DOUGLAS DYNAMICS, INC
Form 10-Q
August 09, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

OR

o 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: 001-34728

DOUGLAS DYNAMICS, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**134275891** (I.R.S. Employer Identification No.)

7777 North 73rd Street

Milwaukee, Wisconsin 53223

(Address of principal executive offices) (Zip code)

(414) 354-2310

(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 x No o

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 o No o

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 large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No x

Number of shares of registrant s common shares outstanding as of August 8, 2011 was 22,003,912

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Douglas Dynamics, Inc.

Consolidated Balance Sheets

(In thousands except share data)

	June 30, 2011 (unaudited)	December 31, 2010 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 165	$ 20,149
Accounts receivable, net	56,381	37,040
Inventories	30,905	23,481
Deferred income taxes	7,181	7,142
Prepaid income taxes		29
Prepaid and other current assets	909	1,131
Total current assets	95,541	88,972
Property, plant, and equipment, net	21,298	21,962
Assets held for sale	1,732	1,779
Goodwill	107,222	107,222
Other intangible assets, net	124,348	126,948
Deferred financing costs, net	3,786	953
Other long-term assets	158	207
Total assets	$ 354,085	$ 348,043
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 4,966	$ 2,847
Accrued expenses and other current liabilities	13,522	11,923
Accrued interest	305	23
Income taxes payable	3,183	
Current portion of long-term debt	1,071	1,183
Total current liabilities	23,047	15,976
Retiree health benefit obligation	7,430	7,235
Pension obligation	10,329	10,753
Deferred income taxes	25,104	22,650
Deferred compensation	947	1,067
Long-term debt, less current portion	122,714	119,971
Other long-term liabilities	525	898
Stockholders equity:		

Common Stock, par value $0.01, 200,000,000 shares authorized, 22,003,912 and 21,579,655 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively		220		216
Additional paid-in capital		129,714		127,695
Stockholders notes receivable				(482)
Retained earnings		38,550		46,495
Accumulated other comprehensive loss, net of tax		(4,495)		(4,431)
Total stockholders equity		163,989		169,493
Total liabilities and stockholders equity	$	354,085	$	348,043

See the accompanying notes to consolidated financial statements

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Douglas Dynamics, Inc.

Consolidated Statements of Operations

(In thousands, except share and per share data)

	Three Months Ended		Six Months Ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
	(unaudited)		(unaudited)	
Net sales	$ 71,557	$ 66,243	$ 95,047	$ 80,890
Cost of sales	45,219	41,182	59,638	53,849
Gross profit	26,338	25,061	35,409	27,041
Selling, general, and administrative expense	6,751	7,900	12,661	13,708
Intangibles amortization	1,300	1,540	2,600	3,080
Management fees-related party	9	5,966	26	6,313
Income from operations	18,278	9,655	20,122	3,940
Interest expense, net	(2,142)	(2,989)	(4,347)	(6,704)
Loss on extinguishment of debt	(673)	(7,967)	(673)	(7,967)
Other income (expense), net	(74)	(1)	(187)	5
Income (loss) before taxes	15,389	(1,302)	14,915	(10,726)
Income tax expense (benefit)	5,666	(1,377)	5,992	(5,082)
Net income (loss)	$ 9,723	$ 75	$ 8,923	$ (5,644)
Less net income attributable to participating securities	114		110	
Net income (loss) attributable to common shareholders	$ 9,609	$ 75	$ 8,813	$ (5,644)
Weighted average number of common shares outstanding:				
Basic	21,661,662	18,236,818	21,536,441	16,339,816
Diluted	21,768,385	18,520,117	21,667,544	16,339,816
Earnings (loss) per share:				
Basic	$ 0.44	$	$ 0.41	$ (0.35)
Diluted	$ 0.44	$	$ 0.41	$ (0.35)
Cash dividends declared and paid per share:	$ 0.20	$	$ 0.77	$

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Consolidated Statements of Cash Flows

(in thousands)

	Six Months Ended June 30, 2011	June 30, 2010
	(unaudited)	
Operating activities		
Net income (loss)	$ 8,923	$ (5,644)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	4,102	6,644
Amortization of deferred financing costs	286	611
Loss on extinguishment of debt	673	7,967
Amortization of debt discount	56	
Stock-based compensation	746	1,821
Provision for losses on accounts receivable	408	167
Deferred income taxes	2,415	2,216
Changes in operating assets and liabilities:		
Accounts receivable	(19,749)	(26,640)
Inventories	(7,424)	1,073
Prepaid and other assets and prepaid income taxes	300	(6,729)
Accounts payable	2,119	1,267
Accrued expenses and other current liabilities	5,064	(7,349)
Deferred compensation	(120)	125
Benefit obligations and other long-term liabilities	(666)	(237)
Net cash used in operating activities	(2,867)	(24,708)
Investing activities		
Capital expenditures	(840)	(1,854)
Proceeds from sale of equipment	49	
Net cash used in investing activities	(791)	(1,854)
Financing activities		
Stock repurchases		(2)
Proceeds from exercise of stock options	1,277	
Payment of call premium and post payoff interest on senior notes redemption		(3,876)
Collection of stockholders notes receivable	482	540
Payments of financing costs	(3,454)	(2,605)
Dividends paid	(16,868)	
Revolver borrowings		20,000
Proceeds from public offering, net		63,938
Borrowings on long-term debt	123,750	40,000
Repayment of long-term debt	(121,513)	(150,525)

