ARTS WAY MANUFACTURING CO INC
Form 10-Q
October 09, 2018

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 August 31, 2018

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 No. 0-5131

ART'S-WAY MANUFACTURING CO., INC.

(Exact name of registrant as specified in its charter)

DELAWARE	42-0920725
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

5556 Highway 9

Armstrong, Iowa 50514
(Address of principal executive offices)

(712) 864-3131

(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 [ ]

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).

Yes [x]   No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]	Accelerated filer [ ]
Non-accelerated filer [x]	Smaller reporting company [x]
	Emerging growth company [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

[ ]

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 common shares outstanding as of October 2, 2018: 4,207,144

Art's-Way Manufacturing Co., Inc.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

ART'S-WAY MANUFACTURING CO., INC.
Condensed Consolidated Balance Sheets

	(Unaudited) **August 31, 2018**	**November 30, 2017**
Assets		
Current assets:		
Cash	$*4,888*	$*212,400*
Accounts receivable-customers, net of allowance for doubtful accounts of $24,630 and $32,298 in 2018 and 2017, respectively	*2,141,167*	*1,910,294*
Inventories, net	*10,668,767*	*11,966,722*
Cost and profit in excess of billings	*79,602*	*65,146*
Net investment in sales-type leases, current	*142,242*	-
Assets of discontinued operations	-	*2,454*
Other current assets	*175,735*	*275,755*
Total current assets	*13,212,401*	*14,432,771*
Property, plant, and equipment, net	*5,654,140*	*5,946,957*
Assets held for lease, net	*1,663,855*	*1,217,164*
Deferred income taxes	*1,005,250*	*901,396*
Goodwill	*375,000*	*375,000*
Net investment in sales-type leases, long-term	*186,779*	-
Other assets of discontinued operations	-	*1,425,000*
Other assets	*77,824*	*81,545*
Total assets	$*22,175,249*	$*24,379,833*
Liabilities and Stockholders' Equity		
Current liabilities:		
Line of credit	$*2,693,530*	$*2,462,530*
Current portion of long-term debt	*225,405*	*221,230*
Accounts payable	*846,596*	*673,653*
Customer deposits	*133,924*	*600,325*
Billings in Excess of Cost and Profit	*71,723*	*48,211*
Accrued expenses	*1,234,306*	*981,558*
Liabilities of discontinued operations	-	*59,149*

Income taxes payable	3,500	3,100
Total current liabilities	5,208,984	5,049,756
Long-term liabilities		
Long-term liabilities of discontinued operations	-	590,366
Long-term debt, excluding current portion	2,580,387	2,748,677
Total liabilities	7,789,371	8,388,799
Commitments and Contingencies (Notes 8 and 9)		
Stockholders' equity:		
Undesignated preferred stock - $0.01 par value. Authorized 500,000 shares in 2018 and 2017; issued 0 shares in 2018 and 2017.	-	-
Common stock – $0.01 par value. Authorized 9,500,000 shares in 2018 and 2017; issued 4,216,430 in 2018 and 4,158,752 in 2017	42,164	41,587
Additional paid-in capital	3,016,565	2,859,052
Retained earnings	11,354,884	13,353,830
Accumulated other comprehensive income	-	(257,010)
Treasury stock, at cost (9,286 in 2018 and 1,954 in 2017 shares)	(27,735)	(6,425)
Total stockholders' equity	14,385,878	15,991,034
Total liabilities and stockholders' equity	$22,175,249	$24,379,833

See accompanying notes to condensed consolidated financial statements.

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ART'S-WAY MANUFACTURING CO., INC.
Condensed Consolidated Statements of Operations (Unaudited)

