WSI INDUSTRIES, INC.
Form 10-Q
April 03, 2015
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**UNITED STATES**

**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 quarterly period ended March 1, 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 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 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 "larger accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 2,912,443 shares of common stock were outstanding as of March 31, 2015.

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**WSI INDUSTRIES, INC.**

**AND SUBSIDIARIES**

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Item 1.

Financial Statements

Part 1.

Financial Information

Item 1. Financial Statements

WSI INDUSTRIES, INC.

AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

March 1,

August 31,

2015

2014

Assets

Current Assets:

Cash and cash equivalents

$ 3,849,935 $ 3,233,436

Accounts receivable

4,444,141 5,963,498

Inventories

4,837,836 3,767,027

Prepaid and other current assets

582,867 227,699

Deferred tax assets

110,123 112,829

Total Current Assets

13,824,902 13,304,489

Property, Plant and Equipment – Net

12,668,006 13,303,514

Goodwill and other assets, net

2,381,152 2,383,157

Total Assets

$ 28,874,060 $ 28,991,160

Liabilities and Stockholders' Equity

Current Liabilities:

Trade accounts payable

$ 2,632,263 $ 2,869,029

Accrued compensation and employee withholdings

622,417 699,987

Other accrued expenses

316,628 153,913

Current portion of long-term debt

| | | |
|---|---|---|
| | 1,487,721 | 1,615,041 |
| Total Current Liabilities | | |
| | 5,059,029 | 5,337,970 |
| Long-term debt, less current portion | | |
| | 8,113,348 | 8,555,243 |
| Deferred tax liabilities | | |
| | 2,079,076 | 1,983,672 |
| Stockholders' Equity: | | |
| Common stock, par value $.10 a share; authorized 10,000,000 shares; issued and outstanding 2,912,443 and 2,908,893 shares, respectively | | |
| | 291,244 | 290,889 |
| Capital in excess of par value | | |
| | 3,573,886 | 3,480,450 |
| Deferred compensation | | |
| | - | (24,644 ) |
| Retained earnings | | |
| | 9,757,477 | 9,367,580 |
| Total Stockholders' Equity | | |
| | 13,622,607 | 13,114,275 |
| Total Liabilities and Stockholders' Equity | | |
| | $ 28,874,060 | $ 28,991,160 |

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 | | 26 weeks ended | |
|---|---|---|---|---|
| | March 1, 2015 | February 23, 2014 | March 1, 2015 | February 23, 2014 |
| Net sales | $ 11,737,633 | $ 10,483,998 | $ 21,835,803 | $ 20,683,319 |
| Cost of products sold | 10,053,909 | 9,232,943 | 19,112,848 | 18,081,524 |
| Gross margin | 1,683,724 | 1,251,055 | 2,722,955 | 2,601,795 |
| Selling and administrative expense | 912,839 | 746,196 | 1,612,625 | 1,446,361 |
| Interest and other income | (1,221 ) | (1,238 ) | (2,725 ) | (2,222 ) |
| Interest expense | 81,800 | 102,451 | 170,269 | 215,680 |
| Income before income taxes | 690,306 | 403,646 | 942,786 | 941,976 |
| Income taxes | 234,704 | 145,403 | 320,547 | 339,202 |
| Net income | | | | |

| | | | | |
|---|---|---|---|---|
| | $ 455,602 | $ 258,243 | $ 622,239 | $ 602,774 |
| Basic earnings per share | $ .16 | $ .09 | $ .21 | $ .21 |
| Diluted earnings per share | $ .15 | $ .09 | $ .21 | $ .20 |
| Cash dividend per share | $ .04 | $ .04 | $ .08 | $ .08 |
| Weighted average number of common shares outstanding, basic | 2,909,183 | 2,898,325 | 2,906,757 | 2,895,295 |
| Weighted average number of common shares outstanding, diluted | 2,958,185 | 2,953,330 | 2,959,600 | 2,951,571 |

See notes to condensed consolidated financial statements.

WSI INDUSTRIES, INC.

AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| 26 weeks ended | March 1, 2015 | February 23, 2014 |
|---|---|---|
| **Cash Flows From Operating Activities:** | | |
| Net income | $ 622,239 | $ 602,774 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation | 988,036 | 1,137,866 |
| Amortization | 2,005 | 2,005 |
| Deferred taxes | 171,047 | 339,201 |
| Stock option compensation expense | 112,828 | 105,634 |

Changes in assets and liabilities:

| | | |
|---|---|---|
| Decrease (increase) in accounts receivable | 1,519,357 | (87,244 ) |
| Increase in inventories | (1,070,809 ) | (63,812 ) |
| (Increase) decrease in prepaid and other current assets | (355,168 ) | 197,212 |
| (Decrease) increase in accounts payable and accrued expenses | (227,471 ) | 195,026 |
| Net cash provided by operations | 1,762,064 | 2,428,662 |
| **Cash Flows From Investing Activities:** | | |
| Purchase of property, plant and equipment | (78,528 ) | (173,766 ) |
| Net cash used in investing activities | (78,528 ) | (173,766 ) |
| **Cash Flows From Financing Activities:** | | |
| Payments of long-term debt | (843,215 ) | (986,131 ) |
| Issuance of common stock | 8,520 | 13,839 |
| Dividends paid | (232,342 ) | (231,462 ) |

| | | |
|---|---|---|
| Net cash used in by financing activities | (1,067,037 ) | (1,203,754 ) |
| **Net Increase In Cash And Cash Equivalents** | 616,499 | 1,051,142 |
| **Cash And Cash Equivalents At Beginning Of Year** | 3,233,436 | 1,906,218 |
| **Cash And Cash Equivalents At End Of Reporting Period** | $ 3,849,935 | $ 2,957,360 |
| **Supplemental cash flow information:** | | |
| Cash paid during the period for: | | |
| Interest | $ 171,350 | $ 216,436 |
| Income taxes | $ 149,500 | $ - |
| Payroll withholding taxes in cashless stock option exercise | $ 2,913 | $ 30,641 |
| Non cash investing and financing activities: | | |
| Acquisition of equipment through financing | $ 274,000 | $ - |

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 March 1, 2015, the condensed consolidated statements of income for the thirteen and twenty-six weeks ended March 1, 2015 and February 23, 2014 and the condensed consolidated statements of cash flows for the twenty-six 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, 2014 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 Annual Report on Form 10-K for the year ended August 31, 2014. 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:

| | March 1, 2015 | August 31, 2014 |
|---|---|---|
| Raw material | | |

| | | | |
|---|---|---|---|
| | $ 2,093,606 | $ 2,018,080 | |
| WIP | | | |
| | 1,349,736 | 823,704 | |
| Finished goods | | | |
| | 1,394,494 | 925,243 | |
| | $ 4,837,836 | $ 3,767,027 | |

3.

OTHER ASSETS

Goodwill and other assets consist of costs resulting from business acquisitions which total $2,368,452 at March 1, 2015 (net of accumulated amortization of $344,812 recorded prior to the adoption of ASC 350 *Goodwill and Other Intangible Assets*) as well as deferred financing costs of $12,700 (net of accumulated amortization of $7,353) incurred in connection with a mortgage agreement entered into with the Company's bank.

4.

DEBT AND LINE OF CREDIT:

During the quarter ended March 1, 2015 the Company renewed and modified its Revolving Line of Credit with its bank. Under the agreement the Company can borrow up to $1 million. The agreement expires on February 28, 2016, is collateralized by all assets of the Company and carries an interest rate of LIBOR plus 2%. The agreement also contains restrictive provisions requiring a minimum net worth, a maximum debt to tangible net worth ratio as well as a debt service coverage ratio. At March 1, 2015 the Company was in compliance with these provisions.

During the quarter ended March 1, 2015, the Company entered into one debt agreement for a total of approximately $274,000 in connection with the acquisition of machinery and equipment. The debt agreement requires monthly payments, carries an interest rate of approximately 3.7% and is secured by the related asset acquired and matures in 2022.

5.

CLAIMS AND CONTINGENCIES:

The Company is exposed to a number of asserted and unasserted claims encountered in the ordinary course of business. Although the outcome of any such claim cannot be predicted, management believes that there are no pending legal proceedings or claims against or involving the Company for which the outcome is likely to have a material adverse effect upon its financial position or results of operations.

