loan balances, as we took an additional \$1,000,000 to finance equipment purchases and acquisitions, and increased interest rates. This increase was offset by an increase in other income due primarily to larger cash balances, caused by increased customer deposits and profits from operations that earned interest.

Income before tax in 2005 was up 60% to \$1,474,000 compared to \$924,000 in 2004. Net income of \$977,000 for 2005 compared to \$1,402,000 in 2004. The decline in our net income is the result of the reversal of the deferred tax valuation allowance that was established in prior years and during 2004 we reduced this allowance resulting in the recognition of income tax benefit of approximately \$479,000. Fiscal 2005 reflected normalized tax expense resulting in \$497,000 of tax expense, a \$976,000 increase over 2004. Although we are recording tax expense, cash payments for income taxes was only \$53,000 during 2005 due to the utilization of our operating loss carryforwards.

We continue to strive to reduce costs, and continue our move to a lean manufacturing environment. We also continue to invest in our future through research and development as well as new equipment and acquisitions. We believe as of 2005, our overall company has strengthened through the consolidation of manufacturing facilities, new product offerings and the acquisition of Art's-Way Vessels, Inc. The backlog of orders booked in February 2006, totaled approximately \$7,158,000. Art's-Way Vessels, Inc. had a backlog of \$2,303,000, and Art's-Way Manufacturing had a backlog of \$4,855,000. Art's-Way Manufacturing had approximately \$4,707,000 in backlog a year ago. Overall we are looking forward to another strong year.

Liquidity and Capital Resources

Twelve months ended November 30, 2005

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Our main sources of funds were from our ability to generate cash from operations. Cash provided from operations was \$2,497,000 for fiscal year 2005. We are very excited about our ability to generate cash and what that means for our company as we look to the future. We will continue reinvesting in our company to strengthen its foundation and maximize long-term growth.

In 2005 we paid a dividend to our stockholders for the first time in several years. This had a cash impact of \$98,000.

Twelve months ended November 30, 2004

Our main sources of funds were obtained from our line of credit with West Bank. These funds were used to purchase fixed assets, with the balance used towards working capital. Capital expenditures for the year ended November 30, 2004 were \$563,000 consisting mainly of two major expenditures. We purchased a paint line costing \$330,000 and are in the installation process. We also invested \$113,000 in tooling for the new model 6812 sugar beet harvester. These two items totaled 80% of our capital expenditures in 2004.

Inventories increased significantly in 2004; \$6,298,000 compared to \$3,447,000 in 2003. This was partially due to the significant increase in steel prices during 2004. Nearly our entire inventory is steel based and we estimate that 20% of the increase was driven by steel prices. We also carried approximately \$1,000,000 of inventory related to our sugar beet harvesters. We had intended for a large build in 2004, however as we moved our new harvester from prototype to production, we ran into typical transition issues. We will consume all carryover inventories in the 2005 build of harvesters. At the end of 2004 we also purchased large amounts of raw steel for our grinder mixer build, but the build was delayed slightly and the units were not shipped until 2005. This demand on cash was partially offset by the increase in accounts payable related to these inventory purchases.

Accrued expenses for the fiscal year ended 2004 were up as a result of rising insurance costs and increased commissions' payable due to increased sales in November.

### Capital Resources

We have long-term financing through West Bank. Credit facilities consist of three loan agreements totaling \$5,500,000.

Facility #1 is a revolving line of credit for \$3,500,000 with advances funding the working capital, letter of credit and corporate credit card needs that mature on March 31, 2006. We are in the process of securing an extension for an additional year and expect to receive this extension. The interest rate is West Bank's prime interest rate plus 1%, adjusted daily. Monthly interest only payments are required and the unpaid principal is due on the maturity date. Collateral consists of a first position on our assets owned including, but not limited to inventories, accounts receivable, machinery and equipment. As of November 30, 2005 and 2004, the Company had borrowed \$0 and \$870,071 respectively, against Facility #1.

Facility #2 is long-term financing for \$2,000,000 that is supported by a guarantee issued by the United States Department of Agriculture (USDA) for 75% of the loan amount outstanding. The variable interest rate is West Bank's prime interest rate plus 1.5%, adjusted daily, monthly principle and interest payments are amortized over 20 years with final maturity date of March 31, 2023.

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Facility #3 is long-term financing for \$1,000,000 that is also supported by a guarantee issued by the USDA for 75% of the loan amount outstanding. The loan for \$1,000,000 was used for new product development.

Collateral for Facilities #2 and #3 is primarily real estate with a second position on assets of Facility #1. The USDA subordinates collateral rights in all assets other than real estate in an amount equal to West Bank's other credit commitments. As of November 30, 2005 the outstanding balance on Facility #2 and #3 was \$1,754,866 and \$974,356 respectively compared to \$1,836,565 and \$0 at November 30, 2004.

J. Ward McConnell, Jr. was required to personally guarantee Facility #1, Facility #2 and Facility #3 on an unlimited and unconditional basis. The guarantees of Facility #1, Facility #2 and Facility #3 shall be reduced after the first three years to a percentage representing his ownership of the Company. Mr. McConnell's guarantees shall be removed from Facility #1 and Facility #2 in the event that his ownership interest in the Company is reduced to a level less than 20% after the first three years of the loan. The Company compensates Mr. McConnell for his personal guarantees at an annual percentage rate of 2% of the outstanding balances paid monthly. Guarantee fee payments to Mr. McConnell were approximately \$56,000 and \$47,000, for the years ended November 30, 2005, and 2004, respectively.

