ARTS WAY MANUFACTURING CO INC
Form 10-Q
April 14, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarter Ended February 28, 2003 Commission File No. 0-5131

ART'S-WAY MANUFACTURING CO., INC.
(Exact name of registrant as specified in its charter)

DELAWARE	42-0920725
State of Incorporation	I.R.S. Employer Identification No.

Hwy 9 West, Armstrong, Iowa	50514
Address of principal executive offices	Zip Code

Registrant's telephone number, including area code: (712) 864-3131

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, 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 an accelerated filer (as defined in Rule 12b-2).
Yes __ No X

Number of common shares outstanding as of March 21, 2003: 1,938,176

ART'S-WAY MANUFACTURING CO., INC.

CONDENSED STATEMENT OF OPERATIONS

(Unaudited)

	Three Months Ended February 28, 2003	November 30, 2002
Net Sales	$ 2,508,877	$ 2,641,892
Cost of goods sold	1,870,449	2,071,292
Gross Profit	638,428	570,600

Expense		
Engineering	18,923	14,879
Selling	128,193	128,296
General and administravtive	352,428	401,226
Total expenses	499,544	544,401
Income from operations	138,884	26,199
Other expenses:		
Interest expense	17,979	60,589
Other	6,065	14,111
Total other expenses	24,044	74,700
Income (loss) before income taxes	114,840	(48,501)
Income tax expense	2,031	-
Net Income (loss)	$ 112,809	$ (48,501)
Net income (loss) per share:		
Basic	$ 0.06	$ (0.03)
Diluted		
Common shares and equivalent outstanding:		
Basic	1,938,176	1,411,954
Diluted	1,947,272	1,411,954

See accompanying notes to financial statements.

ART'S-WAY MANUFACTURING CO., INC.

CONDENSED BALANCE SHEETS

(Unaudited)

	February 28, 2003	November 30, 2002
ASSETS		
Current Assets		
Cash	$ 76,396	$ 75,358
Accounts receivable-customers, net of allowance for doubtful accounts of $54,500 and $50,000 in February and November,respectively	1,651,416	592,945
Inventories	3,567,581	3,576,707
Other current assets	115,613	95,385
Total current assets	5,411,006	4,340,395
Property, plant and equipment, at cost	10,725,972	10,725,972
Less accumalated depreciation	9,821,130	9,751,260
Net property, plant and equipment	904,842	974,712
Inventories, noncurrent	430,509	430,509
Other assets	175,849	175,849
Total Assets	$ 6,922,206	$ 5,921,465

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Notes payable to bank	$ 172,818	$ 319,222
Current portion of long-term debt	356,669	356,669
Accounts payable	661,198	523,492
Customer deposits	1,086,408	249,756
Accrued expenses	780,210	630,972
Total current liabilities	3,057,303	2,080,111
Long-term liabilities	187,204	187,204
Long-term debt, excluding current portion	431,570	520,830
Total liabilities	$ 3,676,077	$ 2,788,145
Stockholders' Equity		
Common stock - $.01 par value. Authorized 5,000,000 shares; issued 1,938,176 shares in February and in November	19,382	19,382
Additional paid-in capital	1,634,954	1,634,954
Retained earnings	1,591,793	1,478,984
Total stockholders' equity	3,246,129	3,133,320
Total liabilities and stockholders' equity	$ 6,922,206	$ 5,921,465

See accompanying notes to financial statements.

ART'S-WAY MANUFACTURING CO., INC.

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended February 28, 2003	February 28, 2002
CASH FLOW FROM OPERATIONS:		
Net income (loss)	$ 112,809	$ (48,501)
Adjustment to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	69,870	60,953
Changes in working capital components:		
(Increase) decrease in:		
Accounts receivable	(1,058,471)	(442,614)
Inventories	9,126	458,670
Other current assets	(20,228)	6,770
Increase (decrease) in:		
Accounts payable	137,706	(146,641)
Customer deposits	836,652	560,748
Accrued expenses	149,238	56,200
Net cash provided by operating activities	236,702	505,585
CASH FLOW FROM INVESTING ACTIVITIES:	0	0
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from (payments of) notes payable to bank	(146,404)	(1,079,545)
Principal payments on term debt	(89,260)	(89,191)
Proceeds from issuance of common stock from treasury	0	53,253
Proceeds from issuance of common stock	0	746,747

Net cash used in financing activities	(235,664)	(368,736)
Net increase in cash	1,038	136,849
Cash at beginning of period	75,358	4,375
Cash at end of period	$ 76,396	$ 141,224
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$ 17,979	$ 64,033
Income taxes	3,301	4,032

See accompanying notes to financial statements.

ART'S-WAY MANUFACTURING CO., INC.

