

ARTS WAY MANUFACTURING CO INC  
Form 10-Q  
March 31, 2015  
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended February 28, 2015  
or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of  
1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-5131

ART'S-WAY MANUFACTURING CO., INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

42-0920725

(I.R.S. Employer Identification No.)

5556 Highway 9

Armstrong, Iowa 50514

(Address of principal executive offices)

(712) 864-3131

(Registrant's telephone number, including area code)

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

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

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

Large Accelerated filer

Accelerated filer

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

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

Number of common shares outstanding as of March 18, 2015: 4,061,052

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

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

## Condensed Consolidated Balance Sheets

	(Unaudited)	
	<b>February 28, 2015</b>	<b>November 30, 2014</b>
<b>Assets</b>		
Current assets:		
Cash	\$902,041	\$511,716
Accounts receivable-customers, net of allowance for doubtful accounts of \$42,801 and \$35,175 in 2015 and 2014, respectively	2,786,565	2,961,834
Inventories, net	16,133,176	15,089,280
Deferred taxes	1,274,730	1,259,943
Cost and Profit in Excess of Billings	-	17,543
Income taxes receivable	7,904	100,417
Other current assets	458,067	125,229
Total current assets	21,562,483	20,065,961
Property, plant, and equipment, net	11,532,096	11,680,792
Assets held for lease, net	42,546	58,500
Goodwill	993,729	993,729
Other Assets	45,198	47,360
Total assets	\$34,176,052	\$32,846,342
<b>Liabilities and Stockholders’ Equity</b>		
Current liabilities:		
Line of credit	\$3,473,367	\$2,569,106
Current portion of term debt	1,293,675	1,283,897
Accounts payable	1,046,180	874,653
Customer deposits	786,836	95,411
Billings in Excess of Cost and Profit	170,155	96,382
Accrued expenses	1,411,048	1,584,328
Total current liabilities	8,181,261	6,503,777
Long-term liabilities		
Deferred taxes	1,141,580	1,141,580
Long Term debt, excluding current portion	5,622,642	5,949,329
Total liabilities	14,945,483	13,594,686

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Commitments and Contingencies (Notes 6 and 7)

Stockholders' equity:

Undesignated preferred stock - \$0.01 par value. Authorized 500,000 shares in 2015 and 2014; issued and outstanding 0 shares in 2015 and 2014.	-	-
Common stock – \$0.01 par value. Authorized 9,500,000 shares in 2015 and 2014; issued and outstanding 4,059,552 in 2015 and 4,048,552 in 2014	40,596	40,486
Additional paid-in capital	2,651,686	2,638,651
Retained earnings	16,538,287	16,572,519
Total stockholders' equity	19,230,569	19,251,656
Total liabilities and stockholders' equity	\$34,176,052	\$32,846,342

See accompanying notes to condensed consolidated financial statements.

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

## Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended	
	<b>February 28, 2015</b>	<b>February 28, 2014</b>
Sales	\$7,289,129	\$6,237,336
Cost of goods sold	5,236,994	4,896,923
Gross profit	2,052,135	1,340,413
Expenses:		
Engineering	115,679	113,539
Selling	564,714	536,149
General and administrative	1,042,593	985,661
Total expenses	1,722,986	1,635,349
Income (loss) from operations	329,149	(294,936 )
Other income (expense):		
Interest expense	(79,485 )	(53,939 )
Other	(4,864 )	5,675
Total other income (expense)	(84,349 )	(48,264 )
Income (loss) before income taxes	244,800	(343,200 )
Income tax expense (benefit)	76,605	(84,888 )
Net income (loss)	\$168,195	\$(258,312 )
Net income per share:		
Basic net income (loss) per share	\$0.04	\$(0.06 )
Diluted net income (loss) per share	\$0.04	\$(0.06 )
Weighted average outstanding shares used to compute basic net income per share	4,050,507	4,046,552
Weighted average outstanding shares used to compute diluted net income per share	4,051,754	4,046,552

See accompanying notes to condensed consolidated financial statements.

