

Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

WSI INDUSTRIES INC  
Form 10-Q  
June 30, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

---

ACT OF 1934

For the quarterly period ended May 30, 2004

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 of organization)

(I. R. S. Employer  
Identification No.)

Osseo, Minnesota

55369

(Address of principal executive offices)

(Zip Code)

(763) 428-4308

(Registrant's telephone number, including area code)

(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.

## Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

Yes    X       No  
-----       -----

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes               No    X  
-----       ---

### APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

2,555,629 Common Shares were outstanding as of June 28, 2004.

WSI INDUSTRIES, INC.

AND SUBSIDIARIES

INDEX

Page No.  
-----

### PART I      FINANCIAL INFORMATION:

#### Item 1.   Financial Statements

Condensed Consolidated Balance Sheets May 30, 2004 (Unaudited)  
and August 31, 2003 3

Condensed Consolidated Statements of Operations  
Thirteen and Thirty-Nine weeks ended May 30, 2004  
and May 25, 2003 (Unaudited) 4

Condensed Consolidated Statements of Cash Flows  
Thirty-Nine weeks ended May 30, 2004  
and May 25, 2003 (Unaudited) 5

Notes to Condensed Consolidated Financial Statements (Unaudited) 6, 7, 8

Item 2.   Management's Discussion and Analysis of Financial Condition and  
Results of Operations 9, 10, 11

Item 4.   Controls and Procedures 12

### PART II.   OTHER INFORMATION:

Item 6.   Exhibits and Reports on Form 8-K 12

Signatures 13

# Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

2

## Part I. Financial Information

### Item I. Financial Statements

#### WSI INDUSTRIES, INC AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	MAY 30, 2004 ----	AUGUST 31, 2003 ----
	(Unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	\$ 845,237	\$ 891,218
Accounts receivable	1,618,557	1,530,811
Inventories	648,369	606,262
Prepaid and other current assets	76,948	75,747
Deferred tax assets	169,387	169,387
	-----	-----
Total Current Assets	3,358,498	3,273,425
	-----	-----
Property, Plant and Equipment - Net	3,596,765	1,718,599
	-----	-----
Deferred tax assets	1,647,184	1,813,270
	-----	-----
Intangible assets and deferred financing, net	2,390,497	2,368,452
	-----	-----
	\$10,992,944	\$ 9,173,746
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade accounts payable	\$ 616,729	\$ 403,277
Accrued compensation and employee withholdings	266,095	384,857
Miscellaneous accrued expenses	137,583	150,289
Current portion of long-term debt	279,471	195,720
	-----	-----
Total Current Liabilities	1,299,878	1,134,143
	-----	-----
Long term debt, less current portion	2,404,826	648,008
	-----	-----
STOCKHOLDERS' EQUITY:		
Common stock, par value \$.10 a share; authorized 10,000,000 shares; issued and outstanding 2,557,629 and 2,551,129 shares, respectively	255,763	255,113
Capital in excess of par value	1,837,441	1,826,901
Retained earnings	5,195,036	5,309,581
	-----	-----
Total Stockholders' Equity	7,288,240	7,391,595
	-----	-----
	\$10,992,944	\$ 9,173,746
	=====	=====

See notes to condensed consolidated financial statements

# Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

3

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

	13 weeks ended		39 weeks ended	
	May 30, 2004	May 25, 2003	May 30, 2004	May 2003
Net sales	\$ 3,147,009	\$ 3,051,583	\$ 8,568,737	\$ 7,844,000
Cost of products sold	2,735,548	2,435,876	7,338,416	6,355,000
Gross margin	411,461	615,707	1,230,321	1,489,000
Selling and administrative expense	315,368	375,950	974,047	1,065,000
Interest and other income	(16,716)	(11,441)	(62,496)	(73,000)
Interest and other expense	17,895	23,164	48,920	102,000
Earnings from operations before income taxes	94,914	228,034	269,850	394,000
Income tax expense	34,169	82,092	97,146	142,000
Net earnings	\$ 60,745	\$ 145,942	\$ 172,704	\$ 252,000
Basic earnings per share	\$ .02	\$ .06	\$ .07	\$ .07
Diluted earnings per share	\$ .02	\$ .06	\$ .07	\$ .07
Cash dividend per share	\$ .0375	\$ --	\$ .1125	\$ .1125
Weighted average number of common shares	2,557,189	2,462,165	2,553,442	2,464,000
Weighted average number of Dilutive common shares Outstanding	2,627,420	2,462,165	2,627,832	2,464,000

See notes to condensed consolidated financial statements.

