WSI INDUSTRIES, INC.
Form 10-Q
January 09, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended November 30, 2008

OR

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

For the transition period from __________ to __________

Commission file number 0-619
WSI Industries, Inc.
(Exact name of registrant as specified in its charter)

Minnesota	**41-0691607**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
213 Chelsea Road, Monticello, Minnesota	**55362**
(Address of principal executive offices)	**(Zip Code)**

(763) 295-9202
(Registrant s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 þ No o

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 2,859,336 shares of common stock were outstanding as of December 31, 2008.

WSI INDUSTRIES, INC.
AND SUBSIDIARIES
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Part I. Financial Information

Item I. Financial Statements

WSI INDUSTRIES, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	November 30, 2008	August 31, 2008
Assets		
Current Assets:		
Cash and cash equivalents	$ 2,090,937	$ 1,843,601
Accounts receivable	3,460,974	3,753,354
Inventories	2,668,279	2,536,006
Prepaid and other current assets	204,349	188,933
Deferred tax assets	190,300	163,829
Total Current Assets	8,614,839	8,485,723
Property, Plant and Equipment Net	8,163,955	7,230,515
Deferred tax assets	475,785	557,689
Goodwill and other assets, net	2,371,207	2,372,861
	$ 19,625,786	$ 18,646,788
Liabilities and Stockholders Equity		
Current Liabilities:		
Trade accounts payable	$ 2,391,338	$ 2,498,624
Accrued compensation and employee withholdings	433,798	719,208
Other accrued expenses	61,558	54,723
Current portion of long-term debt	1,124,084	1,025,414
Total Current Liabilities	4,010,778	4,297,969
Long-term debt, less current portion	6,477,142	5,237,460
Stockholders Equity:		
Common stock, par value $.10 a share; authorized 10,000,000 shares; issued and outstanding 2,859,336 and 2,825,358 shares, respectively	285,933	282,536

Deferred compensation	(333,918)	(245,984)
Capital in excess of par value	2,688,661	2,573,797
Retained earnings	6,497,190	6,501,010
Total Stockholders Equity	9,137,866	9,111,359
	$ 19,625,786	$ 18,646,788

See notes to condensed consolidated financial statements

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WSI INDUSTRIES, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	13 weeks ended	
	November 30, 2008	November 25, 2007
Net sales	$ 6,035,431	$ 5,974,584
Cost of products sold	5,208,766	4,855,541
Gross margin	826,665	1,119,043
Selling and administrative expense	582,540	576,998
Gain on sale of equipment		(97,861)
Interest and other income	(5,688)	(22,105)
Interest and other expense	92,497	67,067
Earnings from operations before income taxes	157,316	594,944
Income taxes	56,633	208,231
Net income	$ 100,683	$ 386,713
Basic earnings per share	$ .04	$ .14
Diluted earnings per share	$ .04	$ .14
Cash dividend per share	$ .0375	$ .0375
Weighted average number of common shares outstanding, basic	2,784,514	2,723,559
Weighted average number of common Shares outstanding, diluted	2,798,030	2,804,071

See notes to condensed consolidated financial statements.

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WSI INDUSTRIES, INC.
AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	13 weeks ended	
	November 30, 2008	November 27, 2007
Cash Flows From Operating Activities:		
Net income	$ 100,683	$ 386,713
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	237,297	187,249
Amortization of deferred finance cost	1,654	1,653
Gain on sale of equipment		(97,861)
Deferred taxes	55,433	201,679
Stock option compensation expense	34,979	21,786
Changes in assets and liabilities:		
Decrease in accounts receivable	292,380	27,890
(Increase) decrease in inventories	(132,273)	342,034
Increase in prepaid expenses	(15,416)	(79,587)
Decrease in accounts payable and accrued expenses	(390,512)	(570,809)
Net cash provided by operations	184,225	420,747
Cash Flows From Investing Activities:		
Purchase of property, plant and equipment	(251,694)	(36,102)
Proceeds from sale of equipment		97,861
Net cash (used in) provided by investing activities	(251,694)	61,759
Cash Flows From Financing Activities:		
Payments of long-term debt	(205,691)	(156,991)
Proceeds from issuance of long-term debt	625,000	
Dividends paid	(104,504)	(102,134)
Net cash provided by (used in) financing activities	314,805	(259,125)
Net Increase In Cash And Cash Equivalents	247,336	223,381
Cash And Cash Equivalents At Beginning Of Year	1,843,601	1,626,801
Cash And Cash Equivalents At End Of Reporting Period	$ 2,090,937	$ 1,850,182

Supplemental cash flow information:		
Cash paid during the period for:		
Interest	$ 92,736	$ 67,284
Payroll withholding taxes in cashless stock option exercise	$ 4,651	$
Income taxes	$ 1,200	$ 6,552
Non-cash investing and financing activities:		
Acquisition of equipment through capital lease	$ 919,043	$ 1,195,920

See notes to condensed consolidated financial statements.