Net cash used in financing activities		(16,326)		(32,530)
Change in cash and cash equivalents		(19,984)		(59,092)
Cash and cash equivalents at beginning of period		20,149		69,073
Cash and cash equivalents at end of period	$	165	$	9,981

See the accompanying notes to consolidated financial statements.

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Douglas Dynamics, Inc.

Notes to Unaudited Consolidated Financial Statements

(in thousands except share and per share data)

1. Basis of presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the financial statements and related footnotes included in our Form 10-K (Commission File No. 1-34728) filed with the Securities and Exchange Commission.

We operate as a single business unit.

Secondary Public Offering

On May 20, 2011, certain of the stockholders of Douglas Dynamics, Inc. (the Company), including affiliates of Aurora Capital Group and Ares Management, closed a registered secondary offering of 5,750,000 shares (the Shares) of the Company s common stock. The Company did not receive any proceeds from the sale of its stock by the selling stockholders in the offering.

Capitalization summary upon closing of the secondary offering:

Common stock issued and outstanding at March 31, 2011:	21,848,947
Shares issued for options exercised in connection with offering:	154,965
Common stock issued and outstanding as of June 30, 2011:	22,003,912

Interim Consolidated Financial Information

The accompanying consolidated balance sheet as of June 30, 2011 and the consolidated statements of operations for the three and six months ended June 30, 2011 and 2010 and cash flows for the six months ended June 30, 2011 and 2010 have been prepared by the Company and have not been audited.

As required by the new debt agreement the Company entered into in the second quarter of 2011, the Company entered into an interest-rate swap agreement to hedge against the potential impact on earnings from increases in market interest rates. Under the interest rate swap agreement, the Company will receive or make payments on a monthly basis starting July 18, 2011, which is one month from the date the interest rate swap agreement was entered into, based on the differential between 6.335% and LIBOR plus 4.25% (with a LIBOR floor of 1.5%). The tax effected negative fair market value of the interest rate swap of ($64) is included in Accumulated other comprehensive loss at June 30, 2011 on the balance sheet. This fair value was determined using level 2 inputs as defined in Accounting Standards Codification (ASC) 820. The interest rate swap contract on $50,000 notional amount of the term loan expires in December 2014. The Company does not expect to record any unrecognized loss into earnings in the next twelve months. Additionally, other comprehensive income (loss) includes the net income (loss) of the Company plus the Company s adjustments for its defined benefit retirement plans based on the measurement date as of the Company s year-end. Other comprehensive income (loss) was $9,659 and $8,859 for the three and six months ended June 30, 2011, respectively. Other comprehensive income (loss) was $212 and $(5,507) for the three and six months ended June 30, 2010, respectively.

The Company s business is seasonal and consequently its results of operations and financial condition vary from quarter-to-quarter. Because of this seasonality, the Company s results of operations for any quarter may not be indicative of results of operations that may be achieved for a subsequent quarter or the full year, and may not be similar to results of operations experienced in prior years. The Company attempts to manage the seasonal impact of snowfall on its revenues in part through its pre-season sales program. This pre-season sales program encourages the Company s distributors to re-stock their inventory during the second and third quarters in anticipation of the peak fourth quarter retail sales period by offering favorable pre-season pricing and payment deferral until the fourth quarter. Thus, the Company tends to generate its greatest volume of sales during the second and third quarters. By contrast, its revenue and operating results tend to be lowest during the first quarter, as management believes the Company s end-users prefer to wait until the beginning of a snow season to purchase new equipment and as the Company s distributors sell off inventory and wait for the pre-season sales incentive period to re-stock inventory. Fourth quarter sales vary from year-to-year as they are primarily driven by the level, timing and location of snowfall during the quarter. This is because most of the Company s fourth quarter sales and shipments consist of re-orders by distributors seeking to restock inventory to meet immediate customer needs caused by snowfall during the winter months.

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2. Fair Value

Fair value is the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability s fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Fair value measurements are categorized into one of three levels based on the lowest level of significant input used: Level 1 (unadjusted quoted prices in active markets); Level 2 (observable market inputs available at the measurement date, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data).