Other terms and conditions of all three facilities include providing monthly internally prepared financial reports including accounts receivable aging schedules and borrowing base certificates and year-end audited financial statements. The borrowing bases shall limit advances from Facility #1 to 60% of accounts receivable less than 90 days, 60% of finished goods inventory, 50% of raw material inventory and 50% of work-in-process inventory plus 40% of appraisal value of machinery and equipment. Covenants include, but are not limited to, restrictions on debt service coverage ratio, debt/tangible net worth ratio, current ratio, capital expenditures, and tangible net worth. During the year ended November 30, 2005, we violated the restriction on capital expenditures, payment of dividends and loan to third parties. Under our loan agreement West Bank would have had the right to call the loan and/or increase the interest rate by three percentage points. As stated above, we provide West Bank with monthly financial statements, as well as a cash flow statement on a monthly basis. Therefore they were aware of the amount of capital expenditures we had incurred throughout the year. They were also aware of the decision to pay dividends, and the inter-company loan to Art's-Way Vessels, Inc. in connection with the asset purchase from Vessels Systems, Inc., well in advance of the actual expenditures. The bank views this spending favorably, and waived the covenants.

### Contractual Obligations

| Contractual Obligation   | Total     | Payments due by period |         |         |           |
|--------------------------|-----------|------------------------|---------|---------|-----------|
|                          |           | <1 yr                  | 1-3 yrs | 3-5 yrs | >5 yrs    |
| Long-term debt           |           |                        |         |         |           |
| including interest       | 3,825,193 | 386,316                | 666,600 | 666,600 | 2,105,677 |
| Capital lease obligation | 0         | 0                      | 0       | 0       | 0         |
| Operating lease          |           |                        |         |         |           |
| obligation               | 125,000   | 125,000                | 0       | 0       | 0         |
| Purchase Obligations     | 80,000    | 80,000                 | 0       | 0       | 0         |
| Other                    | 0         | 0                      | 0       | 0       | 0         |
| Total                    | 4,030,193 | 591,316                | 666,600 | 666,600 | 2,105,677 |

\* Based on current interest rates at November 30, 2005.

Our current ratio and its working capital are as shown in the following table:

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|                     | November 30, 2005 | November 30, 2004 |
|---------------------|-------------------|-------------------|
| Current Assets      | \$9,481,557       | \$7,946,007       |
| Current Liabilities | 2,060,486         | 2,513,444         |
| Working Capital     | \$7,421,071       | \$5,432,563       |
| Current Ratio       | 4.6               | 3.2               |

### Utilization of Deferred Tax Assets

At November 30, 2005 and 2004, we had established a deferred tax asset valuation allowance of approximately \$41,000. In assessing our deferred tax assets, management considers whether it is more likely than not that some portion of all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. In 2004 we utilized a portion of our net operating loss carryforward. Beginning in fiscal 2005 our financial results reflected the accrual of income tax expenses of \$497,000, as opposed to 2004 when we recorded a net tax benefit of \$479,000.

For tax purposes, at November 30, 2005 we have utilized all of our net operating loss carryforwards. We had approximately \$132,000 of research and development credits and \$41,000 of state tax credits which begin to expire in the 2012 and 2007, respectively. We also had \$41,000 in AMT credits that will not expire.

### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

### Item 7 Financial Statements

#### Report of Independent Registered Public Accounting Firm

To the Board of Directors  
Art's-Way Manufacturing Co., Inc.  
Armstrong, Iowa

We have audited the consolidated balance sheets of Art's-Way Manufacturing Co., Inc. and subsidiary as of November 30, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and cash flows for the two years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Art's-Way Manufacturing Co., Inc. and subsidiary as of November 30, 2005 and 2004, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Des Moines, Iowa  
January 9, 2006

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

#### Table of Contents

|   | Page       |
|---|------------|
| Consolidated Statements of Operations -<br>Years ended November 30, 2005 and 2004           | F-3        |
| Consolidated Balance Sheets -<br>November 30, 2005 and 2004                                 | F-4        |
| Consolidated Statements of Stockholders' Equity -<br>Years ended November 30, 2005 and 2004 | F-5        |
| Consolidated Statements of Cash Flows -<br>Years ended November 30, 2005 and 2004           | F-6        |
| Notes to Consolidated Financial Statements -<br>Years ended November 30, 2005 and 2004      | F-7 - F-17 |

### ARTS-WAY MANUFACTURING CO., INC. Consolidated Statements of Operations Years ended November 30, 2005 and 2004

|                                | 2005         | 2004         |
|--------------------------------|--------------|--------------|
| Net sales                      | \$14,618,904 | \$12,784,396 |
| Cost of goods sold             | 10,213,951   | 9,186,971    |
| Gross profit                   | 4,404,953    | 3,597,425    |
| <b>Expenses:</b>               |              |              |
| Engineering                    | 483,831      | 189,587      |
| Selling                        | 680,219      | 734,141      |
| General and administrative     | 1,551,213    | 1,581,458    |
| Total expenses                 | 2,715,263    | 2,505,186    |
| Income from operations         | 1,689,690    | 1,092,239    |
| <b>Other income (expense):</b> |              |              |
| Interest expense               | (261,162)    | (180,013)    |
| Other                          | 45,792       | 11,416       |
| Total other expense            | (215,370)    | (168,597)    |
| Income before income taxes     | 1,474,320    | 923,642      |
| Income tax (benefit)           | 497,003      | (478,631)    |
| Net income                     | \$977,317    | \$1,402,273  |
| <b>Net income per share:</b>   |              |              |
| Basic                          | \$0.50       | \$0.72       |
| Diluted                        | 0.50         | 0.72         |

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See accompanying notes to consolidated financial statements.

