## SHOPSMITH INC

Form 10-Q
February 11, 2003

## Table of Contents

FORM 10-Q<br>SECURITIES AND EXCHANGE COMMISSION<br>WASHINGTON, D.C. 20549<br>Quarterly Report Pursuant To Section 13 or 15 (d)<br>Of the Securities Exchange Act of 1934

For the quarterly period ended December 28, 2002
Commission File Number 0-9318

## SHOPSMITH, INC.

(Exact Name of Registrant as specified in its charter)

Ohio
(State of Incorporation)
6530 Poe Avenue
Dayton, Ohio
(Address of Principal
45414
(Zip Code)

Executive Offices)
Registrant s Telephone Number 937-898-6070
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.

$$
\text { Yes }[\mathrm{X}] \quad \text { No }[\text { ] }
$$

Indicate the number of shares outstanding of each of the registrant sclasses of common stock as of January 17, 2003.

Common shares, without par value: $2,605,233$ shares.
Page 1

## TABLE OF CONTENTS

CONSOLIDATED BALANCE SHEETS
CONSOLIDATED BALANCE SHEETS
CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (DEFICIT) SHOPSMITH INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS
SHOPSMITH, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Results of Operations
Liquidity and Financial Position
Forward Looking Statements
Item 3. Quantitative and qualitative disclosures about market risk.
Item 4. Controls and Procedures.
PART II. OTHER INFORMATION
Item 6. Exhibits and Reports on Form 8-K
SIGNATURES
Exhibit 4.14 Promissory Note
Exhibit 99.2 Certification
Exhibit 99.3 Certification

## Table of Contents

SHOPSMITH, INC. AND SUBSIDIARIES
INDEX
Page No.
Part I. Financial Information:
Item 1. Financial Statements
Consolidated Balance Sheets- December 28, 2002 and March 30, 2002 ..... 3-4
Consolidated Statements of Operations and Retained Earnings (Deficit) Three Months and Nine Months Ended December 28, 2002 and December 29, 2001 ..... 5
Consolidated Statements of Cash Flows- Nine Months Ended December 28, 2002 and December 29, 2001 ..... 6
Notes to Consolidated Financial Statements ..... 7-8
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations ..... 9-10
Item 3. Quantitative and qualitative disclosures about market risk ..... 11
Item 4. Controls and procedures ..... 11
Part II. Other Information
Item 6. Exhibits and Reports on Form 8-K ..... 12
Signatures ..... 12
Certifications ..... 13-14

## Table of Contents

SHOPSMITH INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

|  | $\begin{gathered} \text { December } 28, \\ 2002 \end{gathered}$ | $\begin{gathered} \text { March 30, } \\ 2002 \end{gathered}$ |
| :---: | :---: | :---: |
|  | (Unaudited) |  |
| ASSETS |  |  |
| Current Assets: |  |  |
| Cash and equivalents | \$ 825 | \$ 76,324 |
| Restricted cash | 24,940 | 151,585 |
| Accounts receivable: |  |  |
| Trade, less allowance for doubtful accounts: |  |  |
| \$909,539 on December 28, and \$774,708 on March 30, | 1,680,879 | 1,642,366 |
| Inventories |  |  |
| Finished products | 986,856 | 875,888 |
| Raw materials and work in process | 1,352,930 | 1,427,369 |
| Total inventories | 2,339,786 | 2,303,257 |
| Prepaid expenses | 177,175 | 218,660 |
| Total current assets | 4,223,605 | 4,392,192 |
| Properties: |  |  |
| Land, building and improvements | 3,148,348 | 3,143,908 |
| Machinery, equipment and tooling | 6,722,321 | 6,714,886 |
| Total cost | 9,870,669 | 9,858,794 |
| Less accumulated depreciation and amortization | 7,174,414 | 7,029,128 |
| Net properties | 2,696,255 | 2,829,666 |
| Long-term portion of accounts receivable trade, less allowance for doubtful accounts: |  |  |
| \$186,248 on December 28, and \$116,432 on March 30, | 529,692 | 215,476 |
| Other assets | 2,303 | 2,303 |
| Total assets | \$7,451,855 | \$7,439,637 |