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

## Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Three Months Ended	
	<b>February 28, 2015</b>	<b>February 28, 2014</b>
Cash flows from operations:		
Net income (loss)	\$ 168,195	\$(258,312 )
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Stock based compensation	13,145	-
Loss on disposal of property, plant, and equipment	7,269	-
Depreciation expense	229,454	212,989
Bad debt expense (recovery)	7,626	(5,966 )
Deferred income taxes	(14,787 )	-
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	167,643	594,980
Inventories	(1,043,896)	(998,188 )
Income taxes receivable	92,513	(116,824 )
Other assets	(330,677 )	(381,292 )
Increase (decrease) in:		
Accounts payable	171,526	250,684
Contracts in progress, net	91,316	22,243
Customer deposits	691,425	1,134,311
Accrued expenses	(173,280 )	(288,108 )
Net cash provided by operating activities	77,472	166,517
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(86,528 )	(432,032 )
Proceeds from sale of assets	14,456	-
Net cash (used in) investing activities	(72,072 )	(432,032 )
Cash flows from financing activities:		
Net change in line of credit	904,261	452,810
Repayment of term debt	(316,909 )	(308,330 )
Dividends paid to stockholders	(202,428 )	-
Net cash provided by financing activities	384,925	144,480
Net increase/(decrease) in cash	390,325	(121,035 )
Cash at beginning of period	511,716	207,950
Cash at end of period	\$902,041	\$86,915
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$80,860	\$53,939



Income taxes	-	32,902
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See accompanying notes to condensed consolidated financial statements.

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## Notes to Unaudited Condensed Consolidated Financial Statements

### 1) Description of the Company

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

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

We have organized our business into four operating segments. Management separately evaluates the financial results of each segment because each is a strategic business unit offering different products and requiring different technology and marketing strategies. Our agricultural products segment (“Manufacturing”) manufactures farm equipment under the Art’s-Way Manufacturing label and private labels. Our pressurized vessels segment (“Vessels”) manufactures pressurized vessels. Our modular buildings segment (“Scientific”) manufactures modular buildings for various uses, commonly animal containment and research laboratories and our tools segment (“Metals”) manufactures steel cutting tools and inserts. For detailed financial information relating to segment reporting, see Note 12, “Segment Information.”

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

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

## **2) Summary of Significant Account Policies**

### Statement Presentation

The foregoing condensed consolidated financial statements of the Company are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's Annual Report on Form 10-K and the amendment thereto on Form 10-K/A for the fiscal year ended November 30, 2014. The results of operations for the three months ended February 28, 2015 are not necessarily indicative of the results for the fiscal year ending November 30, 2015.

### Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the three months ended February 28, 2015. Actual results could differ from those estimates.

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

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



Basic and diluted earnings (loss) per common share have been computed based on the following as of February 28, 2015 and February 28, 2014:

	<b>For the three months ended</b>	
	<b>February 28, 2015</b>	<b>February 28, 2014</b>
<b>Basic:</b>		
Numerator: net income	\$168,195	\$(258,312 )
Denominator: average number of common shares outstanding	4,050,507	4,046,552
Basic earnings per common share	\$0.04	\$(0.06 )
<b>Diluted:</b>		
Numerator: net income	\$168,195	\$(258,312 )
Average number of common shares outstanding	4,050,507	4,046,552
Effect of dilutive stock options	1,247	0
Denominator: dilutive average number of common shares outstanding	4,051,754	4,046,552
Diluted earnings per common share	\$0.04	\$(0.06 )

#### 4) Inventory

Major classes of inventory are:

	<b>February 28, 2015</b>	<b>November 30, 2014</b>
Raw materials	\$9,159,541	\$10,037,055
Work in process	639,035	467,110
Finished goods	10,079,813	8,504,062
	\$19,878,389	\$19,008,227
Less: Reserves	(3,745,213 )	(3,918,947 )
	\$16,133,176	\$15,089,280

#### 5) Accrued Expenses

Major components of accrued expenses are:

	<b>February 28, 2015</b>	<b>November 30, 2014</b>
Salaries, wages, and commissions	\$541,554	\$673,934
Accrued warranty expense	246,490	234,266
Other	623,004	676,128
	<b>\$1,411,048</b>	<b>\$1,584,328</b>

#### **6)Product Warranty**

The Company offers warranties of various lengths to its customers depending on the specific product and terms of the customer purchase agreement. The average length of the warranty period is one year from the date of purchase. The Company's warranties require it to repair or replace defective products during the warranty period at no cost to the customer. The Company records a liability for estimated costs that may be incurred under its warranties. The costs are estimated based on historical experience and any specific warranty issues that have been identified. Although historical warranty costs have been within expectations, there can be no assurance that future warranty costs will not exceed historical amounts. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the balance as necessary. The accrued warranty balance is included in accrued expenses as shown in Note 5.