NOTES TO 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-K for the year ended November 30, 2002. The results of operations for the first quarter ended February 28, 2003 are not necessarily indicative of the results for the fiscal year ending November 30, 2003.

2. INCOME (LOSS) PER SHARE

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

The difference in shares utilized in calculating basic and diluted net income (loss) per share represents the number of shares issued under the Company's stock option plans less shares assumed to be purchased with proceeds from the exercise of the stock options. Due to the net loss for the quarter ended February 28, 2002, the anti-dilutive effect of the Company's stock option plans is not included in the calculation of diluted loss per share for that period. The reconciling item between the shares used in the computation of basic and diluted earnings per share for the first quarter ended February 28, 2003 is 9,096 equivalent shares for the effect of dilutive stock options.

3. INVENTORIES

Major classes of inventory are:	February 28, 2003	November 30, 2002

Raw material	$ 906,731	$ 1,065,166
Work-in-process	1,401,327	1,209,007
Finished goods	1,690,032	1,733,043
Total	$ 3,998,090	$ 4,007,216
Less inventories classified as noncurrent	430,509	430,509
Inventories, current	$3,567,581	$3,576,707

4. ACCRUED EXPENSES

Major components of accrued expenses are:	February 28, 2003	November 30, 2002
Salaries, wages and commissions	$ 298,414	$ 294,220
Accrued warranty expense	55,612	60,232
Other	426,184	276,520
Total	$ 780,210	$ 630,972

5. LOAN AND CREDIT AGREEMENTS

Line of Credit

The Company has a credit agreement with a lending institution (lender) that provides for a revolving line of credit (credit facility) and a term loan and expires December 1, 2003. The credit facility allows for borrowings up to $4,500,000, subject to borrowing base percentages on the Company's accounts receivable and inventory, and allowing for letters of credit for $100,000. At February 28, 2003, the Company has borrowed $172,818 and has $100,000 in outstanding letters of credit. At November 30, 2002, the Company had borrowed $319,222 and had $100,000 in outstanding letters of credit. At February 28, 2003 and November 30, 2002, $1,741,000 and $1,038,000 were available for borrowings, respectively. The interest rate is based on the lender's referenced rate and is variable based upon certain performance objectives. Under the terms of the agreement, the Company will not pay more than 4% over the reference rate, nor less than the reference rate during the term of the agreement. The outstanding borrowings bear interest at 8.25% at February 28, 2003.

The term loan was for an original principal amount of $1,991,000. The principal amount is repayable in monthly installments of $23,700 with the remaining balance due on December 1, 2003.

All loans, advances and other obligations, liabilities and indebtedness of the Company are secured by all present and future assets. The Company pays an unused line fee equal to three-eighths of 1% of the unused portion of the revolving line of credit. The Company's cash account has been restricted by the lender, such that any available cash is used to pay down on the credit facility.

During 1999, the Company was notified by its lender that the Company does not fit the lender's customer profile and was requested to relocate its financing needs.

At November 30, 2000 and 1999, the Company was in default of a loan covenant, the fixed maturity coverage ratio, of their credit facility and term loan. The lender notified the Company that the current loan agreement provided that the lender may, as a result of any event of default, accelerate the payment of all obligations. As a result, all term borrowings associated with this lender had been classified as current. The lender did not call for the acceleration of the payment of all obligations, but retained the right to do so at any time.

The initial term of the loan agreement ended on August 31, 2000. In a letter dated May 26, 2000, the Company was notified that the lender did not intend to extend the term of the loan agreement beyond the termination date. Therefore, all of the obligations outstanding under the credit agreement and term loan amounting to $4,383,825 at August 31, 2000 were due and payable on August 31, 2000.

During the period between August 31, 2000 and August 31, 2001, the loan agreement was amended several times to provide for extensions of various lengths from 30 days to 90 days. On September 1, 2001, the lender sold the loan to another lending institution (new lender). Under this arrangement, the Company continued to operate under the same terms as existed prior to the sale. The new lender granted an extension from September 1, 2001 through November 15, 2001. On February 25, 2003, the lender granted forbearance and waived its right to demand payment because of existing covenant defaults until December 1, 2003. Therefore, the portion of the term loan not due until December 1, 2003 has been classified as long-term debt in the accompanying balance sheet.

Management believes alternative long-term financing can be obtained from different lenders on acceptable terms and that the Company will be able to meet its obligations under a new credit agreement when completed.

