

WSI INDUSTRIES, INC.

Form 10-Q

June 30, 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 May 31, 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)**

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

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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 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 June 22, 2015.

**WSI INDUSTRIES, INC.**

**AND SUBSIDIARIES**

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Item I. Financial Statements

WSI INDUSTRIES, INC.

AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

**May 31,**

**August 31,**

**2015**

**2014**

**Assets**

**Current Assets:**

Cash and cash equivalents

\$ 3,362,316    \$ 3,233,436

Accounts receivable

4,091,386    5,963,498

Inventories

5,684,251      3,767,027

Prepaid and other current assets

444,922      227,699

Deferred tax assets

112,902      112,829

Total Current Assets

13,695,777      13,304,489

Property, Plant and Equipment ,net

13,342,072      13,303,514

Goodwill and other assets, net

2,380,149      2,383,157      \$ 29,417,998      \$ 28,991,160

**Liabilities and Stockholders' Equity**

**Current Liabilities:**

Trade accounts payable

\$ 2,636,885      \$ 2,869,029

Accrued compensation and employee withholdings

522,515      699,987

Other accrued expenses

37,025      153,913

Current portion of long-term debt

1,553,596      1,615,041

Total Current Liabilities

4,750,021      5,337,970

Long-term debt, less current portion

8,723,153      8,555,243

Deferred tax liabilities

1,960,320      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

3,643,197      3,480,450

Deferred compensation

-      (24,644 )

Retained earnings

10,050,063      9,367,580

Total Stockholders' Equity

13,984,504      13,114,275      \$ 29,417,998      \$ 28,991,160

See notes to condensed consolidated financial statements.



WSI INDUSTRIES, INC.

AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

13 weeks ended

39 weeks ended

May 31,

May 25,

May 31,

May 25,

2015

2014

2015

2014

Net sales

\$ 12,368,163	\$ 10,702,145	\$ 34,203,966	\$ 31,385,464
---------------	---------------	---------------	---------------

Cost of products sold

11,105,038	9,220,735	30,217,886	27,302,259
------------	-----------	------------	------------

Gross margin

1,263,125	1,481,410	3,986,080	4,083,205
-----------	-----------	-----------	-----------

Selling and administrative expense

726,854	883,085	2,339,479	2,329,446
---------	---------	-----------	-----------

Interest and other income

(1,483 )	(1,740 )	(4,207 )	(3,961 )
----------	----------	----------	----------

Interest expense

89,142	98,597	259,411	314,276
--------	--------	---------	---------

Income before income taxes

448,612	501,468	1,391,397	1,443,444
---------	---------	-----------	-----------

Income taxes

39,528	180,528	360,075	519,730
--------	---------	---------	---------

Net income

\$ 409,084	\$ 320,940	\$ 1,031,322	\$ 923,714
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Basic earnings per share

\$ .14	\$ .11	\$ .35	\$ .32
--------	--------	--------	--------

Diluted earnings per share

\$ .14	\$ .11	\$ .35	\$ .31
--------	--------	--------	--------

Cash dividend per share

\$ .04	\$ .04	\$ .12	\$ .12
--------	--------	--------	--------

Weighted average number of common shares outstanding, basic

2,912,443	2,903,374	2,908,652	2,897,988
-----------	-----------	-----------	-----------

Weighted average number of common shares outstanding, diluted

2,964,158	2,978,670	2,961,119	2,960,604
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See notes to condensed consolidated financial statements.

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WSI INDUSTRIES, INC.

AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

39 weeks ended

May 31,

May 25,

2015

2014

**Cash Flows From Operating Activities:**

Net income

\$ 1,031,322    \$ 923,714

Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:

Depreciation

1,480,747    1,687,550

Amortization

3,008    3,008

Deferred taxes

(23,425 )    515,292

Stock option compensation expense

182,140      176,060

Changes in assets and liabilities:

Decrease in accounts receivable

1,872,112      488,763

Increase in inventories

(1,917,224 )      (449,795 )

Decrease (increase) in prepaid expenses

(217,223 )      120,735

Increase (decrease) in accounts payable and accrued expenses

(529,417 )      148,920

Net cash provided by operations

1,882,040      3,614,247

**Cash Flows From Investing Activities:**

Purchase of property, plant and equipment

(127,415 )      (190,495 )

Net cash used in investing activities

(127,415 )      (190,495 )

**Cash Flows From Financing Activities:**

Payments of long-term debt

(1,285,425 )      (1,457,598 )

Issuance of common stock

8,520      13,840

Dividends paid

(348,840 )    (347,612 )

Net cash used in financing activities

(1,625,745 )    (1,791,370 )

**Net Increase In Cash And Cash Equivalents**

128,880    1,632,382

**Cash And Cash Equivalents At Beginning Of Year**

3,233,436    1,906,218

**Cash And Cash Equivalents At End Of Reporting Period**

\$ 3,362,316    \$ 3,538,600

**Supplemental cash flow information:**

Cash paid during the period for:

Interest

\$ 259,411    \$ 314,763

Income taxes

\$ 468,735    \$ 4,438

Payroll withholding taxes in cashless stock option exercise

\$ 2,913    \$ 36,663

Non-cash investing and financing activities:

Acquisition of machinery through financing

\$ 1,391,890    \$ -

See notes to condensed consolidated financial statements.