Changes in the Company's product warranty liability for the three months ended February 28, 2015 and February 28, 2014 are as follows:

	<b>For the three months ended</b>	
	<b>February 28, 2015</b>	<b>February 28, 2014</b>
Balance, beginning	\$234,266	\$220,719
Settlements / adjustments	(91,525 )	(151,577)
Warranties issued	103,749	84,313
Balance, ending	\$246,490	\$153,455

## **7) Loan and Credit Agreements**

On May 1, 2013, the Company began to move all banking arrangements previously held through West Bank to U.S. Bank. The relationship with U.S. Bank now includes an \$8,000,000 revolving line of credit (the "Line of Credit") which was renewed in 2014, and is now scheduled to mature on May 1, 2015. The Line of Credit is renewable annually with advances funding the Company's working capital needs and is secured by real property and fixed asset collateral. We expect to renew the line of credit prior to its maturity date. The interest rate is U.S. Bank's prime interest rate, adjusted each time that the Federal prime rate changes, with a minimum rate of 3.50%. As of February 28, 2015, the interest rate was the minimum of 3.50%. Monthly interest-only payments are required and the unpaid principal is due on the maturity date. As of February 28, 2015, the Company had a principal balance of \$3,473,367 outstanding against the Line of Credit, with \$2,603,803 remaining available. The Line of Credit states that the borrowing base will be an amount equal to the sum of 75% of accounts receivable (discounted for aged accounts and customer balances exceeding 20% of aggregate receivables), plus 50% of inventory (this component cannot exceed \$6,000,000 and only includes finished goods and raw materials deemed to be in good condition and not obsolete), less any outstanding loan balance of the Line of Credit, and less undrawn amounts of outstanding letters of credit issued by U.S. Bank or any affiliate. The Company's obligations under the Line of Credit are evidenced by a Revolving Credit Note effective May 1, 2013, a Revolving Credit Agreement dated May 1, 2013 and certain other ancillary documents.

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

On May 29, 2014, the Company obtained \$1,000,000 in long-term debt from U.S. Bank to partially pay down the line of credit draw from 2013 that it had used to finance the purchase of the building and property of Ohio Metal Working Products Company in Canton, Ohio. The maturity date of this loan is May 25, 2017, with a final payment of principal and accrued interest in the amount of \$890,000 due May 25, 2017. This loan is secured by a mortgage on the building and property acquired from Ohio Metal Working Products Company in Canton, Ohio pursuant to a Mortgage, Security Agreement and Assignment of Rents between the Company and U.S. Bank, dated May 29, 2014.

Except for the U.S. Bank UHC Loan (as defined below), each of the Company's term loans from U.S. Bank is governed by a Term Note and a Term Loan Agreement. Each Term Loan Agreement and the Revolving Credit Agreement require the Company to provide monthly internally prepared financial reports, year-end audited financial statements, and a monthly aging of accounts receivable. The Company, as of the end of each fiscal quarter, must maintain a debt to tangible net worth ratio of not more than 1.5 to 1.0 and a fixed charge coverage ratio of at least 1.15 to 1.00. The Company was in compliance with all covenants under the Term Loan Agreements and the Revolving Credit Agreement as measured on February 28, 2015. The next measurement date is May 31, 2015. The loans are secured by a first position security interest on the assets of the Company and its subsidiaries, including but not limited to, inventories, machinery, equipment and real estate, in accordance with the Business Security Agreements entered into by the Company and its subsidiaries and the Pledge Agreements entered into by the subsidiaries. Additionally, the Company has mortgaged certain real property in favor of U.S. Bank as documented by mortgage agreements dated May 1, 2013 and May 29, 2014 (together, the "Mortgages").



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

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

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

On May 1, 2010, the Company obtained a loan to finance the purchase of an additional facility located in West Union, Iowa to be used as a distribution center, warehouse facility, and manufacturing plant for certain products under the Art's-Way brand. The funds for this loan were made available by the Iowa Finance Authority by the issuance of tax exempt bonds. This loan had an original principal amount of \$1,300,000 and an interest rate of 3.5%. On February 1, 2013, the interest rate was decreased to 2.75%. The other terms of the loan remain unchanged.