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WSI INDUSTRIES, INC.
AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS:

The condensed consolidated balance sheet as of November 30, 2008, the condensed consolidated statements of income for the thirteen weeks ended November 30, 2008 and November 25, 2007 and the condensed consolidated statements of cash flows for the thirteen weeks then ended, respectively, have been prepared by the Company without audit. In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made.

The condensed consolidated balance sheet at August 31, 2008 is derived from the audited consolidated balance sheet as of that date. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. Therefore, these condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s 2008 annual report to shareholders. The results of operations for interim periods are not necessarily indicative of the operating results for the full year.

2. INVENTORIES

Inventories consist primarily of raw material, work-in-progress (WIP) and finished goods and are valued at the lower of cost or market value:

	November 30, 2008	August 31, 2008
Raw material	$ 1,128,304	$ 1,004,577
WIP	908,969	883,284
Finished goods	631,006	648,145
	$ 2,668,279	$ 2,536,006

3. GOODWILL AND OTHER ASSETS

Goodwill and other assets consist of costs resulting from business acquisitions which total $2,368,452 (net of accumulated amortization of $344,812 recorded prior to the adoption of SFAS No. 142 Goodwill and Other Intangible Assets). The Company assesses the valuation or potential impairment of its goodwill by utilizing a present value technique to measure fair value by estimating future cash flows. The Company constructs a discounted cash flow analysis based on various sales and cost assumptions to estimate the fair value of the Company (which is the only reporting unit). The result of the analysis performed in the fiscal 2008 fourth quarter did not indicate an impairment of goodwill. The Company will analyze goodwill more frequently should changes in events or circumstances, including reductions in anticipated cash flows generated by our operations, occur.

The Company recorded $33,063 of deferred financing costs incurred in connection with mortgages entered into in order to purchase the Company s facility in Monticello, Minnesota. The costs are being amortized over five years on a straight-line basis with the Company incurring $1,653 of amortization expense for the quarters ended November 30, 2008 and November 25, 2007, respectively.

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4. DEBT:

During the quarter ended November 30, 2008, the Company entered into a capitalized lease of approximately $919,000 in connection with the acquisition of machinery and equipment. The lease carried an interest rate of approximately 6.5% and matures in 2015.

5. EARNINGS PER SHARE:

The following table sets forth the computation of basic and diluted earnings per share:

	Thirteen weeks ended	
	November 30, 2008	November 25, 2007
Numerator for earnings per share:		
Net income	$ 100,683	$ 386,713
Denominator:		
Denominator for basic earnings per share weighted average shares	2,784,514	2,723,559
Effect of dilutive securities:		
Employee and non-employee options	13,516	80,512
Dilutive common shares Denominator for diluted earnings per share	2,798,030	2,804,071
Basic earnings per share	$ .04	$ .14
Diluted earnings per share	$ .04	$ .14

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Item 2.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
And
RESULTS OF OPERATIONS

Critical Accounting Policies and Estimates:

Management s Discussion and Analysis of Financial Condition and Results of Operations discuss our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities.

We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the result of which forms the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Results may differ from these estimates due to actual outcomes being different from those on which we based our assumptions. The estimates and judgments utilized are reviewed by management on an ongoing basis and by the audit committee of our board of directors at the end of each quarter prior to the public release of our financial results.

The critical accounting policies and estimates followed in the preparation of the financial information contained in this Quarterly Report on Form 10-Q are the same as those described in the Company s Annual Report on Form 10-K for the year ended August 31, 2008. Refer to the Annual Report on Form 10-K for detailed information on accounting policies.

Results of Operations:

Net sales were $6,035,000 for the quarter ending November 30, 2008; a 1% increase from the same period of the prior year with increases in sales from the Company s all terrain vehicle (ATV) and energy markets being offset by decreases in sales from the Company s motorcycle market.

Sales from the Company s ATV and motorcycle markets were $3,290,000 and $3,757,000 for the quarters ended November 30, 2008 and November 25, 2007, respectively. Sales from the ATV market increased by 10% during the fiscal 2009 first quarter; however that sales increase was more than offset by a decrease in sales in the motorcycle market that occurred as a result of a softening of demand.

Sales from the Company s energy market amounted to $2,112,000 in the first quarter as compared to $1,423,000 in the prior year s first quarter. The Company experienced a softening in demand from most of its energy programs in fiscal 2009 first quarter as compared to the fiscal 2008 fourth quarter.

Sales from the Company s aerospace and defense markets totaled $486,000 and $531,000 for the quarters ended November 30, 2008 and November 25, 2007, respectively. The Company believes that these decreases are not a result of significant change in a customer or product requirement, but rather a result of a general decrease in the level of business with the Company s customers in these markets.