4

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

39 weeks ended

# Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

	May 30, 2004	May 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 172,704	\$ 252,704
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	450,330	473,330
Deferred taxes	166,086	142,086
Changes in assets and liabilities:		
Increase in accounts receivable	(87,746)	(70,746)
(Increase) decrease in inventories	(42,107)	170,107
Increase in prepaid expenses	(1,201)	(19,201)
Increase in accounts payable and accrued expenses	81,984	87,984
Net cash provided by operations	740,050	1,036,050
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(2,044,171)	(155,171)
Net cash used in investing activities	(2,044,171)	(155,171)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Stock options exercised	11,190	
Purchase of Company stock	--	(8,190)
Issuance of long-term debt	1,710,000	
Payments of long-term debt	(153,756)	(965,756)
Deferred financing costs	(22,045)	
Dividends paid	(287,249)	
Net cash provided by (used) in financing activities	1,258,140	(973,140)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(45,981)	(92,140)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	891,218	1,115,218
CASH AND CASH EQUIVALENTS AT END OF REPORTING PERIOD	\$ 845,237	\$ 1,023,078
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	\$ 17,894	\$ 107,894
Income taxes	\$ --	\$ 4,000
Noncash investing and financing activities:		
Acquisition of machinery through capital lease	\$ 284,325	\$ 284,325

See notes to condensed consolidated financial statements.

## Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

### 1. CONSOLIDATED FINANCIAL STATEMENTS:

The condensed consolidated balance sheet as of May 30, 2004, the condensed consolidated statements of operations for the thirty-nine weeks ended May 30, 2004 and May 25, 2003 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, 2003 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 generally accepted accounting principles 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 2003 annual report to shareholders. The results of operations for interim periods are not necessarily indicative of the operating results for the full year.

### 2. PURCHASE OF REAL PROPERTY:

On May 3, 2004, the Company completed the purchase of a facility located in Monticello, Minnesota. The purchase price was \$1,900,000 and was paid for by a combination of cash and debt. The building is approximately 49,000 square feet in size on a nine-acre lot.

### 3. INVENTORIES

Inventories consist primarily of raw material, work-in-progress (WIP) and finished goods. The following table breaks out the values in each category net of the inventory valuation allowances of \$433,976 and \$422,930 at May 30, 2004 and August 31, 2003, respectively.

	May 30, 2004	August 31, 2003
	-----	-----
Raw material	\$109,816	\$185,785
WIP	258,661	211,188
Finished goods	279,892	209,289
	-----	-----
	\$648,369	\$606,262
	=====	=====

### 4. DEBT AND LINE OF CREDIT:

As described in Note 2, the Company purchased a new facility on May 3, 2004. In order to facilitate the purchase, the Company entered into two mortgage agreements. The first mortgage was with its bank for \$1,360,000 with a monthly payment of \$8,307 based on a 25-year amortization schedule. Interest is at 5.37% with a provision to adjust the rate after 5 years to the monthly five-year Treasury yield plus 2.5%. The entire principal balance is due May 1, 2014.

# Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

6

The second mortgage is with the City of Monticello Economic Development Authority (MEDA) for \$350,000 with a monthly payment of \$1,483 based on a 25-year amortization schedule. Interest is at 2.0%. The entire balance is due after five years on May 1, 2009. The indebtedness to the bank is secured pursuant to a mortgage and security agreement and fixture financing statement and the to MEDA is secured by a mortgage.

In connection with the purchase of the facility, the Company entered into a second amendment and modification of its Revolving Loan and Credit Agreement with its bank. The agreement is in the maximum amount of \$1 million with interest at prime and is secured by all assets of the Company. It contains restrictive provisions concerning yearly capital expenditures, maximum debt to net worth and minimum current ratios, as well a minimum debt service coverage ratio. The Company has not accessed the Revolver since the original inception of the agreement on December 2, 2002. The modified agreement expires December 31, 2004.

The Company also entered into a new capital lease agreement during the quarter. The amount financed was \$284,000 with payments over seven years at an imputed interest rate of 6.07%. The Company currently has three capitalized leases with principal balances owing in an amount of \$974,000 all secured by various pieces of manufacturing equipment.