### ARTS-WAY MANUFACTURING CO., INC. Consolidated Balance Sheets November 30, 2005 and 2004

| Assets  | 2005          | 2004          |
|---|---------------|---------------|
| <b>Current assets:</b>  |               |               |
| Cash  | \$1,198,238   | \$116,001     |
| Accounts receivable customers,<br>net of allowance for doubtful<br>accounts of \$46,385 and<br>\$30,417 in 2005 and 2004,<br>respectively | 956,391       | 737,008       |
| Inventories, net  | 6,525,051     | 6,298,049     |
| Deferred taxes  | 673,000       | 539,000       |
| Real estate loan receivable   | 0             | 165,725       |
| Other current assets  | 128,877       | 90,224        |
| Total current assets  | 9,481,557     | 7,946,007     |
| <br>Property, plant, and equipment, net   | <br>1,890,660 | <br>1,308,088 |
| Inventories, noncurrent   | 144,871       | 459,792       |
| Deferred taxes  | 191,000       | 786,000       |
| Other assets  | 74,353        | 146,006       |
| Total assets  | \$11,782,441  | \$10,645,893  |
| <br><b>Liabilities and Stockholders<br/>Equity</b>  |               |               |
| <b>Current liabilities:</b>   |               |               |
| Notes payable to bank   | \$0           | \$870,071     |
| Current portion of term debt  | 223,946       | 174,674       |
| Accounts payable  | 530,722       | 536,929       |
| Customer deposits   | 569,354       | 77,975        |
| Accrued expenses  | 736,464       | 853,795       |
| Total current liabilities   | 2,060,486     | 2,513,444     |
| <br>Long term liabilities   | <br>0         | <br>144,766   |
| Term debt, excluding current portion  | 2,558,273     | 1,788,242     |
| Total liabilities   | 4,618,759     | 4,446,452     |
| <br><b>Stockholders equity:</b>   |               |               |
| Common stock-\$0.01 par value.  |               |               |
| Authorized 5,000,000 shares;<br>issued 1,963,176 and 1,938,176<br>shares in 2005 and 2004   |               |               |
|   | 19,632        | 19,382        |
| Additional paid-in capital  | 1,719,787     | 1,634,954     |
| Retained earnings   | 5,424,263     | 4,545,105     |
| Total stockholders equity   | 7,163,682     | 6,199,441     |
| Total liabilities and<br>stockholders equity  | \$11,782,441  | \$10,645,893  |

See accompanying notes to consolidated financial statements.

### ARTS-WAY MANUFACTURING CO., INC. Consolidated Statements of Stockholders Equity Years ended November 30, 2005 and 2004

| Common stock        | Additional         | Retained | Total |
|---------------------|--------------------|----------|-------|
| Number of<br>shares | paid-in<br>capital | earnings |       |
| Par value           |                    |          |       |

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|                        |           |          |             |             |             |  |
|------------------------|-----------|----------|-------------|-------------|-------------|--|
| Balance,               |           |          |             |             |             |  |
| November 30, 2003      | 1,938,176 | \$19,382 | \$1,634,954 | \$3,142,832 | \$4,797,168 |  |
| Net income             | 0         | 0        | 0           | 1,402,273   | 1,402,273   |  |
| Balance,               |           |          |             |             |             |  |
| November 30, 2004      | 1,938,176 | \$19,382 | \$1,634,954 | \$4,545,105 | \$6,199,441 |  |
| Exercise of            |           |          |             |             |             |  |
| stock options          | 25,000    | 250      | 79,033      | 0           | 79,283      |  |
| Stock based            |           |          |             |             |             |  |
| compensation           | 0         | 0        | 5,800       | 0           | 5,800       |  |
| Dividends paid, \$0.05 |           |          |             |             |             |  |
| per share              | 0         | 0        | 0           | (98,159)    | (98,159)    |  |
| Net income             | 0         | 0        | 0           | 977,317     | 977,317     |  |
| Balance,               |           |          |             |             |             |  |
| November 30, 2005      | 1,963,176 | \$19,632 | \$1,719,787 | \$5,424,263 | \$7,163,682 |  |

See accompanying notes to consolidated financial statements.

ARTS-WAY MANUFACTURING CO., INC.  
Consolidated Statements of Cash Flows  
Years ended November 30, 2005 and 2004

|   | 2005        | 2004        |
|---|-------------|-------------|
| Cash flows from operations:   |             |             |
| Net income  | \$977,317   | \$1,402,273 |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |             |
| Stock based compensation  | 5,800       | 0           |
| (Gain) Loss on sale of property, plant, and equipment                             | (8,486)     | 7,134       |
| Depreciation and amortization   | 268,616     | 311,314     |
| Deferred income taxes   | 461,000     | (507,000)   |
| Changes in assets and liabilities, net of Vessel Systems Inc acquisition:         |             |             |
| (Increase) decrease in:   |             |             |
| Accounts receivable   | 21,202      | 148,882     |
| Inventories   | 204,736     | (2,827,698) |
| Other current assets  | 127,072     | 59,961      |
| Other, net  | 71,653      | (30,000)    |
| Increase (decrease) in:   |             |             |
| Accounts payable  | (6,207)     | 453,055     |
| Customer deposits   | 491,379     | 24,419      |
| Accrued expenses  | (117,331)   | 151,678     |
| Net cash provided by/(used in) operating activities                               | 2,496,751   | (805,982)   |
| Cash flows from investing activities:   |             |             |
| Purchases of property, plant, and equipment                                       | (378,420)   | (563,116)   |
| Purchase of assets of Vessels Systems Inc.  | (844,284)   | 0           |
| Proceeds from sale of property, plant, and equipment                              | 22,600      | 2,416       |
| Net cash (used in) investing activities   | (1,200,104) | (560,700)   |
| Cash flows from financing activities:   |             |             |
| Proceeds from Line of Credit  | 0           | 870,071     |
| Payments on Line of Credit  | (870,071)   | 0           |
| Payments of notes payable to bank   | (180,697)   | (187,440)   |
| Payments of long-term liabilities   | (144,766)   | 0           |