Continued

## Table of Contents

|  | $\begin{gathered} \text { December } 28, \\ 2002 \end{gathered}$ | $\begin{gathered} \text { March } 30, \\ 2002 \end{gathered}$ |
| :---: | :---: | :---: |
|  | (Unaudited) |  |
| LIABILITIES AND SHAREHOLDERS EQUITY |  |  |
| Current liabilities: |  |  |
| Accounts payable | \$ 1,529,211 | \$ 1,582,636 |
| Note payable | 400,000 | 400,000 |
| Current portion of long-term debt and capital lease obligation | 106,235 | 104,836 |
| Customer advances | 84,582 | 126,181 |
| Accrued liabilities: |  |  |
| Compensation, employee benefits and payroll taxes | 399,737 | 289,559 |
| Sales taxes payable | 56,136 | 80,570 |
| Accrued recourse liability | 131,444 | 147,786 |
| Accrued expenses | 277,427 | 257,544 |
| Other | 70,940 | 75,470 |
| Total current liabilities | 3,055,712 | 3,064,582 |
| Long-term debt and capital lease obligation | 2,400,432 | 2,479,344 |
| Total liabilities | 5,456,144 | 5,543,926 |
| Shareholders equity: |  |  |
| Preferred shares- without par value; authorized 500,000; none issued Common shares- without par value; authorized 5,000,000; issued and outstanding 2,605,233 shares on December 28, and March 30, | 2,806,482 | 2,806,482 |
| Deficit | $(810,771)$ | $(910,771)$ |
| Total shareholders equity | 1,995,711 | 1,895,711 |
| Total liabilities and shareholders equity | \$7,451,855 | \$7,439,637 |

See notes to consolidated financial statements.

## Table of Contents

SHOPSMITH INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (DEFICIT)

|  | Three Months Ended |  | Nine Months Ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { December } 28, \\ 2002 \end{gathered}$ | $\begin{gathered} \text { December 29, } \\ 2001 \end{gathered}$ | $\begin{gathered} \text { December 28, } \\ 2002 \end{gathered}$ | $\begin{gathered} \text { December 29, } \\ 2001 \end{gathered}$ |
|  | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| Net sales | \$3,986,866 | \$4,617,061 | \$ 10,608,638 | \$ 10,943,202 |
| Cost of products sold | 2,039,175 | 2,387,571 | 5,192,364 | 5,362,391 |
| Gross margin | 1,947,691 | 2,229,490 | 5,416,274 | 5,580,811 |
| Selling expenses | 1,446,248 | 1,901,997 | 3,919,028 | 4,969,104 |
| Administrative expenses | 456,423 | 404,047 | 1,327,745 | 1,324,924 |
| Total operating expenses | 1,902,671 | 2,306,044 | 5,246,773 | 6,294,028 |
| Income (loss) from operations | 45,020 | $(76,554)$ | 169,501 | $(713,217)$ |
| Non-recurring gain from demutualization of insurance company |  | 153,381 | 95,462 | 153,381 |
| Interest income | 35,658 | 20,218 | 85,902 | 53,996 |
| Interest expense | 82,664 | 65,645 | 255,481 | 189,911 |
| Other income, net | 1,986 | 2,029 | 4,616 | 8,784 |
| Income (loss) before taxes |  | 33,429 | 100,000 | $(686,967)$ |
| Income tax expense |  |  |  |  |
| Net income (loss) |  | 33,429 | 100,000 | $(686,967)$ |
| Retained earnings: |  |  |  |  |
| Beginning | $(810,771)$ | 159,106 | $(910,771)$ | 879,502 |
| Ending | \$ (810,771) | \$ 192,535 | \$ (810,771) | \$ 192,535 |
| Net income (loss) per common share (Note 3) |  |  |  |  |
| Basic | \$ | \$ 0.01 | \$ 0.04 | \$ (0.26) |
| Diluted | \$ | \$ 0.01 | \$ 0.04 | \$ (0.26) |

See notes to consolidated financial statements.
Page 1 of 1

## Table of Contents

## SHOPSMITH INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS



See notes to consolidated financial statements.