This loan from the Iowa Finance Authority, which has been assigned to The First National Bank of West Union (n/k/a Bank 1<sup>st</sup>), is governed by a Manufacturing Facility Revenue Note dated May 28, 2010 as amended February 1, 2013 and a Loan Agreement dated May 1, 2010 and a First Amendment to Loan Agreement dated February 1, 2013 (collectively, "the IFA Loan Agreement"), which requires the Company to provide quarterly internally prepared financial reports and year-end audited financial statements and to maintain a minimum debt service coverage ratio of 1.5 to 1.0, which is measured at November 30 of each year. Among other covenants, the IFA Loan Agreement also requires the Company to maintain proper insurance on, and maintain in good repair, the West Union Facility, and continue to conduct business and remain duly qualified to do business in the State of Iowa. The loan is secured by a mortgage on the Company's West Union Facility, pursuant to a Mortgage, Security Agreement, Assignment of Leases and Rents and Fixture Financing Statement dated May 1, 2010 between the Company and The First National Bank of West Union (the "West Union Mortgage").

If the Company commits an event of default under the IFA Loan Agreement and does not cure the event of default within the time specified by the IFA Loan Agreement, the lender may cause the entire amount of the loan to be immediately due and payable and take any other action that it is lawfully permitted to take or in equity to enforce the Company's performance.

The Company was in compliance with all covenants under the IFA Loan Agreement as measured on November 30, 2014. The next measurement date is November 30, 2015.

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

	<b>February 28, 2015</b>	<b>November 30, 2014</b>
U.S. Bank loan payable in monthly installments of \$42,500 including interest at 2.98%, due May 1, 2018	\$1,547,175	\$1,662,311
U.S. Bank loan payable in monthly installments of \$11,000 including interest at 2.98%, due May 1, 2018	824,342	850,930
U.S. Bank loan payable in monthly installments of \$12,550 including interest at 2.98%, due May 1, 2018	935,517	965,889
U.S. Bank loan payable in monthly installments of \$27,800 including interest at 2.98%, due May 1, 2018	1,334,497	1,407,366
U.S. Bank loan payable in monthly installments of \$11,700 including interest at 3.15%, due May 10, 2017	557,634	588,101
U.S. Bank loan payable in monthly installments of \$5,556 including interest at 2.98%, due May 25, 2017	971,717	980,940
Iowa Finance Authority loan payable in monthly installments of \$12,500 including interest at 2.75%, due June 1, 2020	745,435	777,689
Total term debt	\$6,916,317	\$7,233,226
Less current portion of term debt	1,293,675	1,283,897
Term debt, excluding current portion	\$5,622,642	\$5,949,329

## **8) Recently Issued Accounting Pronouncements**

### Presentation of an Unrecognized Tax Benefit

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

### Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers" which supersedes the guidance in "Revenue Recognition (Topic 605)" and requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period and is to be applied retrospectively, with early application not permitted. We are evaluating the new standard, but do not at this time expect this standard to have a material impact on our consolidated financial statements.

### Going Concern

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements – Going Concern" which is authoritative guidance on management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and provide related footnote disclosures, codified in ASC 205-40, *Going Concern*. The guidance provides a definition of the term substantial doubt, requires an evaluation every reporting period including interim periods, provides principles for considering the mitigating effect of management's plans, requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, requires an express statement and other disclosures when substantial doubt is not alleviated, and requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). ASU No. 2015-15 is effective for annual reporting periods ending after December 15, 2016. The Company will adopt this guidance for the year-ended November 30, 2017, and it will apply to each interim and annual period thereafter. Its adoption is not expected to have a material effect on the Company's consolidated financial statements.

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

On January 27, 2011, the Board of Directors of the Company authorized and approved the Art's-Way Manufacturing Co., Inc. 2011 Equity Incentive Plan (the "2011 Plan"). The 2011 Plan was approved by the stockholders on April 28, 2011. It replaced the Employee Stock Option Plan and the Directors' Stock Option Plan (collectively, the "Prior Plans"), and no further stock options will be awarded under the Prior Plans. Awards to directors and executive officers under the 2011 Plan will be governed by the forms of agreement approved by the Board of Directors.

The 2011 Plan permits the plan administrator to award nonqualified stock options, incentive stock options, restricted stock awards, restricted stock units, performance awards, and stock appreciation rights to employees (including

officers), directors, and consultants. The Board of Directors has approved a director compensation policy pursuant to which non-employee directors are automatically granted non-qualified stock options to purchase 2,000 shares of common stock annually or initially upon their election to the Board, which are fully vested.