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|   |             |           |
|---|-------------|-----------|
| Proceeds from term debt                     | 1,000,000   | 0         |
| Proceeds from the exercise of stock options | 79,283      | 0         |
| Dividends paid to stockholders              | (98,159)    | 0         |
| Net cash provided by (used in)              |             |           |
| financing activities                        | (214,410)   | 682,631   |
| Net increase/(decrease) in cash             | 1,082,237   | (684,051) |
| Cash at beginning of period                 | 116,001     | 800,052   |
| Cash at end of period                       | \$1,198,238 | \$116,001 |

### Supplemental disclosures of cash flow information:

#### Cash paid/(received) during the period for:

|              |           |           |
|--------------|-----------|-----------|
| Interest     | \$246,598 | \$177,049 |
| Income taxes | 52,993    | (8,323)   |

### Supplemental schedule of investing activities:

#### Vessel Systems Inc acquisition:

|                               |           |     |
|-------------------------------|-----------|-----|
| Accounts Receivable           | \$240,585 | \$0 |
| Inventories                   | 116,817   | 0   |
| Property, plant and equipment | 486,882   | 0   |
| Cash paid                     | \$844,284 | \$0 |

See accompanying notes to consolidated financial statements.

## Notes to Consolidated Financial Statements

### (1) Summary of Significant Accounting Policies

#### (a) Nature of Business

Art's-Way Manufacturing Co., Inc. is primarily engaged in the fabrication and sale of metal products in the agricultural sector of the United States economy. Major product offerings include animal feed processing equipment, sugar beet and potato harvesting equipment, land maintenance equipment, finished mowing and crop shredding equipment, seed planting equipment and truck bodies. A significant part of the Company's business is supplying hay blowers to several original equipment manufacturers (OEMs). Another important part of the Company's business is after market service parts that are available to keep its branded and OEM produced equipment operating to the satisfaction of the end user of the Company's products.

Art's-Way Vessels, Inc. is primarily engaged in the fabrication and sale of pressurized vessels and tanks.

#### (b) Principles of Consolidation

The consolidated financial statements include the accounts of Art's-Way Manufacturing Co., Inc. and its wholly-owned subsidiary, Art's-Way Vessels, Inc., which became active in October 2005 after purchasing certain assets of Vessel Systems, Inc. All material inter-company accounts and transactions are eliminated in consolidation.

#### (c) Accounts Receivable

Accounts receivable are carried at original invoice amount less an estimate made for doubtful accounts based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Accounts receivable are written-off when deemed uncollectible. Recoveries



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of accounts receivable previously written-off are recorded when received. Accounts receivable are considered past due 60 days past invoice date.

### (d) Inventories

Inventories are stated at the lower of cost or market, and cost is determined using the first-in, first-out (FIFO) method. Management monitors the carrying value of inventories using inventory control and review processes that include, but are not limited to, sales forecast review, inventory status reports, and inventory reduction programs. The Company records inventory write downs to market based on expected usage information for raw materials and historical selling trends for finished goods. Additional write downs may be necessary if the assumptions made by management do not occur. The Company has classified inventories not expected to be consumed in its manufacturing process or its parts fulfillment business within the Company's normal operating cycle as a non-current asset in the accompanying balance sheets.

### (e) Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Depreciation of plant and equipment is provided using the straight-line method, based on the estimated useful lives of the assets which range from three to thirty-three years.

### (f) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating losses. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is entirely dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversals of deferred tax liabilities, projected future taxable income, and tax planning strategies in, making this assessment.

### (g) Revenue Recognition

Revenue is recognized when risk of ownership and title pass to the buyer, generally upon the shipment of the product. Shipping costs charged to customers are included in net sales. Freight costs incurred are included in cost of goods sold. In very limited circumstances, and only upon a written customer agreement, we recognize revenue upon the production and invoicing of the products.

### (h) Research and Development

Research and development costs are expensed when incurred. Such costs approximated \$285,000 and \$10,000 for the years ended November 30, 2005, and 2004, respectively.

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### (i) Income Per Share

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

Basic and diluted earnings per common share have been computed based on the following as of November 30, 2005 and 2004:

|  | 2005      | 2004        |
|--|-----------|-------------|
| Basic:                                       |           |             |
| Numerator, net income                        | \$977,317 | \$1,402,273 |
| Denominator, average number of common shares |           |             |
| Outstanding                                  | 1,951,108 | 1,938,176   |
| Basic earnings per common share              | \$0.50    | \$0.72      |
| Diluted                                      |           |             |
| Numerator, net income                        | \$977,317 | \$1,402,273 |
| Denominator:                                 |           |             |
| Average number of common                     | 1,951,108 | 1,938,176   |
| Effect of dilutive stock options             | 19,113    | 20,281      |
|  | 1,970,221 | 1,958,457   |
| Diluted earnings per common share            | \$0.50    | \$0.72      |

### (j) Stock Based Compensation

The Company accounts for stock options in accordance with the provisions of APB Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees, and related interpretations. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. Statement of Financial Accounting Standards No. 123 (SFAS 123), Accounting for Stock-Based Compensation, permits entities to recognize as expense over the vesting period by the fair value of all stock-based awards on the date of grant. SFAS 123 also allows entities to continue to apply the provisions of APB 25 and provide pro forma net income and income per share disclosure for employee stock option grants, as if the fair-value-based method defined in SFAS 123 had been applied. The Company has elected to continue to apply the provisions of APB 25 and provide the pro forma disclosure provisions of SFAS 123.