## Table of Contents



## Table of Contents

|  | Three Months Ended |  | Nine Months Ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { December 28, } \\ 2002 \end{gathered}$ | $\begin{gathered} \text { December 29, } \\ 2001 \end{gathered}$ | $\begin{gathered} \text { December } 28, \\ 2002 \end{gathered}$ | $\begin{gathered} \text { December 29, } \\ 2001 \end{gathered}$ |
| Net income (loss) | \$ | \$ 33,429 | \$ 100,000 | \$ (686,967) |
| Weighted average shares | 2,605,233 | 2,605,233 | 2,605,233 | 2,605,233 |
| Additional dilutive shares |  | 8,400 |  |  |
| Total dilutive shares | 2,605,233 | 2,613,633 | 2,605,233 | 2,605,233 |
| Basic income (loss) per share | \$ | \$ 0.01 | \$ 0.04 | \$ (0.26) |
| Diluted income (loss) per share | \$ | \$ 0.01 | \$ 0.04 | \$ (0.26) |

## Edgar Filing: SHOPSMITH INC - Form 10-Q

## Table of Contents

## SHOPSMITH, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. In the opinion of management, all adjustments (consisting of only normal and recurring adjustments) have been made as of December 28, 2002 and December 29, 2001 to present the financial statements fairly. However, the results of operations for the nine months then ended are not necessarily indicative of results for the full fiscal year. The financial statements and notes are presented as permitted by Form 10-Q, and do not contain certain information included in the annual financial statements. The financial statements accompanying this report should be read in conjunction with the financial statements and notes thereto included in the Annual Report to Shareholders for the year ended March 30, 2002.
2. The provision for income taxes is as follows:
<Insert TaxProv tab here>

Taxable income for the nine months ended December 28, 2002 was offset by a net operating loss carry forward (The remaining net operating loss carry forward asset of $\$ 1,376,000$ was not shown as an asset because of a valuation allowance against the Company s ability to realize the tax benefit).
3. Basic income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted income (loss) per share reflects per share amounts that would have resulted if stock options had been converted into common stock. The following reconciles amounts reported in the financial statements:
<Insert EPS tab here>

There were no additional dilutive shares included in the computation for the periods ended December 28, 2002 and for the quarter ended December 29, 2001 because the stock options were anti-dilutive.

$$
\text { Page } 7
$$

## Edgar Filing: SHOPSMITH INC - Form 10-Q

## Table of Contents

4. During fiscal 2002, entered into an arrangement with John R. Folkerth, the Company s CEO, which allows the Company to borrow up to $\$ 500,000$ with interest at twelve percent. The maximum authorized borrowing was increased to $\$ 600,000$ in July 2002. Substantially all personal property except for certain receivables are pledged as collateral. Interest is due monthly and the note is payable on demand. At December 28, 2002 and March 30, 2002, there was $\$ 400,000$ outstanding under this arrangement. Borrowings from Mr. Folkerth are subject to Mr. Folkerth s approval and are payable upon demand by Mr. Folkerth.
5. On December 31, 2002, Shopsmith entered into a loan agreement with Provident Bank which allows the Company to borrow up to the lesser of $\$ 750,000$ or $80 \%$ of eligible receivables due from Lowes Companies, Inc., with interest charged at one and one-half percent over the bank s prime rate. The agreement requires compliance with certain net income, net worth, and miscellaneous covenants. Substantially all personal property is pledged as collateral.
6. One customer exceeded the $10 \%$ level of consolidated net sales. A major retailer represented $37 \%$ of net sales for the quarter ended December 28, 2002 and $33 \%$ of net sales for the nine months ended December 28, 2002.