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

	February 28, 2003	November 30, 2002
Installment term debt payable in monthly installments of $23,700, plus interest at four percent over the bank's national money market rate (8.25%), due on demand, secured (a)	$ 534,271	$ 605,371
State of Iowa Community Development Block Grant promissory notes at zero percent interest, maturity 2006, with quarterly principal payments of $11,111	155,556	166,667
State of Iowa Community Development Block Grant local participation promissory notes at 4% interest, maturity 2006, with quarterly payments of $7,007	98,412	105,461
Total term debt	788,239	877,499

Less current portion of term debt	356,669	356,669
Term debt, excluding current portion	$ 431,570	$ 520,830

(a)All borrowings under the installment term loan payable are secured by the cash, accounts receivable, inventories, and property, plant, and equipment of the Company. The agreement required the Company to maintain specified ratios, as defined, of debt-to-tangible net worth and net cash income to current maturities, and restricted the Company from issuing any dividends.

6. RELATED PARTY TRANSACTION

In February 2002, the Company sold common stock to an existing shareholder, Mr. J. Ward McConnell, Jr., at estimated fair value. Proceeds from the sale of the stock were $800,000. Mr. McConnell has agreed that without prior approval of the Board of Directors, excluding himself and his son, he will not acquire as much as fifty percent (50%) of the Company's common stock and will not take the Company private. Immediately after the transaction, Mr. McConnell was elected as Chairman of the Board of Directors of the Company. His son, Marc McConnell, is also a Board Member.

Item 2

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

(a) Liquidity and Capital Resources

The Company's main source of funds for the quarter ended February 28, 2003 were payments received from customers for advance payments on sugar beet equipment to be delivered in the second and third quarter. These sources were offset by an increase in accounts receivable and payments on the Company's note payable and term debt. The increase in accounts receivable results from the high level of OEM sales in February 2003 which are sold on 30 day terms.

The positive cash flow from operations of $236,702 was used to reduce bank notes by $235,664. As of February 28, 2003, the Company had no material commitments for capital expenditures.

See footnote 5 of the notes to the condensed financial statements for a discussion of the Company's credit facility.

The Company is mindful of the necessity to continue to control its costs, as it intends to finance its working capital and pay down its debt through cash from operations.

(b) Results of Operations

Overall sales for the first quarter of fiscal 2003 were approximately $2,509,000, or 5% lower than last year's first quarter sales of approximately $2,642,000. Sales of Art's-Way products were 21% lower and OEM sales were 12% higher than one year ago. OEM sales included products for two original equipment manufacturers. The reduction in sales reflects the continuing weakness in the farm economy.

Gross profit, as a percent of sales, was 25% for the quarter ended February 28, 2003, as compared to 22% for the same period in 2002.

Operating expenses in the first quarter 2003 decreased $45,000 from 2002. This decrease is primarily due to changing the health insurance plan offered to the employees. As a percent of sales, operating expenses were 20% and 21% for the three months ended February 28, 2003 and 2002, respectively.

Other expenses decreased by $51,000 from the previous year. Reduction in bank borrowings combined with lower interest rates and reduced volume in our financed accounts receivable resulted in this reduction.

The order backlog as of February 28, 2003 is $2,916,000, compared to $2,292,000 one year ago. These orders primarily will be delivered in the second and third quarter of the current fiscal year. The current year backlog includes $1,187,000 in orders for beet equipment compared to $771,000 last year at this time. OEM backlog is $731,000 to be shipped in the second and third quarter.

(c) Critical Accounting Policies

The Company's critical accounting policies involving the more significant judgments and assumptions used in the preparation of the financial statements as of February 28, 2003, have remained unchanged from November 30, 2002. 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 the Company's Annual report on Form 10-K for the year ended November 30, 2002.

Item 3

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The Company does not have any additional market risk exposure other than what was outlined in the November 30, 2002, 10-K filing.

Item 4

DISCLOSURE CONTROLS AND PROCEDURES

Within 90 days of the filing date of this quarterly report, the Company's Chief Executive Officer and Finance Manager have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15(d)-14(c)) and, based on their evaluation, have concluded that the disclosure controls and procedures are effective. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective action with regard to significant deficiencies and material weaknesses.

Part II - Other Information

ITEM 1. LITIGATION AND CONTINGENCIES

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

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

10.6 Forbearance Agreement
99.1 Certification of Financial Statements

(b) Reports on Form 8-K:

None

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 April 14, 2003 By: /s/John C. Breitung
(John C. Breitung, President)

By: /s/Seth LaBore
Date April 14, 2003 (Seth LaBore, Finance Manager)

CERTIFICATIONS

I, John C. Breitung, certify that:

1.I have reviewed this quarterly report on Form 10-Q of Art's-Way Manufacturing Co., Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quartely report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and rocedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 14, 2003

/s/ John C. Breitung
President and Chief
Executive Officer

OM504759.1

CERTIFICATIONS

I, Seth F. La Bore, certify that:

1.I have reviewed this quarterly report on Form 10-Q of Art's-Way Manufacturing Co., Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quartely report;

4. The registrant's other certifying officers and I are responsible for

establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and rocedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 14, 2003

/s/ Seth F. LaBore
Finance Manager

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