Since the Company applies APB Opinion No. 25 in accounting for its plans, compensation cost has only been recognized related to stock options issued with an exercise price less than the grant date current fair value. The impact on net income and earnings per share is insignificant, had the Company recorded compensation cost based on the fair value at the grant date for its stock options under SFAS No. 123.

### (k) Use of Estimates

Management of the Company has made a number of estimates and assumptions related to the reported amount of assets and liabilities, reported amount of revenues and expenses, and the disclosure of contingent assets and liabilities to prepare these financial statements in

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conformity with generally accepted accounting principles. These estimates include the valuation of the Company's accounts receivable, inventories and realizability of the deferred tax assets. Actual results could differ from those estimates.

### (1) Recently Issued Accounting Pronouncements

The Financial Accounting Standards Board (FASB) has issued Statement No. 123 (Revised), Share-Based Payment (FAS 123(R)). This Statement establishes standards for accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments, or that may be settled by the issuance of those equity instruments. Statement No. 123(R) covers a wide range of share-based compensation arrangements, including share options, restricted share plans, performance-based awards, share appreciation rights and employee share purchase plans. FAS 123(R) replaces existing requirements under FASB Statement No. 123, Accounting for Stock-Based Compensation, and eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25, Accounting for Stock Issued to Employees. For the Company, the Statement is effective as of the first interim or annual reporting period that begins after December 15, 2005. The Company is assessing the effects of FAS 123(R).

### (2) Allowance for Doubtful Accounts

A summary of the Company's activity in the allowance for doubtful accounts is as follows:

|                              | 2005     | 2004     |
|------------------------------|----------|----------|
| Balance, beginning           | \$30,417 | \$39,250 |
| Provision charged to expense | 19,909   | 16,100   |
| Less amounts charged-off     | (3,941)  | (24,933) |
| Balance, ending              | \$46,385 | \$30,417 |

### (3) Inventories

Major classes of inventory are:

|                 | 2005        | 2004        |
|-----------------|-------------|-------------|
| Raw materials   | \$2,820,591 | \$2,867,914 |
| Work in process | 455,077     | 1,495,985   |
| Finished goods  | 3,394,254   | 2,393,942   |
|                 | \$6,669,922 | \$6,757,841 |

Inventories as of November 30, 2005 and 2004 are stated net of a reserve for slow moving inventory of approximately \$923,000 and \$1,071,000, respectively.

### (4) Property, Plant, and Equipment

Major classes of property, plant, and equipment are:

|                                       | 2005       | 2004       |
|---------------------------------------|------------|------------|
| Land                                  | \$180,909  | \$180,909  |
| Buildings and improvements            | 2,704,570  | 2,679,055  |
| Manufacturing machinery and equipment | 9,163,149  | 8,516,686  |
| Trucks and automobiles                | 104,016    | 104,016    |
| Furniture and fixtures                | 110,834    | 119,882    |
|                                       | 12,263,478 | 11,600,548 |

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|                               |             |             |
|-------------------------------|-------------|-------------|
| Less accumulated depreciation | 10,372,818  | 10,292,460  |
| Property, plant and equipment | \$1,890,660 | \$1,308,088 |

(5) Accrued Expenses

Major components of accrued expenses are:

|                                  | 2005      | 2004      |
|----------------------------------|-----------|-----------|
| Salaries, wages, and commissions | \$371,680 | \$412,663 |
| Accrued warranty expense         | 131,832   | 119,912   |
| Other                            | 232,952   | 321,220   |
|                                  | \$736,464 | \$853,795 |

(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 1 year from 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.

Changes in the Company's product warranty liability for the years ended November 30, 2005, and 2004 are as follows:

|                                     | 2005      | 2004      |
|-------------------------------------|-----------|-----------|
| Balance, beginning                  | \$119,912 | \$59,207  |
| Settlements made in cash or in-kind | (294,633) | (158,216) |
| Warranties issued                   | 306,553   | 218,921   |
| Balance, ending                     | \$131,832 | \$119,912 |

(7) Loan and Credit Agreements

We have a revolving line of credit for \$3,500,000 with advances funding the working capital, letter of credit and corporate credit card needs that mature on March 31, 2006. The interest rate is West Bank's prime interest rate, adjusted daily. Monthly interest only payments are required and the unpaid principal is due on the maturity date. Collateral consists of a first position on assets owned by the Company including, but not limited to inventories, accounts receivable, machinery and equipment. As of November 30, 2005 and 2004, the Company had borrowed none and \$870,071, respectively. Other terms and conditions of the debt with West Bank include providing monthly internally prepared financial reports including accounts receivable aging schedules and borrowing base certificates and year-end audited financial statements. The borrowing base shall limit advances from line of credit to 60% of accounts receivable less than 90 days, 60% of finished goods inventory, 50% of raw material inventory and 50% of work-in-process inventory plus 40% of appraisal value of machinery and equipment.

