ARTS WAY MANUFACTURING CO INC
Form 10QSB
April 17, 2007

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

FORM 10-QSB

(Mark One)

[x] Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934. For the quarterly period ended February 28, 2007

[ ] 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 Small Business Issuer as Specified in Its Charter)

DELAWARE	42-0920725
(State or Other Jurisdiction of Incorporation or Organization)	I.R.S. Employer Identification No.

Hwy 9 West, Armstrong, Iowa
50514
(Address of Principal Executive Offices)

(712) 864-3131
Issuer's Telephone Number, Including Area Code

Check whether the issuer (1) has 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 requirements for the past 90 days. Yes X No __

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

Number of common shares outstanding as of April 16, 2007: 1,978,176

Transitional Small Business Disclosure Format (check one): Yes _ No X

ARTS-WAY MANUFACTURING CO., INC.
Consolidated Statements of Operations
Condensed
(Unaudited)

	Three Months Ended	
	February 2007	February 2006
Net sales	$ 5,275,037	$ 4,302,088
Cost of goods sold	3,776,777	2,926,683
Gross profit	1,498,260	1,375,405

Expenses:		
Engineering	79,088	91,040
Selling	232,347	192,259
General and administrative	679,826	601,448
Total expenses	991,261	884,747
Income from operations	506,999	490,658
Other income (expense):		
Interest expense	(105,971)	(82,342)
Other	182,689	16,636
Total other expense	76,718	(65,706)
Income before income taxes	583,717	424,952
Income tax	203,388	152,983
Net income	$ 380,329	$ 271,969
Net income per share:		
Basic	$ 0.19	$ 0.14
Diluted	0.19	0.14
Common shares and equivalent outstanding:		
Basic	1,978,176	1,964,009
Diluted	1,982,502	1,976,443

See accompanying notes to consolidated financial statements.

ARTS-WAY MANUFACTURING CO., INC.
Consolidated Balance Sheets
Condensed

Assets	(Unaudited) February 2007	November 2006
Current assets:		
Cash	$ 3,287,818	$ 2,072,121
Accounts receivable-customers, net of allowance for doubtful accounts of $115,437 and $108,372 in February and November, respectively	2,950,415	2,313,290
Inventories, net	6,826,294	5,998,175
Profit in excess of billings	12,396	0
Deferred taxes	672,000	672,000
Insurance Recievable	871,400	0
Other current assets	200,396	163,114
Total current assets	14,820,719	11,218,700
Property, plant, and equipment, net	2,846,402	3,185,298
Deferred taxes	100,000	100,000
Other assets	96,478	110,240
Total assets	$ 17,863,599	$ 14,614,238
Liabilities and Stockholders Equity		
Current liabilities:		
Notes payable to bank	$ 412,527	$ 0
Current portion of term debt	270,058	220,559
Accounts payable	1,350,553	587,555
Customer deposits	1,834,258	424,205
Billings in Excess of Cost and Profit	473,092	57,266
Accrued expenses	1,347,635	1,427,658
Total current liabilities	5,688,123	2,717,243
Term debt, excluding current portion	3,749,149	3,852,372

Total liabilities	9,437,272	6,569,615
Stockholders equity:		
Common stock $0.01 par value. Authorized 5,000,000 shares; issued 1,978,176 and 1,963,176 shares in 2007 and 2006	19,782	19,782
Additional paid-in capital	1,767,072	1,765,697
Retained earnings	6,639,473	6,259,144
Total stockholders equity	8,426,327	8,044,623
Total liabilities and stockholders equity	$ 17,863,599	$ 14,614,238

See accompanying notes to consolidated financial statements.