WSI INDUSTRIES, INC.

AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1.

CONDENSED Consolidated Financial Statements:

The condensed consolidated balance sheet as of May 31, 2015, the condensed consolidated statements of operations for the thirteen and thirty-nine weeks ended May 31, 2015 and May 25, 2014 and the condensed consolidated statements of cash flows for the thirty-nine 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 2014 annual report to shareholders on Form 10-K. 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:

May 31,



August 31,

2015

2014

Raw material

\$ 3,239,919    \$ 2,018,080

WIP

1,272,868    823,704

Finished goods

1,171,464    925,243    \$ 5,684,251    \$ 3,767,027

The Company did not dispose of any significant obsolete inventory during the quarter ended May 31, 2015 and therefore there was no material effect on gross margin from any dispositions.

3.

Goodwill And OTHER Assets:

Goodwill and other assets consist of costs resulting from business acquisitions which total \$2,368,452 at May 31, 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 \$11,697 (net of accumulated amortization of \$8,355) incurred in connection with a mortgage agreement entered into with the Company's bank.

4.

DEBT:

During the end of the quarter ended May 31, 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.

5.

INCOME TAXES:

The Company's effective tax rate in its fiscal 2015 third quarter was 8.8% and as compared to 36% in its fiscal 2014 third quarter. During the quarter, the Company hired an outside consulting firm to conduct an analysis to see if certain activities the Company performs qualify for the Research & Development tax credit (R&D credit) as defined by Internal Revenue Code Section 41. As a result of the analysis, the Company determined that it is performing activities that qualify for the R&D credit, and during the quarter ended May 31, 2015, the Company recognized a tax benefit of \$113,000 that related to actual R&D credits claimed in its fiscal year 2014 federal and state tax returns as well as estimated R&D credits accumulated to date for fiscal year 2015. The fiscal 2015 credits relate to the last four months of calendar year 2014 which constitute the first four months of the Company's fiscal 2015 year. At the present time, the R&D credit statute has not been renewed for calendar year 2015, and therefore no R&D tax credits can be claimed for any months in calendar 2015 if and until the statute gets renewed by Congress.

6.

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.

7.

EARNINGS PER SHARE:

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

Thirteen weeks ended

Thirty-nine weeks ended

May 31,

May 25,

May 31,

May 25,

2015

2014

2015

2014

Numerator for basic and diluted earnings per share:

Net income

\$ 409,084    \$ 320,940    \$ 1,031,322    \$ 923,714

Denominator

Denominator for basic earnings per share – weighted average shares

2,912,443    2,903,374    2,908,652    2,897,988

Effect of dilutive securities:

Employee and non-employee options

51,715    75,296    52,467    62,616

Dilutive common shares

Denominator for diluted earnings per share

2,964,158	2,978,670	2,961,119	2,960,604
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Basic earnings per share

\$ .14	\$ .11	\$ .35	\$ .32
--------	--------	--------	--------

Diluted earnings per share

\$ .14	\$ .11	\$ .35	\$ .31
--------	--------	--------	--------

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:

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Net sales were \$12,368,000 for the quarter ended May 31, 2015 compared to \$10,702,000 in the same period of the prior year, an increase of 16%. Year-to-date sales for the first three quarters of fiscal 2015 were \$34,204,000 compared to \$31,385,000 in the prior year, an increase of 9%. Sales by product line for the quarter and year-to-date periods are as below:

Fiscal Third Quarter Thirteen Weeks Ended

Fiscal Third Quarter Year-to-Date Ended

Percent

Percent

Dollar

Percent

Percent

Dollar

May 31,

of Total

May 25,

of Total

Percent

May 31,

of Total

May 25,

of Total

Percent

2015

Sales

2014

Sales

Change

2015



Sales

2014

Sales

Change

Recreational

Vehicles

\$ 11,078,000	89 %	\$ 8,950,000	83 %	24 %	\$ 28,861,000	84 %	\$ 25,314,000	81 %	14 %
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Energy

573,000	5 %	1,140,000	11 %	-50 %	3,019,000	9 %	3,659,000	12 %	-17 %
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Aerospace

Defense & Other

717,000	6 %	612,000	6 %	17 %	2,324,000	7 %	2,412,000	7 %	-4 %
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Total Sales

\$ 12,368,000	100 %	\$ 10,702,000	100 %	16 %	\$ 34,204,000	100 %	\$ 31,385,000	100 %	9 %
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The Company's sales from its recreational vehicle market were up 24% for the fiscal 2015 third quarter as compared to the prior year quarter and its year-to-date sales were up 14%. Sales increases for the fiscal 2015 third quarter were due primarily to a new product line that had minimal sales in the prior year's quarter. Year-to-date sales also increased due primarily to the same new product line.