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J. Ward McConnell, Jr. was required to personally guarantee the debt with West Bank on an unlimited and unconditional basis. The guarantee of the term debt shall be reduced after the first three years to a percentage representing his ownership of the Company. Mr. McConnell's guarantee shall be removed from the term debt in the event that his ownership interest in the Company is reduced to a level less than 20% after the first three years of the loan. The Company compensates Mr. McConnell for his personal guarantee at an annual percentage rate of 2% of the outstanding balance to be paid monthly. Guarantee fee payments to Mr. McConnell were approximately \$53,000 and \$47,000, for the years ended November 30, 2005, and 2004, respectively. A summary of the Company's term debt is as follows:

|  | 2005        | 2004        |
|--|-------------|-------------|
| West Bank loan payable in monthly installments of \$17,776 including interest at Bank's prime rate plus 1.5% due Mach 31, 2023 (A) (B)                           | \$1,754,866 | \$1,836,565 |
| West Bank loan payable in monthly installments of \$10,000 including interest at Bank's prime rate plus 1.5% due March 31, 2015 (A) (B)                          | 974,356     | --          |
| State of Iowa Community Development Block Grant promissory note at 0% interest, maturity 2006 with quarterly principal payments of \$11,111                      | 33,334      | 77,778      |
| State of Iowa Community Development Block Grant local participation promissory notes at 4% interest, maturity 2006, with quarterly principal payments of \$7,007 | 19,663      | 48,573      |
| Total term debt  | 2,782,219   | 1,962,916   |
| Less current portion of term debt  | 223,946     | 174,674     |
| Term debt, excluding current portion   | \$2,558,273 | \$1,788,242 |

(A) Notes are supported by a guarantee issued by the United States Department of Agriculture (USDA) for 75% of the loan amount outstanding. Collateral for these loans are primarily real estate with a second position on assets securing the line of credit. The USDA subordinates collateral rights in all assets other than real estate in an amount equal to West Bank's other credit commitments.

(B) Covenants include, but are not limited to, restrictions on payment of dividends, debt service coverage ratio, debt/tangible net worth ratio, current ratio, limitation on capital expenditures, and tangible net worth. During the year ended November 30, 2005, and 2004, the Company violated certain debt covenants that were waived.

A summary of the minimum maturities of term debt follows for the years ending November 30:

| Year: | Amount |
|-------|--------|
|-------|--------|

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|            |             |
|------------|-------------|
| 2005       | \$223,946   |
| 2006       | 182,352     |
| 2007       | 193,918     |
| 2008       | 206,326     |
| 2009       | 219,545     |
| Thereafter | 1,756,132   |
|            | \$2,782,219 |

(8) **Employee Benefit Plans** The Company sponsors a defined contribution 401(k) savings plan which covers substantially all full-time employees who meet eligibility requirements. Participating employees may contribute as salary reductions a minimum of 4% of their compensation up to the limit prescribed by the Internal Revenue Code. The Company began making 25% matching contribution up to 1% of eligible compensation starting June 2005. The Company recognized an expense of \$10,613 and none related to this plan during the years ending November 30, 2005 and 2004, respectively.

(9) **Stock Option Plans**

Under the 2001 Director Option Plan, stock options may be granted to non-employee directors to purchase shares of common stock of the Company at a price not less than fair market value at the date the options are granted. Non-employee directors who have served for at least one year are automatically granted options to purchase 5,000 shares of common stock. Options granted are nonqualified stock options. The option price, vesting period, and term are set by the Compensation Committee of the Board of Directors of the Company. Options for an aggregate of 50,000 common shares may be granted under the Plan. Each option will be for a period of 10 years and may be exercised at a rate of 25% at the date of grant and 25% on the first, second, and third anniversary date of the grant on a cumulative basis. At November 30, 2004, the Company had approximately 5,000 shares available for issuance pursuant to subsequent grants under the 2001 Director Option Plan.

Under the previously effective 1991 Employee Stock Option Plan, stock options were granted to key employees to purchase shares of common stock of the Company at a price not less than fair market value at the date the options are granted. Options granted were either nonqualified or incentive stock options. The option price, vesting period, and term were set by the Compensation Committee of the Board of Directors of the Company. Each option was for a period of 10 years and could be exercised at a rate of 25% at the date of grant and 25% on the first, second, and third anniversary date of the grant on a cumulative basis. Effective April 2001, the period available for option grants under the 1991 Employee Stock Option Plan expired, and as a result, no shares are available for issuance pursuant to subsequent grants under the 1991 Employee Stock Option Plan.

A summary of changes in the stock option plans is as follows:

|  | November 30 |         |
|--|-------------|---------|
|  | 2005        | 2004    |
| Options outstanding at beginning of period | 45,000      | 45,000  |
| Granted                                    | 5,000       | -       |
| Exercised                                  | (25,000)    | -       |
| Options outstanding at end of period       | 25,000      | 45,000  |
| Options price range for the period         | \$ 2.32     | \$ 2.32 |

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|   | To      | To      |
|---|---------|---------|
|   | \$ 5.21 | \$ 3.50 |
| Options exercisable at<br>end of period | 20,000  | 41,250  |

At November 30, 2005 and 2004, the weighted-average remaining contractual life of options outstanding was 6.9 years and 6.4 years respectively, and the weighted-average exercise price was \$3.22 and \$2.74, respectively. The weighted-average exercise price for options exercisable at November 30, 2005 was \$2.98.

The per share weighted-average fair value of stock options granted in the year ended November 30, 2005, was \$2.30, on the date of grant using the Black Scholes option-pricing model with the following weighted-average assumptions: expected dividend yield 0.0%, risk-free interest rate 4.25%, expected volatility factor of 30.01%, and an expected life of 10 years.