The following table presents financial assets and liabilities measured at fair value on a recurring basis and discloses the fair value of long-term debt:

	Fair Value at 6/30/2011	Fair Value at 12/31/2010
Assets:		
Assets (a)	$	$
Total Assets	$	$
Liabilities:		
Long term debt (b)	124,714	120,397
Other long-term liabilities Interest rate swap(c)	103	
Total Liabilities	$ 124,817	$ 120,397

(a) The Company does not have any financial assets that are required to be measured at fair value on a recurring basis.

(b) The fair value of the Company s long-term debt, including current maturities, is estimated using discounted cash flows based on the Company s current incremental borrowing rates for similar types of borrowing arrangements, which is a level 2 input for all periods presented. Meanwhile, long-term debt is recorded at carrying amount, net of discount, as disclosed on face of balance sheet.

(c) Valuation models are calibrated to initial trade price. Subsequent valuations are based on observable inputs to the valuation model (e.g. interest rates and credit spreads). Model inputs are changed only when corroborated by market data. A credit risk adjustment is made on each swap using observable market credit spreads. Thus, inputs used to determine fair value of the interest rate swap are level 2 inputs.

3. Inventories

Inventories consist of the following:

	June 30, 2011	December 31, 2010
Finished goods and work-in-process	$ 29,401	$ 21,896
Raw material and supplies	1,504	1,585
	$ 30,905	$ 23,481

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4. Property, plant and equipment

Property, plant and equipment are summarized as follows:

	June 30, 2011	December 31, 2010
Land	$ 960	$ 960
Land improvements	1,768	1,768
Buildings	12,564	12,554
Machinery and equipment	22,361	22,343
Furniture and fixtures	6,678	6,482
Mobile equipment and other	1,136	1,019
Construction-in-process	879	422
Total property, plant and equipment	46,346	45,548
Less accumulated depreciation	(25,048)	(23,586)
Net property, plant and equipment	$ 21,298	$ 21,962

5. Long-Term Debt

Long-term debt is summarized below:

	June 30, 2011	December 31, 2010
Term Loan	$ 123,785	$ 121,154
Total long-term debt	123,785	121,154
Less current maturities	1,071	1,183
	$ 122,714	$ 119,971

On April 18, 2011, the Company amended its senior credit facilities to, among other things, (i) increase the borrowing ability under the revolving credit agreement by $10,000, and (ii) amend certain of the provisions in its senior credit facilities which govern the Company s ability to pay dividends. Consequently, as of April 18, 2011, the Company s senior credit facilities consisted of a $125,000 term loan facility and a $70,000 revolving credit facility with a group of banks. Prior to the April 2011 changes to the Company s senior credit facilities, the interest on the original $85,000 term loan facility was (at the Company s option) either the base rate (which shall be no less than 3%) plus 3.5% or the eurodollar rate (which shall be no less than 2%) plus 4.5%. The interest for the additional $40,000 in the Company s term loan facility was an interest rate equal to (at the Company s option) either the base rate (which shall be no less than 3%) plus 4% or the eurodollar rate (which shall be no less than 2%) plus 5%. Under the previous revolving credit facility, the margin for base rate loans was either 0.25% or 0.50% and the margin for eurodollar rate loans was either 1.25% or 1.50%, in each case determined based on the Company s leverage ratio from time to time. The previous term loans consisted of an initial term loan of $85,000 and a tack on of $40,000. These were replaced by a term loan of $125,000. The $60,000 revolving credit facility was amended and restated to provide for borrowings of up to $70,000. The agreement for the new term loan (the Term Loan Credit Agreement) provides for a senior secured term loan facility in the aggregate principal amount of $125,000 and generally bears interest at (at the Company s election) either (i) 3.25% per annum plus the greatest of (a) the Prime Rate (as defined in the Term Loan Credit Agreement) in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the

Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) 1.00% plus the greater of (1) the London Interbank Offered Rate for a one month interest period multiplied by the Statutory Reserve Rate (as defined in the Term Loan Credit Agreement) and (2) 1.50% or (ii) 4.25% per annum plus the greater of (a) the London Interbank Offered Rate for the applicable interest period multiplied by the Statutory Reserve Rate and (b) 1.50%. The revolving credit facility as amended and restated (the Revolving Credit Agreement) provides that the Company has the option to select whether borrowings will bear interest at either (i) 2.25% per annum plus the London Interbank Offered Rate for the applicable interest period multiplied by the Statutory Reserve Rate or (ii) 1.25% per annum plus the greatest of (a) the Prime Rate in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) the London Interbank Offered Rate for a one month interest period multiplied by the Statutory Reserve Rate plus 1%. The maturity date for the Company s amended and restated revolving credit facility is April 18, 2016, and the Company s new term loan amortizes in nominal amounts quarterly with the balance payable on April 18, 2018.

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The new term loan entered into in the second quarter of 2011 was issued at a $1,250 discount which will be amortized over the term of the new term loan.