ARTS-WAY MANUFACTURING CO., INC.
Consolidated Statements of Cash Flows
Condensed
(Unaudited)

	Three Months Ended	
	February 2007	February 2006
Cash flows from operations:		
Net income	$ 380,329	$ 271,970
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock based compensation	1,375	1,256
(Gain) Loss on sale of property, plant, and equipment	334,040	0
Depreciation and amortization	75,957	53,429
Deferred income taxes	0	140,000
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(637,125)	(1,413,037)
Inventories	(828,119)	(11,610)
Other current assets	(37,282)	(27,471)
Insurance Recievable	(871,400)	0
Other, net	13,762	0
Increase (decrease) in:		
Accounts payable	762,998	161,551
Billings in Excess of Costs	403,430	0
Customer deposits	1,410,053	1,152,694
Accrued expenses	(80,023)	(88,316)
Net cash provided by operating activities	927,995	240,466
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(71,101)	(334,497)
Net cash (used in) investing activities	(71,101)	(334,497)
Cash flows from financing activities:		
Net change in line of credit	412,527	43,484
Payments of notes payable to bank	(53,724)	(44,151)
Proceeds from the exercise of stock options	0	11,599
Net cash provided by (used in) financing activities	358,803	10,932
Net increase/(decrease) in cash	1,215,697	(83,099)
Cash at beginning of period	2,072,121	1,198,238

Cash at end of period	$ 3,287,818	$ 1,115,139

Supplemental disclosures of cash flow information:
Cash paid/(received) during the period for:

Interest	$ 105,970	$ 90,906
Income taxes	282,000	12,902

See accompanying notes to consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statement Presentation

The financial statements 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-KSB for the year ended November 30, 2006. The results of operations for the first quarter ended February 28, 2007 are not necessarily indicative of the results for the fiscal year ending November 30, 2007.

2. INVENTORIES

Major classes of inventory are:

	February 28, 2007	November 30, 2006
Raw material	$ 4,334,572	$ 3,260,897
Work-in-process	591,591	981,979
Finished goods	3,001,967	2,886,860
Total	$ 7,928,129	$ 7,129,736
Less reserves	1,101,836	1,131,561
Inventories	$ 6,826,294	$ 5,998,175

3. ACCRUED EXPENSES

Major components of accrued expenses are:

	February 28, 2007	November 30, 2006
Salaries, wages and commissions	$ 461,447	$ 464,609
Accrued warranty expense	221,089	230,740
Income tax	257,716	356,712
Other	407,423	375,597
Total	$ 1,347,675	$ 1,427,658

4. PRODUCT WARRANTY

The Company offers limited 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 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 three months ended February 28, 2007 and February 28, 2006 are as follows:

	2007	2006
Balance, beginning	$230,740	$131,832
Settlements made in cash or in-kind	(107,694)	(110,413)
Warranties issued	98,043	63,021
Balance, ending	$221,089	$84,440

5. LOAN AND CREDIT AGREEMENTS

The Company has a revolving line of credit for $3,500,000 with advances funding the working capital, letter of credit and corporate credit card needs that matures on April 30, 2007. 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 February 28, 2007 and 2006, the Company had borrowed approximately $413,000 and $43,000, respectively. Total amount available for borrowing at February 28, 2007 was $3,087,000. 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.

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 $15,000 and $14,000, for the quarter ended February 28, 2007, and 2006, respectively.

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

	February 28, 2007	November 30, 2006
West Bank loan payable in monthly installments of $17,776 including interest at Bank's prime rate plus 1.5%, due March 31, 2023 (A) (B)	$ 1,689,348	$ 1,701,843
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)	$ 935,657	$ 943,034
West Bank loan payable in monthly installments of $22,063 including interest at Bank's prime rate plus 1.0% due April 2016	$1,394,202	$1,428,054
Total term debt	$ 4,019,207	$ 4,072,931
Less current portion of term debt	$ 270,058	$ 220,559
Term debt, excluding current portion	$ 3,749,149	$ 3,852,372

(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.

6. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2006, the FASB issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (Issued 6/06). This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. For the Company, the Statement is effective for fiscal years beginning after December 15, 2006. The Company is assessing the effects of Financial Interpretation No. 48.