Page 8

## Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

## Results of Operations

Shopsmith manufactures and sells woodworking products. Our core product, the Mark V is sold directly to consumers through demonstration sales events and indirectly to consumers through distributors, primarily Lowe $s$ where Shopsmith also conducts sales demonstrations, along with smaller amounts through other efforts. Mark V sales demonstrations are done in shopping malls, at home shows, and at state fairs. Other woodworking products and accessories are sold through mail and Internet channels. Shopsmith recognizes revenue for these orders at the time of product shipment.

Third quarter sales decreased to $\$ 3,987,000$ or $13.6 \%$ from $\$ 4,617,000$ generated a year ago. This decrease occurred primarily in our demonstration sales of the Mark V, other than demonstrations done at Lowe s stores. Year to date sales decreased to $\$ 10,609,000$ or $3.1 \%$ from $\$ 10,943,000$ last year.

Gross margin rates increased by one half of a percentage point compared to the same quarter last year, and by $0.1 \%$ on a year to date basis. Operating expenses were reduced by $\$ 403,000$ to $\$ 1,903,000$ in the third quarter from $\$ 2,306,000$ in last year sthird quarter. On a year to date basis, operating expenses dropped by $\$ 1,143,000$ to $\$ 5,151,000$ from $\$ 6,294,000$ the prior year. Operating expenses were reduced by improved expense control on Mark V sales events, as well as through reductions in compensation costs. Employee benefit costs were reduced by $\$ 95,000$ year to date, due to proceeds from the Anthem insurance demutualization.

During the fiscal year ending March 2003, Shopsmith has implemented a employee salary reduction plan. The plan took effect May 19, 2002 and continued until December 28, 2002. Salary reductions of participants (officers, managers and certain key employees) aggregated $\$ 38,000$ and $\$ 91,000$ during the three and nine months ended December 28, 2002, respectively. As part of this plan, fiscal 2003 pre-tax income above $\$ 100,000$ will be used to return the amount of the reduction and to pay an additional incentive equal to the amount of the reduction, as income permits. The salary reductions were restored at the end of the Company s third quarter. An expense of $\$ 147,000$ has been accrued based on year to date results before the offsetting accrual for exceeding $\$ 100,000$. The next $\$ 35,000$ of additional earnings in the fourth quarter of fiscal 2003 will be offset by increases to the accrual for payment returning the salary reduction and paying the incentive amounts. If the plan had not been in effect for the three and nine months ended December 28, 2002, results would have been $\$ 73,000$ and $\$ 156,000$, respectively.

Provisions for recoverable Federal income taxes (\$0 in both FY2003 and FY 2002) are based on estimated annual effective rates, less a valuation reserve. The zero Federal income tax amount in FY2003 was due to the utilization of the net loss carryforwards.

Because of the factors above, a net income of $\$ 0$ or $\$ .00$ per diluted share was earned in the quarter ended December 28, 2002 compared to a net income of $\$ 33,000$ or $\$ .01$ per diluted share for the same period of last year. For the year to date, net income was $\$ 100,000$ or $\$ .04$ per diluted share compared to a net loss of $\$ 687,000$ or $\$ .26$ per diluted share for the same period last year.

## Liquidity and Financial Position

Cash provided from operations totaled $\$ 14,000$ in the current year compared with a usage of $\$ 622,000$ for the same period of the preceding year. The year to date income of $\$ 100,000$ along with the adjustments for non-cash items, such as depreciation and the provision for doubtful accounts, offset by an increase in receivables explain the change in cash for the period.

The current ratio was 1.38 to 1 at December 28, 2002 compared to 1.43 to 1 at the beginning of the current fiscal year. The debt to equity ratio decreased to 2.73 to 1 from 2.92 to 1 at March 30, 2002.

During fiscal 2002, Shopsmith entered into an arrangement with John R. Folkerth, the Company s CEO, which allows the Company to borrow up to $\$ 500,000$ with interest at twelve percent. The maximum authorized borrowing was increased to $\$ 600,000$ in July 2002. Substantially all personal property except for certain receivables are pledged as collateral. Interest is due monthly and the note is payable on demand. At December 28, 2002, there was $\$ 400,000$ outstanding under this arrangement. Borrowings from Mr. Folkerth are subject to Mr. Folkerth s approval and are payable upon demand by Mr. Folkerth.