(10) Income Taxes

Total income tax expense (benefit) for the years ended November 30, 2005 and 2004 consists of the following:

|   | November 30 |              |
|---|-------------|--------------|
|   | 2005        | 2004         |
| Current expense   | \$574,003   | \$370,369    |
| Benefit of utilization<br>of operating loss<br>carryforward | (538,000)   | (342,000)    |
| Deferred expense (benefit)                                  | 461,000     | (507,000)    |
|   | \$497,003   | \$ (478,631) |

The reconciliation of the statutory Federal income tax rate and the effective tax rate are as follows:

|   | November 30 |         |
|---|-------------|---------|
|   | 2005        | 2004    |
| Statutory federal income tax rate                       | 34.0%       | 34.0%   |
| Other due primarily to change in<br>valuation allowance | (0.3)       | (85.9)  |
|   | 33.7%       | (51.9)% |

Tax effects of temporary differences that give rise to significant portions of the deferred tax assets at November 30, 2005 and 2004 are presented below:

|                                     | November 30 |             |
|-------------------------------------|-------------|-------------|
|                                     | 2005        | 2004        |
| Deferred tax assets:                |             |             |
| Net operating loss<br>carryforwards | \$0         | \$538,000   |
| Tax credits                         | 214,000     | 197,000     |
| Accrued expenses                    | 100,000     | 101,000     |
| Inventory capitalization            | 243,000     | 155,000     |
| Asset reserves                      | 330,000     | 375,000     |
| Property, plant, and equipment      | 18,000      | 0           |
| Total deferred tax assets           | 905,000     | 1,366,000   |
| Less valuation allowance            | 41,000      | 41,000      |
| Net deferred tax assets             | \$864,000   | \$1,325,000 |

At November 30, 2005 the Company has approximately \$132,000 of research and development credits, \$41,000 of state tax credits, and \$41,000 of

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AMT credits. The R&D and state tax credits will begin to expire in 2012 and 2007, respectively.

The Company has established a deferred tax asset valuation allowance of \$41,000 at November 30, 2005 and 2004, due to the uncertainty of realizing its deferred tax assets related to the state tax credits. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

### (11) Disclosures About the Fair Value of Financial Instruments

SFAS 107, Disclosures about Fair Value of Financial Instruments, defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. At November 30, 2005 and 2004, the carrying amount approximates fair value for cash, accounts receivable, accounts payable, notes payable to bank, term debt, 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 loan payable also approximates fair value because the interest rate is variable as it is tied to the lender's borrowing rate.

### (12) Litigation and Contingencies

Various legal actions and claims are pending against the Company. In the opinion of management adequate provisions have been made in the accompanying financial statements for all pending legal actions and other claims.

### (13) Lease Obligations

The Company leases the facility in Dubuque Iowa. Under a operating lease agreement which expires in October 2006. The minimum lease payments for the fiscal year ended November 30, 2006 will be approximately \$125,000. Total rent expense recognized for the year ended November 30, 2005 was \$25,000.

### (14) 2005 Acquisition

Effective October 4, 2005, the Company acquired the operating assets of Vessels Systems, Inc. for a cash purchase price of approximately \$844,000. The operating results of the acquired business are reflected in the Company's consolidated statement of income from the acquisition date forward. The acquisition was made to continue the Company's growth strategy and diversify its product offerings outside the agricultural industry. The purchase price was determined based on an arms-length negotiated value. The transaction was accounted for under the purchase method of accounting, with the purchase price allocated to the individual assets acquired. (See cash flow statement supplemental disclosure)

Proforma sales and net income information for Vessels Systems, Inc. for 2005 and 2004 is not included as management believes that Vessels Systems, Inc. would not have had a material impact on the Company's financial statements.

### (15) Segment Information



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On October 4, 2005, the Company purchased certain assets of Vessels Systems, Inc. which created a separate operating segment. Prior to the date of this acquisition the Company operated in one reportable segment.

Our reportable segments are strategic business units that offer different products. They are managed separately because each business requires different technology and marketing strategies.

There are two reportable segments: agricultural products and pressurized vessels. The agricultural products segment fabricates and sells farming products as well as replacement parts for these products throughout the United States. The pressurized vessel segment produces pressurized tanks.

The accounting policies applied to determine the segment information are the same as those described in the summary of significant accounting policies. Currently interest expense on long-term debt is all located within the agricultural products segment with no interest being charged to the pressurized vessels segment related to intercompany borrowings. Intersegment sales and transfers are accounted for at historical cost.

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. The agricultural products segment information is for the year ended November 30, 2005 and the pressurized vessels segment information is for the period from acquisition to November 30, 2005.

|                                 | Agricultural<br>Products | Pressurized<br>Vessels | Consolidated |
|---------------------------------|--------------------------|------------------------|--------------|
| Revenue from external customers | \$14,261,000             | \$358,000              | \$14,619,000 |
| Income from operations          | 1,683,000                | 7,000                  | 1,690,000    |
| Income before tax               | 1,467,000                | 7,000                  | 1,474,000    |
| Segment profit                  | 972,000                  | 5,000                  | 977,000      |
| Total Assets                    | 10,737,000               | 1,045,000              | 11,782,000   |
| Capital expenditures            | 374,000                  | 4,000                  | 378,000      |
| Depreciation                    | 262,000                  | 7,000                  | 269,000      |

### Item 8. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

Not Applicable

### Item 8A. Controls and Procedures.

Senior management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (a) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure; and (b) recorded, processed, summarized and reported, within the time specified in the SEC's rules and forms. Since that evaluation process was completed there have been no significant changes in our disclosure controls or in other factors that could

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significantly affect these controls.