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

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant vesting period. We estimate the fair value of each stock-based award on the measurement date using the Black-Scholes option valuation model which incorporates assumptions as to stock price volatility, the expected life of the options, risk-free interest rate, and dividend yield. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses historical option exercise and termination data to estimate the expected term the options are expected to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield is calculated using historical dividend amounts and the stock price at the option issuance date. We incurred \$13,145 of stock-based compensation expense during the three months ended February 28, 2015.

## 10) Acquisitions

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

The acquisition also includes a consignment arrangement regarding \$600,000 of select finished good inventory. As part of the arrangement, International agreed to use reasonable efforts to sell the inventory including providing a sales and marketing plan with projections within 60 days of the closing date and meeting with the consignor quarterly to discuss progress. Once a month, International will pay the consignor an amount equal to the cost base of the inventory sold that month. As of February 28, 2015, International had sold \$410,000 of the consigned inventory.

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

On September 30, 2013, the Company acquired the assets of Ohio Metal Working Products Company in Canton, Ohio consisting of inventory, equipment, real property, and intangible assets. A new entity was formed, Ohio Metal Working Products/Art's-Way, Inc. ("Metals"). A new segment called Tools was created for financial reporting purposes. Ohio Metal Working Products/Art's-Way, Inc. is a domestic manufacturer and distributor of standard single point brazed carbide tipped tools as well as PCD (polycrystalline diamond) and CBN (cubic boron nitride) inserts and tools. The amount paid for the acquisition totaled approximately \$3,172,000 (\$1,142,000 in inventory, \$1,200,000 in land and building, \$868,000 in fixed assets, and a reduction for assumed vacation liability of \$38,000). The acquisition was financed by accessing the line of credit available through U.S. Bank, and on May 29, 2014 we granted a mortgage for the property and buildings in the amount of \$1,000,000 which was used to pay down on the line of credit. The operating results of the acquired business are reflected in the Company's consolidated statements of operations from the acquisition date forward. The acquisition was made to continue the Company's growth strategy and diversify its product offerings.

**11) Disclosures About the Fair Value of Financial Instruments**

The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties. At February 28, 2015, and November 30, 2014, the carrying amount approximated fair value for cash, accounts receivable, accounts payable, notes payable to bank, and other current and long-term liabilities. The carrying amounts approximate fair value because of the short maturity of these instruments. The fair value of the Company's installment term loans payable also approximate recorded value because the interest rates charged under the loan terms are not substantially different than current interest rates.



**12) Segment Information**

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

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

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

## Three Months Ended February 28, 2015

	Agricultural Products	Pressurized Vessels	Modular Buildings	Tools	Consolidated
Net Sales from external customers	\$ 5,315,000	\$ 527,000	\$ 650,000	\$ 797,000	\$ 7,289,000
Income (loss) from operations	439,000	(61,000)	(67,000)	18,000	329,000
Income (loss) before taxes	399,000	(67,000)	(73,000)	(14,000)	245,000
Total Assets	25,519,000	2,607,000	2,884,000	3,166,000	34,176,000
Capital expenditures	78,000	2,000	2,000	5,000	87,000
Depreciation & Amortization	140,000	27,000	33,000	29,000	229,000

## Three Months Ended February 28, 2014

	Agricultural Products	Pressurized Vessels	Modular Buildings	Tools	Consolidated
Revenue from external customers	\$ 4,441,000	\$ 424,000	\$ 461,000	\$ 911,000	\$ 6,237,000

Income (loss) from operations	(202,000)	(32,000)	(127,000)	66,000	(295,000)
Income (loss) before tax	(240,000)	(40,000)	(129,000)	66,000	(343,000)
Total Assets	25,019,000	2,687,000	2,573,000	3,488,000	33,766,000
Capital expenditures	412,000	11,000	0	9,000	432,000
Depreciation & Amortization	120,000	27,000	37,000	29,000	213,000

### 13) Subsequent Event

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

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

### Forward-Looking Statements

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of Part I of this report and the audited consolidated financial statements and related notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K and the amendment thereto on Form 10-K/A for the fiscal year ended November 30, 2014. Some of the statements in this report may contain forward-looking statements that reflect our current view on future events, future business, industry and other conditions, our future performance, and our plans and expectations for future operations and actions. In some cases you can identify forward-looking statements by the use of words such as "may," "should," "anticipate," "believe," "expect," "plan," "future," "intend," "could," "predict," "hope," "potential," "continue," or the negative of these terms or other similar expressions. Many of these forward-looking statements are located in this report under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" but they may appear in other sections as well. Forward-looking statements in this report generally relate to: (i) our expectations regarding our warranty costs and order backlog; (ii) our beliefs regarding the sufficiency of working capital and cash flows, and our continued ability to renew or obtain financing on reasonable terms when necessary; (iii) the impact of recently issued accounting pronouncements; (iv) and our expectations concerning our primary capital and cash flow needs.