Sales from the Company s biosciences market totaled $123,000 for the quarter ended November 30, 2008, as compared to the prior year quarter s amount of $146,000. The Company believes that these decreases are not a result of significant change in a customer or product requirement, but rather a result of a general decrease in the level of business with the Company s customers in these markets.

Gross margin for the quarters ended November 30, 2008 and November 25, 2007 were 14% and 19%, respectively. The gross margin decrease for the quarter ended November 30, 2008 is attributable to start-up costs associated with new programs in the energy market. As described above, the Company experienced a softening in demand during the fiscal 2009 first quarter. During the quarter, the Company was commencing production on new parts from its primary customer in the energy field, as well as starting production on a new program from an affiliate of this primary customer. The production in these two areas incurred tooling and other start-up related costs that negatively affected gross margin during the fiscal 2009 first quarter.

Selling and administrative expense of $583,000 for the quarter ending November 30, 2008 was comparable to the prior year quarter s expense of $577,000.

During the prior year quarter ended November 25, 2007, and as part of its program to maintain its capital equipment at the highest technical level, the Company sold some fully-depreciated equipment which generated a gain on sale of equipment of $98,000.

Interest expense in the first quarter of fiscal 2009 was $92,000 compared to $67,000 in first quarter of fiscal 2008 reflecting the investment in new equipment that the Company has made as well as interest related to the Company s building addition completed during the first quarter of fiscal 2009.

The Company recorded income tax expense at an effective tax rate of 36% for the quarter ended November 30, 2008 and 35% for quarter ended November 25, 2007.

Liquidity and Capital Resources:

On November 30, 2008, working capital was $4,604,000 compared to $4,188,000 at August 31, 2008. The ratio of current assets to current liabilities at November 30, 2008 was 2.15 to 1.0 compared to 1.97 to 1.0 at August 31, 2008. The improvement in both measurements is attributable to the generation of cash from operations in the Company s fiscal 2009 first quarter.

It is the Company s belief that its current cash balance, plus future internally generated funds and its line of credit, will be sufficient to enable the Company to meet its working capital requirements through the next 12 months. The Company s line of credit expires February 1, 2009; however, it expects that it will renew the line at that point. No amounts have been borrowed under the line of credit which carries an interest rate at prime.

Cautionary Statement:

Statements included in this Management s Discussion and Analysis of Financial Condition and Results of Operations, in future filings by the Company with the Securities and Exchange Commission, in the Company s press releases and in oral statements made with the approval of an authorized executive officer that are not historical or current facts are forward-looking statements. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made and are not predictions of actual future results.

The following risks and uncertainties, as well as others not now anticipated, in some cases have affected, and in the future could affect, the Company s actual results and could cause the Company s actual financial performance to differ materially from that expressed in any forward-looking statement: (i) the Company s ability to obtain additional manufacturing programs and retain current programs; (ii) the Company s ability to timely and cost effectively ramp up new programs; (iii) the loss of significant business from any one

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of its current customers could have a material adverse effect on the Company; (iv) the Company was dependent upon two customers for 87% of its revenues in fiscal year 2008 and expects that a significant portion of its future revenue will be derived from these customers; (v) a significant downturn in the industries in which the Company participates could have an adverse effect on the demand for Company services; (vi) our sales are concentrated in a limited number of highly competitive industries, each with a limited number of customers; (vii) the prices of our products are subject to a downward pressure from customers and market pressure from competitors; (viii) the Company s ability to curtail its costs and expenses for new manufacturing programs, commensurate with expected revenues; (ix) the Company s ability to comply with covenants of its credit facility; (x) fluctuations in operating results due to, among other things, changes in customer demand for our product in our manufacturing costs and efficiencies of our operations; and (xi) a trend among our customers toward outsourcing manufacturing to foreign operations.

The foregoing list should not be construed as exhaustive and the Company disclaims any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures.

The Company s Chief Executive Officer, Michael J. Pudil, and Chief Financial Officer, Paul D. Sheely, have evaluated the Company s disclosure controls and procedures as of the end of the period covered by this report. Based upon this review, they have concluded that these controls and procedures are effective.

(b) Changes in Internal Controls over Financial Reporting.

There have been no changes in internal control financial reporting that occurred during the fiscal period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION:

ITEM 6. EXHIBITS

A. The following exhibits are included herein:

Exhibit 31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Exchange Act.
Exhibit 31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Exchange Act.
Exhibit 32	Certificate pursuant to 18 U.S.C. §1350.

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.

	WSI INDUSTRIES, INC.
Date: January 9, 2009	/s/ Michael J. Pudil Michael J. Pudil, President & CEO
Date: January 9, 2009	/s/ Paul D. Sheely Paul D. Sheely, Vice President, Finance & CFO

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