There were no changes in our internal control over financial reporting, identified in connection with this evaluation that occurred during the fourth fiscal quarter that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### Item 8B. Other Information.

Not Applicable

## PART III

### Item 9. Directors and Executive Officers of the Registrant.

The information required by Item 9 is incorporated by reference to our Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after November 30, 2005.

We have adopted a Code of Ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller. A copy of the Code of Ethics may be obtained free of charge by writing to us at the following address:

Art's-Way Manufacturing Co., Inc.  
5556 Highway 9  
Armstrong, IA 50514

### Item 10. Executive Compensation.

The information required by Item 10 is incorporated by reference to our Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after November 30, 2005.

### Item 11. Security Ownership of Certain Beneficial Owners & Management and Related Stockholder Matters.

The information required by Item 11 is incorporated by reference to our Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after November 30, 2005.

### Item 12. Certain Relationships and Related Transactions.

The information required by Item 12 is incorporated by reference to our Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after November 30, 2005.

### Item 13. Exhibits.

Please see Exhibit Index.

### Item 14. Principal Accountant Fees and Services.

The information required by Item 14 is incorporated by reference to our Definitive Proxy Statement to be filed pursuant to Regulation 14A within 120 days after November 30, 2005.

Signatures

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In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ART'S-WAY MANUFACTURING CO., INC.

|   |  |
|---|--|
| By: _____<br>John C. Breitung<br>Chief Executive Officer<br>Date: _____ | By: _____<br>Carrie L. Majeski<br>Chief Financial Officer<br>Date: _____ |
|---|--|

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

|   |                               |
|---|-------------------------------|
| _____<br>J. Ward McConnell, Jr.<br>Chairman of the Board and Director | February 28, 2006<br><br>Date |
| _____<br>David R. Castle<br>Director                                  | February 28, 2006<br><br>Date |
| _____<br>George A. Cavanaugh, Jr.<br>Director                         | February 28, 2006<br><br>Date |
| _____<br>James L. Koley<br>Director                                   | February 28, 2006<br><br>Date |
| _____<br>Douglas McClellan<br>Director                                | February 28, 2006<br><br>Date |
| _____<br>Marc H. McConnell<br>Director                                | February 28, 2006<br><br>Date |
| _____<br>Thomas E. Buffamante<br>Director                             | February 28, 2006<br><br>Date |

### Art's-Way Manufacturing Co., Inc. Exhibit Index

| Number | Exhibit Description   |
|--------|---|
| 2      | Agreement & Plan of Merger for Reincorporation of Art's-Way Manufacturing Co., Inc., in Delaware. Incorporated by reference to Exhibit 2 of Annual Report on Form 10-K for the year ended May 27, 1989. |
| 3      | Certificate of Incorporation and By-laws for Art's-Way Manufacturing Co., Inc. Incorporated by reference to Exhibit 3 of Annual Report on Form 10-K for the year ended May 27, 1989.                    |
| 3.1    | Amendments to Bylaws of Art's-Way Manufacturing Co., Inc. Incorporated by reference to Exhibit 3.1 to the Form 10-QSB for the quarter ended May 31, 2004  |
| 10     | Incorporated by reference to the material contracts filed as Exhibit 10 to the Annual Report on Form 10-K for the fiscal year ended May 30, 1991.   |

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- 10.1 Art's-Way Manufacturing Co., Inc. 401 (k) Savings Plan. Incorporated by reference to Exhibit 28 (a) to the Art's-Way Manufacturing Co., Inc. Registration Statement on Form S-8 filed on October 23, 1992.
- 10.2 Art's-Way Manufacturing Co., Inc. Employee Stock Option Plan (1991). Incorporated by reference to Exhibit "A" to Proxy Statement for Annual Meeting of Stockholders held on October 15, 1991.
- 10.3 Art's-Way Manufacturing Co., Inc. Director Stock Option Plan (2001). Incorporated by reference as Exhibit 10.3.1 of the Annual Report on Form 10-K for the fiscal year ended November 30, 2002.
- 10.4 Asset Purchase Agreement between the Company and J. Ward McConnell, Jr., and Logan Harvesters, Inc. Incorporated by reference to Current Report on Form 8-K dated September 6, 1996.
- 10.5 Agreement dated February 12, 2002 between the Company and J. Ward McConnell, Jr., purchase of 640,000 shares of common stock. Incorporated by reference to Current Report on Form 8-K filed February 22, 2002.
- 10.6 Forbearance Agreement and Fifteenth Amendment to Loan and Security Agreement dated January 31, 2003 between the Company and UPS Capital Corporation. Incorporated by reference to the Form 10-Q for the quarter ended February 28, 2003.
- 10.7 Long-term Financing Agreement dated April 25, 2003 between the Company and West Des Moines State Bank. Incorporated by reference to the Form 10-Q for the quarter ended May 31, 2003.
- 10.8 Asset Purchase Agreement between the Company and Obeco Truck Body, Inc. Incorporated by reference to the Form 10-Q filed for the quarter ended August 31, 2003.
- 10.9 Purchase Agreement with Vessels Systems Inc.
- 21 Subsidiaries of the small business issuer.
- 23 Consent of McGladrey & Pullen, LLP
- 31.1 Certification of Chief Executive Officer under the Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer under the Section 302 of the Sabanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer under 18 U.S.C. Section 1350.
- 32.2 Certification of Chief Financial Officer under 18 U.S.C. Section 1350.