You should read this report thoroughly with the understanding that our actual results may differ materially from those set forth in the forward-looking statements for many reasons, including events beyond our control and assumptions that prove to be inaccurate or unfounded. We cannot provide any assurance with respect to our future performance or results. Our actual results or actions could and likely will differ materially from those anticipated in the forward-looking statements for many reasons, including but not limited to: (i) the impact of tightening credit markets on our ability to continue to obtain financing on reasonable terms; (ii) our ability to continue to meet debt obligations and comply with financial covenants; (iii) obstacles related to integration of acquired product lines and businesses; (iv) the effect of general economic conditions, including consumer and governmental spending, on the demand for our products and the cost of our supplies and materials; (v) fluctuations in seasonal demand and our production cycle; and (vi) other factors described from time to time in our reports to the SEC. We do not intend to update the forward-looking statements contained in this report other than as required by law. We caution you not to put undue reliance on any forward-looking statements, which speak only as of the date of this report. You should read this report and the documents that we reference in this report and have filed as exhibits completely and with the understanding that our actual future results may be materially different from what we currently expect. We qualify all of our forward-looking statements by these cautionary statements.

### **Critical Accounting Policies**

Our critical accounting policies involving the more significant judgments and assumptions used in the preparation of the financial statements as of February 28, 2015 have remained unchanged from November 30, 2014. Disclosure of these critical accounting policies is incorporated by reference from Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended November 30, 2014.

### **Results of Operations**

#### *Net Sales and Cost of Sales*

Our consolidated corporate sales for the three-month period ended February 28, 2015 were \$7,289,000 compared to \$6,237,000 during the same respective period in 2014, a \$1,052,000, or 16.9%, increase for the quarter. The increase in revenue for the three-month period ended February 28, 2015 was primarily due to increases in revenue in our Agricultural Products segment. Consolidated gross profit margin for the three-month period ended February 28, 2015 was 28.2% compared to 21.5% in 2014.

Our first quarter sales at Manufacturing were \$5,315,000, compared to \$4,441,000 during the same period of 2014, an increase of \$874,000, or 19.7%. This increase is primarily due to increased sales of our grinder-mixer product lines,

but is somewhat offset by reduced sales of our Universal Harvester reels. During the first quarter of 2014, cold weather caused inefficiencies in our production facility that restricted the availability of our products for shipment. The gross margin of our agricultural products segment for the quarter ended February 28, 2015 was 32.1%, compared to 21.7% for the same period in 2014. Most of this increase is due to greater efficiencies in our manufacturing facilities and improved management of our inventories as compared to the previous year.

Our first quarter sales at Vessels were \$527,000 compared to \$424,000 for the same periods in 2014, an increase of \$103,000, or 24.3%. This increase was caused in part by the addition of our new line of stock tanks available for sale. Gross margin for the quarter ended February 28, 2015 was 5.5% compared to 8.5% for the same period in 2014. This decrease is primarily due to increased freight expenses for delivery of our product to customers.

Our first quarter sales at Scientific were \$650,000 compared to \$461,000 for the same period in fiscal 2014, an increase of \$189,000, or 41.0%. This increase is primarily due to increased sales of our agricultural buildings. Scientific uses the percentage of completion accounting method to calculate revenue and gross margins for all contracts. Gross margin for the quarter ended February 28, 2015 was 12.2% compared to 13.4% for the same period in 2014.

Metals had sales of \$797,000 during the three months ended February 28, 2015, compared to \$911,000 for the same period in 2014, a 12.5% decrease largely due to a general decline in the gas and oil industry. Gross margin at Metals was 29.7% for the first fiscal quarter of 2015, compared to 30.6% for the first quarter of fiscal 2014.