7. STOCK OPTION PLANS

On January 25, 2007 the Board of Directors adopted the 2007 Non-Employee Directors' Stock Option Plan. Options will 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 are automatically or initially granted options to purchase 1,000 shares of common stock annually upon their election to the Board, which are automatically vested. Options granted are nonqualified stock options. The option price and terms are set by the Compensation Committe of the Board of Directors of the Company.

On February 5, 2007 the Board of Directors adopted the 2007 Employee Stock Option Plan subject to Stockholder approval at the Annual Stockholders meeting on April 26, 2007.

8. SEGMENT INFORMATION

On October 4, 2005, the Company purchased certain assets of Vessels Systems, Inc. which created a separate operating segment. On August 2, 2006, the Company purchased certain assets of Tech Space, Inc. which created a third operating segment. Prior to these acquisitions the

Company operated in one reportable segment.

The Company's 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 three reportable segments: agricultural products, pressurized vessels and modular buildings. The agricultural products segment fabricates and sells farming products as well as replacement parts for these products in the United States and worldwide. Export sales amounted to $844,000 and $0 in 2006 and 2005 respectively. The pressurized vessel segment produces pressurized tanks. The modular building segment produces modular buildings for animal containment and various laboratory uses.

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. The agricultural products, pressurized vessels, and modular building segment information are for the first quarter ended February 28, 2007 and February 28, 2006.

February 28, 2007

	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	$3,272,000	$1,052,000	$ 951,000	$5,275,000
Income from operations	288,000	209,000	10,000	507,000
Income before tax	236,000	187,000	161,000	584,000
Segment profit	149,000	125,000	106,000	380,000
Total Assets	13,497,000	1,842,000	2,525,000	17,864,000
Capital expenditures	65,000	6,000	0	71,000
Depreciation	60,000	12,000	4,000	76,000

February 28, 2006

	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	$3,628,000	$674,000	0	$4,302,000
Income from operations	478,000	13,000	0	491,000
Income before tax	409,000	16,000	0	425,000
Segment profit	262,000	10,000	0	272,000
Total Assets	13,046,000	247,000	0	13,293,000
Capital expenditures	320,000	14,000	0	334,000
Depreciation	42,000	11,000	0	53,000

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report. Management's discussion and analysis contains forward-looking statements that involve risks and uncertainties, including but not limited to, quarterly fluctuations in results; customer demand for our products; economic conditions; the achievement of lower costs and expenses; the continued availability of financing in the amount and on the terms required to support future business; and other risks detailed from time to time in our other Securities and Exchange Commission filings. Actual results may differ materially from management's expectations.

(a) Plan of Operation

In the current fiscal year we plan to continue growth through new product development and when appropriate acquisition. We continue to look for new and better ways to improve our product offerings for our end users. We persist in our attempt to improve our efficiencies, through the implementation of lean manufacturing processes.

(b) Management's Discussion and Analysis of Financial Condition and Results of Operations

(i) 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, 2007 have remained unchanged from November 30, 2006. These policies involve revenue recognition, inventory valuation and income taxes. Disclosure of these critical accounting policies is incorporated by reference under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation" in our Annual Report on Form 10-KSB for the year ended November 30, 2006.

(ii) Results of Operations

Our consolidated net sales for the first quarter of 2007 increased 23% to $5,275,000 as compared to $4,302,000 for 2006. A majority of this increase was due to the inclusion of Art's-Way Scientific, Inc., net sales of $950,000, for the first quarter which was acquired in August of 2006 and therefore was not included in last year's first quarter. Art's-Way Manufacturing had revenues totaling $3,273,000 for the first quarter, compared to $3,629,000 for the same period in 2006. This decrease was due to a reduction in sales to our OEM dealers for blowers. Art's-Way Vessels had revenues totaling $1,052,000 for the first quarter, compared to $674,000 for the same period in 2006.