6.

EARNINGS PER SHARE:

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

| | Thirteen weeks ended | | Twenty-Six weeks ended | |
|---|---|---|---|---|
| | March 1, 2015 | February 23, 2014 | March 1, 2015 | February 23, 2014 |
| Numerator for basic and diluted earnings per share: | | | | |
| Net income | $ 455,602 | $ 258,243 | $ 622,239 | $ 602,774 |
| Denominator | | | | |

Denominator for basic earnings per share – weighted average shares

2,909,183 2,898,325 2,906,757 2,895,295

Effect of dilutive securities:

Employee and non-employee options

49,002 55,005 52,843 56,276

Dilutive common shares

Denominator for diluted earnings per share

2,958,185 2,953,330 2,959,600 2,951,571

Basic earnings per share

$ .16 $ .09 $ .21 $ .21

Diluted earnings per share

$ .15 $ .09 $ .21 $ .20

7.

SUBSEQUENT EVENT:

Subsequent to the end of the quarter ended March 1, 2015, the Company acquired three machines and entered into a debt agreement with its bank for approximately $1,118,000. The debt agreement requires monthly payments, carries an interest rate of approximately 3.45% and is secured by the related assets acquired and matures in 2022.

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 condensed 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, 2014. Refer to the Annual Report on Form 10-K for detailed information on accounting policies.

Results of Operations:

Net sales were $11,738,000 for the thirteen weeks ending March 1, 2015, an increase of 12% or $1,254,000 from the same period of the prior year. Year-to-date sales in fiscal 2015 are $21,836,000 compared to $20,683,000 in the prior year which equates to a 6% increase. Total Company sales by product markets are as follows:

Fiscal Second Quarter Thirteen Weeks Ended

Fiscal Second Quarter Year-to-Date Ended

Percent

February

Percent

Dollar

Percent

February

Percent

Dollar

March 1,

of Total

23,

of Total

Percent

March 1,

of Total

23,

of Total

Percent

2015

Sales

2014

Sales

Change

2015

Sales

2014

Sales

Change

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| ATV & Motorcycle | | | | | | | | | |
| | $ 9,865,000 | 84 % | $ 8,513,000 | 81 % | 16 % | $ 17,784,000 | 82 % | $ 16,365,000 | 79 % | 9 % |
| Energy | | | | | | | | | |
| | 939,000 | 8 % | 1,195,000 | 11 % | -21 % | 2,445,000 | 11 % | 2,518,000 | 12 % | -3 % |
| Aerospace, Defense & Other | | | | | | | | | |
| | 934,000 | 8 % | 776,000 | 8 % | 20 % | 1,607,000 | 7 % | 1,800,000 | 9 % | -11 % |
| Total Sales | | | | | | | | | |
| | $ 11,738,000 | 100 % | $ 10,484,000 | 100 % | 12 % | $ 21,836,000 | 100 % | $ 20,683,000 | 100 % | 6 % |

Sales from the Company's ATV and Motorcycle markets were up 16% for the fiscal 2015 second quarter as compared to the prior year quarter. The Company experienced increases in demand from its primary customer across all product lines as well as the introduction of a new product line that had minimal sales in the prior year fiscal second quarter. Year-to-date sales for the ATV and Motorcycle markets were up 9% as compared to the prior year for the same reasons.

Sales from the Company's energy business for the fiscal 2015 second quarter were lower by 21% over the prior year's second quarter as sales generally softened across all product lines during the quarter. Year-to-date sales as of March 1, 2015 were also lower by 3% as compared to the prior year-to-date period. The reductions in sales in fiscal 2015 are a result of lower customer demand for product in both the oilfield equipment and shale fracturing industries and the Company believes the reductions are related to the overall lower market price for oil.