#### *Expenses*

Our first fiscal quarter consolidated selling expenses were \$565,000 compared to \$536,000 for the same period in 2014. These increases are primarily due to increased commission expense due to our higher revenue amounts in the first quarter of fiscal 2015. Selling expenses as a percentage of sales were 7.8% for the three-month period ended February 28, 2015, compared to 8.6% for the same respective period in 2014.

Consolidated engineering expenses were \$116,000 for the three months ended February 28, 2015, compared to \$114,000 for the same period in 2014. Engineering expenses as a percentage of sales were 1.6% for the three-month period ended February 28, 2015, compared to 1.8% for the same respective period in 2014.

Consolidated administrative expenses for the three months ended February 28, 2015 were \$1,042,000 compared to \$985,000 for the same period in 2014. The change in expense is primarily due to increased bonus accruals in fiscal 2015. Administrative expenses as a percentage of sales were 14.3% for the three-month period ended February 28, 2015, compared to 15.8% for the same respective period in 2014.

#### *Income*

Consolidated net income was \$168,000 for the three month period ended February 28, 2015, compared to a net loss of \$258,000 for the same respective period in 2014. This increase in income is due to a \$641,000 increase in operating income in our agricultural products segment in the first quarter of 2015 compared to the first quarter of 2014, but was offset by operating losses at our Vessels and Scientific divisions.

*Order Backlog*

The consolidated order backlog net of discounts as of March 25, 2015 was \$6,844,000 compared to \$10,061,000 as of March 25, 2014. The agricultural products segment order backlog was \$5,711,000 as of March 25, 2015 compared to \$8,739,000 in fiscal 2014. This decrease is partly attributable to decreased orders of our Universal Harvester products. Also, in fiscal 2014 the severe winter weather impacted our production schedule, which delayed our ability to ship products and resulted in a larger backlog. The backlog for the pressurized vessels segment was \$462,000 as of March 25, 2015, compared to \$572,000 in fiscal 2014. The backlog for the modular buildings segment was \$79,000 as of March 25, 2015, compared to \$382,000 in fiscal 2014. The backlog for the tools segment was \$591,000 as of March 25, 2015, compared to \$368,000 in fiscal 2014. Our order backlog is not necessarily indicative of future revenue to be generated from such orders due to the possibility of order cancellations and dealer discount arrangements we may enter into from time to time.

## **Liquidity and Capital Resources**

Our inventories were higher at February 28, 2015 compared to November 30, 2014 as the result of the timing of a portion of our OEM blower sales. Our primary sources of funds for the three months ended February 28, 2015 were proceeds from the U.S. Bank Line of Credit; and we expect our primary capital needs to relate to costs of operation, including production.

We have an \$8,000,000 revolving Line of Credit with U.S. Bank, which, as of February 28, 2015, had an outstanding principal balance of \$3,473,367. The Line of Credit is renewable annually and is scheduled to mature on May 1, 2015. We expect to renew the line of credit prior to its maturity date. For additional information about our financing activities, please refer to Note 8 to the audited consolidated financial statements and to the discussion entitled "Liquidity and Capital Resources," each contained in our Annual Report on Form 10-K and our amendment thereto on Form 10-K/A for the fiscal year ended November 30, 2014, as well as Note 7 to the unaudited condensed consolidated financial statements included in Part I, Item 1 of this Report.

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

## **Off Balance Sheet Arrangements**

None.

## **Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

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

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



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

The persons serving as our principal executive officer and principal financial officer have evaluated the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) and Rule 15d-15(e), as of the end of the period subject to this Report. Based on this evaluation, the persons serving as our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective and provide reasonable assurance that information required to be disclosed by us in the periodic and current reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the periods specified by the Securities and Exchange Commission's rules and forms.

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

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

**PART II – OTHER INFORMATION**

**Item 1. Legal Proceedings.**

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

**Item 1A. Risk Factors.**

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

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

None.

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

None.

**Item 4. Mine Safety Disclosures.**

Not applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

See “Exhibit Index” on page 18 of this report.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ART'S-WAY MANUFACTURING  
CO., INC.

Date: March 31, 2015 By: /s/ Carrie L. Majeski  
Carrie L. Majeski  
President and Chief Executive Officer

Date: March 31, 2015 By: /s/ Amber J. Murra  
Amber J. Murra  
Chief Financial Officer

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

**Exhibit Index**

**Form 10-Q for the Quarterly Period Ended February 28, 2015**

**Exhibit**

**Description**

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