Art's-Way Manufacturing's gross profit decreased in the quarter to 28% as compared to 32% in 2006. The decrease was due primarily to the addition of Art's-Way Scientific. When we purchased Art's-Way Scientific we also purchased their backlog and had to honor pricing from the prior owners. Art's-Way Scientific's gross profit was 20% for the first quarter of 2007. Art's-Way Manufacturing's gross profit was 30% while Art's-Way Vessel's was 32%.

Operating expenses for the quarter increased $107,000 compared to 2006. However, as a percent of sales, operating expenses decreased by two percentage points- 19% in 2007 compared to 21% in 2006. Art's-Way Manufacturing's operating expense as a percentage of sales decreased from 20% in 2005 to 18% in 2006. Art's-Way Vessel operating expenses as a percentage of sales were 12%.

General and administrative expenses for the quarter increased $78,000 as compared to 2006. Substantially all of the increase was due to the addition of Art's-Way Scientific.

Engineering expenses are down $12,000 for the first quarter of 2007 as compared to 2006.

Selling expenses were up for the first quarter of 2007 by $40,000. This is almost entire due to the addition of Art's-Way Scientific, which had selling expenses of $38,000.

We experienced an increase in interest expense of $24,000 in the first quarter of 2007 as a result of a rise in the prime interest rate from the first quarter of 2006. Other income increased by $166,053 in 2007 compared to 2006. This is the result of accounting for the fire and insurance in Monona, Iowa.

On January 16th, 2007, one of our buildings in Monona, Iowa, was completely destroyed by fire. The building housed the production and offices for Art's-Way Scientific. The 36,000 square foot building was a stick built structure with steel siding. We were insured for the loss of the building, its contents as well as the disruption in business. We are currently working with our insurance company to settle the claim. At this time we have received $250,000 towards the claim and we have booked a receivable for the estimated loss of the building of $871,000. We have incurred costs in excess of $900,000 related to the fire, to include $334,000 in loss of fixed assets. We are currently working from one of our other buildings in Monona, Iowa. We are in the process of determining where we will be rebuilding. It is our intent to be in a new building by September 2007. We continue to manufacture buildings and have not lost any orders to date.

The order backlog as of March 31, 2007 is $12,112,000 compared to $5,436,000 one year ago. Art's-Way Manufacturing's order backlog as of March is $3,899,000, Art's-Way Vessels is $2,149,000, and Art's-Way Scientific is $6,064,000.

(iii) Liquidity and Capital Resources

Our main source of funds in the first quarter came from customer deposits which increased $1,410,000 over our 2006 year end. This is a traditional increase for us as our beet programs ran in the first quarter and we offer discounts to our customers for making down payments on their orders. We are working to settle the insurance claim for the building, inventory and assets that were destroyed in Monona, Iowa. We have currently recorded a loss on the assets of $334,000 due to the fire. We are also showing a receivable increase of $871,000 that relates directly to the expected insurance proceeds on the building. Accounts receivable are up $637,000 over our November year end balance. This increase is due to the sales of our blowers to OEM dealers in the last month of the quarter. Inventories increased $828,000. This increase is offset by the decrease in our accounts payable of $763,000, due to bringing in large quantities of steel for our upcoming building of sugar beet equipment.

See footnote 5 of the notes to the consolidated condensed financial statements for a discussion of our credit facilities.

Item 3

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 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 period covered by this report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II - Other Information

ITEM 1. LEGAL PROCEEDINGS

During the period covered by this report, we were not a party to any legal action or claim which was other than routine litigation incidental to our business.

ITEM 6. EXHIBITS

See Exhibit Index on page 15 of this report.

SIGNATURES

In accordance with the requirements 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: ____________________________	By: __________________________
E.W. Muehlhausen	Carrie L. Majeski
President	Chief Financial Officer
Date:_______________________	Date:____________________

Exhibits Index

10.1	Non-Employee Director's Stock Option Plan
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
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.