Sales from the Company's energy business for the fiscal 2015 third quarter and year-to-date periods decreased by 50% and 17%, respectively. The Company's fiscal third quarter's and year-to-date sales were affected by the overall downturn in the energy market due to lower oil prices as well as a continued move by one of the Company's customers to outsource components to lower cost countries.

Sales from the Company's aerospace, defense and other markets increased year over year in the Company's fiscal 2015 third quarter by 17% while year-to-date sales decreased 4%. Fluctuations in quarterly sales are normal for this segment of the Company's business. Fiscal 2015 third quarter sales were positively impacted by sales from the Company's automotive business which had minimal sales in the prior year's third quarter. Year-to-date fiscal 2015 sales were also positively impacted by sales from the automotive industry, but were offset by a loss of sales from the Company's firearms business as well as lower sales in other components of the aerospace, defense and other markets which would be considered normal fluctuations in the Company's sales from these customers. The Company has not had any sales from the firearms business after its fiscal 2014 second quarter.

Gross margin decreased to 10.2% for the quarter ended May 31, 2015 versus 13.8% in the prior year period. Gross margins were negatively impacted manufacturing inefficiencies caused by volume decreases in the Company's energy business as well as increased quality costs. Year-to-date gross margins decreased to 11.7% versus 13.0% in the prior year-to-date period due in large measure to the manufacturing inefficiencies from the Company's energy business.

Selling and administrative expense was \$727,000 for the quarter ended May 31, 2015 versus \$883,000 in the prior year quarter. Year-to-date selling and administrative expense of \$2,339,000 was \$10,000 higher than the comparable prior year period. The year over year quarterly decrease was due in large part to lower incentive compensation and accrued profit sharing.

Interest expense in the third quarter of fiscal 2015 was \$89,000 as compared to \$99,000 in the prior year quarter. Year-to-date interest expense for fiscal 2015 was \$259,000 versus \$314,000 in the prior year. The lower interest costs are a result of a lower level of long-term debt as well as a lower overall effective interest rate on that debt.

The Company recorded income tax expense at an effective tax rate of 8.8% and 25.9% for the quarter and year-to-date periods ended May 31, 2015, respectively. The Company recorded income tax expense at an effective rate of 36% for the quarter and year-to-date periods ended May 25, 2014, respectively. During the fiscal 2015 third quarter, the

Company hired an outside consulting firm to conduct an analysis to see if certain activities the Company performs qualify for the Research & Development tax credit (R&D credit) as defined by Internal Revenue Code Section 41. As a result of the analysis, the Company determined that it is performing activities that qualify for the R&D credit, and during the quarter ended May 31, 2015, the Company recognized a tax benefit of \$113,000 that related to actual R&D credits claimed in its fiscal year 2014 federal and state tax returns as well as estimated R&D credits accumulated to date for fiscal 2015. The fiscal 2015 credits relate to the last four months of calendar year 2014 which constitute the first four months of the Company's fiscal 2015 year. At the present time, the R&D credit statute has not been renewed for calendar year 2015, and therefore no R&D tax credits can be claimed for any months in calendar 2015 if and until the statute gets renewed by Congress.

### Liquidity and Capital Resources

On May 31, 2015 working capital was \$8,496,000 as compared to \$7,967,000 at August 31, 2014. The ratio of current assets to current liabilities at May 31, 2015 was 2.88 to 1.0 compared to 2.49 to 1.0 at August 31, 2014. Improvements in both ratios came primarily from an increase in the level of inventories and lower elements of current liabilities partially offset by a decrease in the level of accounts receivable.

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. At May 31, 2015, the Company had a \$1 million line of credit with its bank that had not been accessed.

### 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 May 31, 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 6. EXHIBITS:

A. The following exhibits are included herein:

Exhibit 31.1 Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act. Exhibit 31.2

Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act

Exhibit 32

Certification 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: June 30, 2015 /s/ Benjamin T. Rashleger

Officer

Benjamin T. Rashleger, President & Chief Executive

Date: June 30, 2015 /s/ Paul D. Sheely

Paul D. Sheely, Vice President, Finance & CFO