On December 31, 2002, Shopsmith entered into a loan agreement with Provident Bank which allows the company to borrow up to the lesser of $\$ 750,000$ or $80 \%$ of eligible receivables due from Lowes Companies, Inc., with interest charged at one and one-half percent over the Bank s prime rate. The agreement requires compliance with certain net income, net worth, and miscellaneous covenants. Substantially all personal
property is pledged as collateral.
In 1999, the Company purchased the building it had been leasing. The seller financed the building purchase. The financing agreement provided for a $\$ 100,000$ down payment and a secured mortgage note for $\$ 2,800,000$ at an $8.75 \%$ interest rate. The note was payable in monthly

Page 9

## Edgar Filing: SHOPSMITH INC - Form 10-Q

## Table of Contents

installments of $\$ 25,785$ with the balance being due and payable in full on January 1, 2003. In March 2002, the agreement was amended to continue the $\$ 25,785$ monthly payments of principal and interest until January 1, 2006 at which time the scheduled balance of approximately $\$ 2,180,000$ will become due and payable.

## Forward Looking Statements

The foregoing discussion and the Company s consolidated financial statements contain certain forward-looking statements that involve risks and uncertainties, including but not limited to the following: (i) the operating cash flows together with currently available working capital may be inadequate to finance the operating needs of the Company; (ii) the demand loan extended to the Company by Mr. John R. Folkerth (as described above) could be called prior to the Company being in a position to repay or refinance the loan; and (iii) cancellation by Lowe s of the in-store sales program.

## Edgar Filing: SHOPSMITH INC - Form 10-Q

## Table of Contents

Item 3. Quantitative and qualitative disclosures about market risk.

Not applicable.
Item 4. Controls and Procedures.

The Company s Chairman and Chief Executive Officer, John R. Folkerth, and the Company s Chief Financial Officer, Mark A. May, have evaluated the Company s internal controls and disclosure controls systems within 90 days of the filing of this report. Messrs. Folkerth and May have concluded that the Company s disclosure controls systems are functioning effectively to provide reasonable assurance that the Company can meet its disclosure obligations. The reporting process is designed to ensure that information required to be disclosed by the Company in the reports that it files or submits with the Commission is recorded, processed, summarized and reported within the time periods specified in the Commission s rules and forms. Since Messrs. Folkerth s and May s most recent review of the Company s internal controls systems, there have been no significant changes in internal controls or in other factors that could significantly affect these controls.

## Page 11

## Edgar Filing: SHOPSMITH INC - Form 10-Q

## Table of Contents

## PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K
(a) Exhibits:
4. Instruments Defining the Rights of Security Holders, Including Indentures
4.14 Promissory Note and Loan Agreement with Provident Bank dated December 31, 2002
99. Additional Exhibits
99.2 Certification of the form 10-Q by John R. Folkerth, the Company s CEO.
99.3 Certification of the form 10-Q by Mark A. May, the Company s CFO.
(b) Reports on Form 8-K:

None

## SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHOPSMITH, INC.
By /S/ Mark A. May
Mark A. May
Vice President of Finance (Principal Financial and Accounting Officer)

Date: February 10, 2003

Page 12

## Edgar Filing: SHOPSMITH INC - Form 10-Q

## Table of Contents

I, John R. Folkerth, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Shopsmith, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statements of 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 the quarterly 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 procedures 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 sother 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: February 10, 2003
By: /s/ John R. Folkerth
John R. Folkerth
Chairman and Chief Executive Officer

## Edgar Filing: SHOPSMITH INC - Form 10-Q

## Table of Contents

I, Mark A. May, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Shopsmith, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statements of 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 the quarterly 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 procedures 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 sother 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 sother 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: February 10, 2003
By: /s/ Mark A. May
Mark A. May

Page 14