The Company s entry into the new term loan facility resulted in a significant modification of the Company s debt which resulted in the write off of unamortized capitalized deferred financing costs of $335 and write off of unamortized debt discount of $338 which in total resulted in a loss on extinguishment of debt of $673 in the Consolidated Statement of Operations during the three months ended June 30,2011.

At June 30, 2011, the Company had no outstanding borrowings on the revolving credit facility and remaining borrowing availability of $65,249.

The Company s senior credit facilities include certain negative and operating covenants, including restrictions on its ability to pay dividends, and other customary covenants, representations and warranties and events of default. The senior credit facilities entered into and recorded by the Company s subsidiaries significantly restrict its subsidiaries from paying dividends and otherwise transferring assets to Douglas Dynamics, Inc. The terms of the Company s revolving credit facility specifically restrict subsidiaries from paying dividends if a minimum availability under the revolving credit facility is not maintained, and both senior credit facilities restrict subsidiaries from paying dividends above certain levels or at all if an event of default has occurred. These restrictions would affect the Company indirectly since the Company relies principally on distributions from its subsidiaries to have funds available for the payment of dividends. In addition, the Company s revolving credit facility includes a requirement that, subject to certain exceptions, capital expenditures may not exceed $10,000 in any calendar year and, if certain minimum availability under the revolving credit facility is not maintained, that the Company comply with a monthly minimum fixed charge coverage ratio test of 1.0:1.0. Compliance with the fixed charge coverage ratio test is subject to certain cure rights under the Company s revolving credit facility. At June 30, 2011, the Company was in compliance with the respective covenants. The credit facilities are collateralized by substantially all assets of the Company.

In accordance with the senior credit facilities, the Company is required to make additional principal prepayments over the above scheduled payments under certain conditions. This includes, in the case of the term loan facility, 100% of the net cash proceeds of certain asset sales, certain insurance or condemnation events, certain debt issuances, and, within 150 days of the end of the fiscal year, 50% of excess cash flow, as defined, including a deduction for certain distributions (which percentage is reduced to 25% or 0% upon the achievement of certain leverage ratio thresholds), for any fiscal year. Excess cash flow is defined in the senior credit facilities as consolidated adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) plus a working capital adjustment less the sum of repayments of debt and capital expenditures subject to certain adjustments, interest and taxes paid in cash, management fees and certain restricted payments (including dividends or distributions). Working capital adjustment is defined in the senior credit facilities as the change in working capital, defined as current assets excluding cash and cash equivalents less current liabilities excluding current portion of long term debt. As of June 30, 2011, the Company was not required to make an excess cash flow payment.

Each of the senior secured facilities entered into in the second quarter of 2011 includes a hedge provision, which requires the Company to enter into an interest rate hedge commencing 90 days after the closing date. The hedging provision requires the Company to hedge the interest rate on at least 25% of the aggregate outstanding principal amount of the term loans. The purpose of the interest rate swap is to reduce the Company s exposure to interest rate volatility. Effective June 20, 2011, the Company entered into an interest rate swap agreement with a notional amount of $50,000. The interest rate swap negative fair value at June 30, 2011 of $103 is included in other long-term liabilities on the Consolidated Balance Sheet. The Company has counterparty credit risk resulting from the interest rate swap, which it monitors on an on-going basis. This risk lies with one global financial institution. Under the interest rate swap agreement, the Company will receive or make payments on a monthly basis starting July 18, 2011, which is one month from the date the interest rate swap was entered into, based on the differential between 6.335% and LIBOR plus 4.25% (with a LIBOR floor of 1.5%). The interest rate swap contract on the term loan expires in December 2014.

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6. Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities are summarized as follows:

	June 30, 2011	December 31, 2010
Payroll and related costs	$ 2,938	$ 2,993
Employee benefits	3,015	2,334
Accrued warranty	3,070	3,399
Other	4,499	3,197
	$ 13,522	$ 11,923

7. Warranty Liability

The Company accrues for estimated warranty costs as sales are recognized and periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. The Company s warranties generally provide, with respect to its snow and ice control equipment, that all material and workmanship will be free from defect for a period of two years after the date of purchase by the end-user, and with respect to its parts and accessories purchased separately, that such parts and accessories will be free from defect for a period of one year after the date of purchase by the end-user. Certain snowplows only provide for a one year warranty. The Company determines the amount of the estimated warranty costs (and its corresponding warranty reserve) based on the Company s prior five years of warranty history utilizing a formula driven by historical warranty expense and applying management s judgment. The Company adjusts its historical warranty costs to take into account unique factors such as the introduction of new products into the marketplace that do not provide a historical warranty record to assess. The warranty reserve is included in Accrued Expenses and Other Current Liabilities in the accompanying consolidated balance sheets.

The following is a rollforward of the Company s warranty liability:

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010