Sales from the Company's aerospace, defense and other markets were up 20% for the fiscal 2015 second quarter over the prior year. The increase in sales came primarily from what the Company believes is a one-time assembly program as well as sales from the Company's ongoing automotive business. The sales from these programs were minimal in the Company's prior year. Sales for the year-to-date March 1, 2015 period were down 11% versus the prior year. While positively affected by the increase in the fiscal 2015 second quarter, the year-to-date sales were lower as the fiscal 2015 first quarter sales were lower than the fiscal 2014 first quarter sales by 34%. The first quarter decrease was partially attributable to one of the Company's customers losing two defense related programs that the Company supplied parts for, as well as a cyclical decrease in demand from two other customers. The Company's sales in the first quarter also decreased due to no sales in its firearms business in fiscal 2015. The Company had sales in its firearm's business in the first quarter of fiscal 2014.

Gross margin in the fiscal 2015 second quarter increased to 14.3% from 11.9% in the prior year quarter. Gross margin was positively affected by a lower level of fixed manufacturing costs as a percent of sales than the prior year's second quarter. Year-to-date gross margin in fiscal 2015 was 12.5%, which was a slight decrease over the prior year-to-date gross margin of 12.6%. The fiscal 2015 year-to-date gross margin was positively affected by the lower level of fixed costs while offset by a higher level of quality costs than the prior year.

Selling and administrative expense of $913,000 for the quarter ending March 1, 2015 was $167,000 higher than in the prior year period due primarily to higher compensation expense which includes accrued incentive compensation and profit sharing. Year-to-date selling and administrative expense of $1,613,000 was $166,000 higher than the comparable prior year period due primarily to the same reason.

Interest expense in the second quarter of fiscal 2015 was $82,000, which was a $21,000 decrease from the prior year quarter. Year-to-date interest expense of $170,000 was lower than the previous year-to-date period by $45,000. The lower interest costs are a result of the lower overall level of long-term debt as well as a lower overall effective interest rate of that debt.

The Company recorded income tax expense at an effective tax rate of 34% for the quarter and year-to-date periods ended March 1, 2015 and 36% for the quarter and year-to-date periods ended February 23, 2014.

Liquidity and Capital Resources:

On March 1, 2015 working capital was $8,766,000 as compared to $7,967,000 at August 31, 2014. The ratio of current assets to current liabilities at March 1, 2015 was 2.73 to 1.0 compared to 2.49 to 1.0 at August 31, 2014. The increase in these measures is primarily a result of an increase in cash and cash equivalents as well as inventories offset by a lower level of accounts receivable at March 1, 2015 versus August 31, 2014.

During the quarter ended March 1, 2015, the Company renewed and modified its Revolving Line of Credit with its bank. Under the agreement the Company can borrow up to $1 million. The agreement expires on February 28, 2016, is collateralized by all assets of the Company and carries an interest rate of LIBOR plus 2%. The agreement also contains restrictive provisions requiring a minimum net worth, a maximum debt to tangible net worth ratio as well as a debt service coverage ratio. At March 1, 2015, the Company was in compliance with these provisions.

Subsequent to the quarter ended March 1, 2015, the Company acquired three machines and entered into a debt agreement with its bank for approximately $1,118,000. The debt agreement requires monthly payments, carries an interest rate of approximately 3.45% and is secured by the related assets acquired and matures in 2022.

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.

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. These risks and uncertainties are described in the Company's Annual Report on Form 10-K for the year ended August 31, 2014, as well as other filings the Company makes with the Securities and Exchange Commission. 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 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.

## ITEM 4. CONTROLS AND PROCEDURES

(a)

Evaluation of Disclosure Controls and Procedures.

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, the CEO and CFO have concluded that as of March 1, 2015 our disclosure controls and procedures were effective.

(b)

Changes in Internal Controls over Financial Reporting.

There have been no changes in internal control over 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 1A. RISK FACTORS

Not Applicable.

### 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.

101.INS**

XBRL Instance

101.SCH**

XBRL Taxonomy Extension Schema

101.CAL**

XBRL Taxonomy Extension Calculation

101.DEF**

XBRL Taxonomy Extension Definition

101.LAB**

XBRL Taxonomy Extension Labels

101.PRE**

XBRL Taxonomy Extension Presentation

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: April 3, 2015

/s/ Benjamin T. Rashleger

Benjamin T. Rashleger, President & CEO

Date: April 3, 2015 /s/ Paul D. Sheely Paul D. Sheely, Vice President, Finance & CFO