## 5. GOODWILL AND INTANGIBLE ASSETS

Under Statements of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, goodwill and intangible assets are deemed to have indefinite lives and are not amortized, but are subjected to annual impairment tests in accordance with the statement. Other intangible assets will continue to be amortized over their useful lives.

The Company adopted the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2002. The Company performed its annual impairment test in the fourth quarter of fiscal 2003 and has determined no charge is warranted.

Goodwill and other intangible assets resulting from acquisitions of business and the formation of the Company consist of the following:

	May 30, 2004 ----	August 31, 2003 ----
Goodwill	\$2,428,264	\$2,428,264
Less accumulated amortization	308,595	308,595
	=====	=====
	\$2,119,669	\$2,119,669
	=====	=====
Other identifiable intangibles:		
Organization Costs	\$ 285,000	\$ 285,000
Less accumulated amortization	36,217	36,217
	=====	=====
	\$ 248,783	\$ 248,783
	=====	=====
Deferred financing	\$ 22,045	
	=====	
	\$2,390,497	\$2,368,452

# Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

=====

7

## 6. EARNINGS PER SHARE:

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

	Thirteen weeks ended		Thirty
	May 30,	May 25,	May 3
	2004	2003	2004
	-----	-----	-----
Numerator for basic and diluted earnings per share:			
Net earnings	\$ 60,745	\$ 145,942	\$ 172,
	=====	=====	=====
Denominator for earnings per share:			
Denominator for basic earnings			
per share - weighted average shares	2,557,189	2,462,165	2,553,
Effect of dilutive securities:			
Employee and non-employee options	70,231	--	74,
	-----	-----	-----
Denominator for diluted earnings			
per share-dilutive common shares	2,627,420	2,462,165	2,627,
	=====	=====	=====
Basic earnings per share	\$ .02	\$ .06	\$
	=====	=====	=====
Diluted earnings per share'	\$ .02	\$ .06	\$
	=====	=====	=====

8

## 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 discusses 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 believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our

## Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

financial statements, so we consider these to be our critical accounting policies. Because of the uncertainty inherent in these matters, actual results could differ from the estimates we used in applying the critical accounting policies. Within the context of these critical accounting policies, we are not currently aware of any reasonably likely event that would result in materially different amounts being reported.

### Allowance for Excess and Obsolete Inventory:

Inventories, which are composed of raw materials, work in process and finished goods, are valued at the lower of cost or market. On a periodic basis, the Company analyzes the level of inventory on hand, its cost in relation to market value and estimated customer requirements to determine whether write-downs for excess or obsolete inventory are required. Actual customer requirements in any future periods are inherently uncertain and thus may differ from our estimates. If actual or expected requirements were significantly greater or lower than the established reserves, we would record a reduction or increase to the obsolescence allowance in the period in which we made such a determination.

### Goodwill Impairment:

The Company evaluates the valuation of its goodwill according to the provisions of SFAS 142 to determine if the current value of goodwill has been impaired. To do this the Company determines the discounted present value of anticipated cash flows based on anticipated results of operations for the coming years. If we have changes in events or circumstances, including reductions in anticipated cash flows generated by our operations, goodwill could become impaired which would result in a charge to earnings.

### Deferred Taxes:

The Company accounts for income taxes using the liability method. Deferred income taxes are provided for temporary difference between the financial reporting and tax bases of assets and liabilities. A valuation allowance would be set up should the realization of any deferred taxes become less likely than not to occur. The valuation allowance is analyzed periodically by the Company and may result in income tax expense different than statutory rates.

9

### Revenue Recognition:

Revenues from sales of product are recorded upon shipment when all of the following criteria of Staff Accounting Bulletin No. 101 have been met: persuasive evidence of an arrangement exists, delivery has occurred, the price to the customer is fixed or determinable and collectibility is reasonably assured. Credit losses relating to customers have been minimal and within management's expectations. Based on management's evaluation of uncollected accounts receivable at the end of each year, bad debts are provided for on the allowance method. Accounts are considered delinquent if they are 120 days past due. The Company mitigates its credit risk by performing credit checks and actively pursuing past due accounts.

### Results of Operations:

Net sales were \$3,147,000 for the quarter ending May 30, 2004, an increase of 3% or \$95,000 from the same period of the prior year. Year-to-date sales in fiscal 2004 were \$8,569,000 compared to \$7,845,000 in the prior year. The

## Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

increase in sales for the quarter, as well as the six months, came from an increase in sales to the Company's recreational vehicle market.

Gross margin decreased to 13% for the quarter ending May 30, 2004 versus 20% in the year ago period. The margin decrease is due to higher material costs, as well as start-up expenses related to a new program in the Company's recreational vehicle market. The decrease is also attributable to higher production supply and machine repairs expense. Year-to-date gross margins were 14% and 19% for the six-month periods ending May 30, 2004 and May 25, 2003, respectively.

Selling and administrative expense of \$315,000 for the quarter ending May 30, 2004 was \$61,000 lower than in the prior year period. The expense is lower due to lower payroll and other compensation costs. In the current fiscal quarter, the Company incurred \$18,000 in costs associated with the acquisition of the new Monticello facility that were included in general and administrative expense. The Company estimates that it will incur \$300,000 of costs associated with the relocation of its business to the new facility. These costs will be incurred over the next six months, the timing of which is dependent on when various parts of the business will relocate to the new building. Year-to-date selling and administrative expense of \$974,000 was \$91,000 lower than the comparable prior year period. Selling and administrative expense for the nine-month period ending May 25, 2003 was negatively affected by \$60,000 of costs associated with a proxy contest that the Company was involved in. The proxy contest was resolved with all costs incurred by the end of the first quarter of fiscal 2003.

Interest expense in the third quarter of fiscal 2004 was \$18,000, which was \$5,000 less than the second quarter of fiscal 2003 amount of \$23,000. Year-to-date interest expense is also lower in 2004 due to lower average levels of debt during the year compared to the prior year period.

The Company recorded income tax expense at an effective tax rate of 36% for the quarter and nine months ended May 30, 2004 and February 23, 2003.

10

### Liquidity and Capital Resources:

On May 30, 2004, working capital was \$2,059,000 compared to \$2,139,000 at August 31, 2003. The ratio of current assets to current liabilities at May 30, 2004 was 2.58 to 1.0 compared to 2.89 to 1.0 at August 31, 2003. The Company's cash balance decreased \$46,000 during the first nine months. The slight decrease in the cash balance and the aforementioned ratios is due to the purchase of the Monticello facility.

As discussed in Note 3 of the Financial Statements, the Company entered into two separate mortgages for the purchase of the Monticello facility. The first mortgage is for \$1,360,000 with an interest rate of 5.37% adjustable after 5 years and payments of \$8,307 with the entire balance due May 1, 2014.

The second mortgage is with the City of Monticello Economic Development Authority for \$350,000 due May 1, 2009. The mortgage has a monthly payment of \$1,483 with interest at 2.0%.

It is the Company's belief that its internally generated funds, as well as its line of credit, will be sufficient to enable the Company to meet its working capital requirements for the next twelve months.

Cautionary Statement:

## Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

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. The following important factors, among others, 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 loss of significant business from any one of its current customers could have a material adverse effect on the Company; (iii) a significant downturn in the industries in which the Company participates could have an adverse effect on the demand for Company services; (iv) the concentration of our sales in a limited number of highly competitive industries; (v) the prices of our products are subject to downward pressure from customers and market pressure from competitors; (vi) the Company's ability to curtail its costs and expenses for new manufacturing programs, commensurate with expected revenues; (vii) the Company's ability to comply with covenants of its credit facility; (viii) fluctuations in operating results due to, among other things, changes in customer demand for our product, in our manufacturing costs and efficiency of our 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.

11

### 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 reviewed the Company's disclosure controls and procedures within 90 days prior to the filing of this report. Based upon this review, these officers believe that the Company's disclosure controls and procedures are effective in ensuring that material information related to the Company is made known to them by others within the Company.

#### (b) Changes in Internal Controls.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls during the quarter covered by this report or from the end of the reporting period to the date of this Form 10-Q.

### PART II. OTHER INFORMATION:

#### Item 6. Exhibits and Reports on Form 8-K:

## Edgar Filing: WSI INDUSTRIES INC - Form 10-Q

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. Section 1350.

B. Reports on Form 8-K:

During the quarter, the Company furnished a Current Report on Form 8-K dated May 11, 2004, reporting under Item 2 the purchase of real property located at 213 Chelsea Road, Monticello, MN and under item 7 various items associated with that purchase.

12

### 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 29, 2004  
-----

/s/ Michael J. Pudil  
-----

Michael J. Pudil, President & CEO

Date: June 29, 2004  
-----

/s/ Paul D. Sheely  
-----

Paul D. Sheely, Vice President, Finance & CFO

13