	Three Months Ended		Nine Months Ended	
	August 31, 2018	**August 31, 2017**	**August 31, 2018**	**August 31, 2017**
Sales	$*5,280,269*	$*6,549,772*	$*15,940,268*	$*15,660,294*
Cost of goods sold	*4,105,012*	*5,104,826*	*12,504,621*	*12,290,041*
Gross profit	*1,175,257*	*1,444,946*	*3,435,647*	*3,370,253*
Expenses:				
Engineering	*201,845*	*107,944*	*458,447*	*372,932*
Selling	*475,604*	*432,562*	*1,448,124*	*1,401,003*
General and administrative	*857,740*	*795,200*	*2,655,844*	*2,560,894*
Impairment of asset held for lease	*199,175*	-	*199,175*	-
Total expenses	*1,734,364*	*1,335,706*	*4,761,590*	*4,334,829*
Income (Loss) from operations	*(559,107*)	*109,240*	*(1,325,943*)	*(964,576*)
Other income (expense):				
Interest expense	*(82,058*)	*(92,351*)	*(220,445*)	*(235,398*)
Other	*(307,735*)	*75,236*	*(487,850*)	*190,155*
Total other income (expense)	*(389,793*)	*(17,115*)	*(708,295*)	*(45,243*)
Income (Loss) from continuing operations before income taxes	*(948,900*)	*92,125*	*(2,034,238*)	*(1,009,819*)
Income tax expense (benefit)	*(182,184*)	*50,477*	*(86,145*)	*(288,919*)
Income (Loss) from continuing operations	*(766,716*)	*41,648*	*(1,948,093*)	*(720,900*)
Discontinued Operations				
Income (loss) from operations of discontinued segment	-	*(26,449*)	*(67,177*)	*(49,238*)
Income tax expense (benefit)	-	*(8,008*)	*(16,324*)	*(15,756*)
Income (Loss) on discontinued operations	-	*(18,441*)	*(50,853*)	*(33,482*)
Net Income (Loss)	*(766,716*)	*23,207*	*(1,998,946*)	*(754,382*)
Earnings (Loss) per share - Basic:				
Continuing Operations	$*(0.18*)	$*0.01*	$*(0.46*)	$*(0.17*)
Discontinued Operations	$-	$-	$*(0.01*)	$*(0.01*)
Net Income (Loss) per share	$*(0.18*)	$*0.01*	$*(0.47*)	$*(0.18*)
Earnings (Loss) per share - Diluted:				
Continuing Operations	$*(0.18*)	$*0.01*	$*(0.46*)	$*(0.17*)
Discontinued Operations	$-	$-	$*(0.01*)	$*(0.01*)

Net Income (Loss) per share	$*(0.18*)	$*0.01*	$*(0.47*)	$*(0.18*)
Weighted average outstanding shares used to compute basic net income per share	*4,209,445*	*4,161,421*	*4,198,250*	*4,148,966*
Weighted average outstanding shares used to compute diluted net income per share	*4,209,445*	*4,161,421*	*4,198,250*	*4,148,966*

See accompanying notes to condensed consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	August 31, 2018	**August 31, 2017**	**August 31, 2018**	**August 31, 2017**
Net Income (Loss)	$*(766,716)*	$*23,207*	$*(1,998,946)*	$*(754,382)*
Other Comprehensive Income (Loss)				
Foreign currency translation adjustsments	-	*65,509*	*3,830*	*60,411*
Release of cumulative translation adjustment due to substantial liquidation of a foreign entity	-	-	*253,180*	-
Total Other Comprehensive Income (Loss)	-	*65,509*	*257,010*	*60,411*
Comprehensive (Loss)	$*(766,716)*	$*88,716*	$*(1,741,936)*	$*(693,971)*

See accompanying notes to condensed consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended	
	August 31, 2018	**August 31, 2017**
Cash flows from operations:		
Net (loss) from continuing operations	$*(1,948,093)*	$*(720,900)*
Net (loss) from discontinued operations	*(50,853)*	*(33,482)*
Adjustments to reconcile net (loss) to net cash (used in) operating activities:		
Stock based compensation	*158,090*	*92,225*
Loss on release of cumulative translation adjustment	*253,180*	-
Realized foreign currency loss	*3,830*	*60,411*
Impairment of asset held for lease	*199,175*	-
(Gain)/Loss on disposal of property, plant, and equipment	*(12,084)*	*20,824*
Depreciation and amortization expense	*681,939*	*516,642*
Bad debt expense (recovery)	*(8,090)*	*15,452*
Deferred income taxes	*(103,854)*	*(319,833)*
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	*(222,783)*	*(1,011,520)*
Inventories	*489,189*	*348,888*
Income taxes receivable	-	*265,924*
Net investment in sales-type leases	*(329,021)*	-
Other assets	*100,020*	*(155,776)*
Increase (decrease) in:		
Accounts payable	*172,943*	*870,377*
Contracts in progress, net	*9,056*	*182,985*
Customer deposits	*(466,401)*	*(164,970)*
Income taxes payable	*400*	*3,100*
Accrued expenses	*252,748*	*14,638*
Net cash provided by (used in) operating activities - continuing operations	*(769,756)*	*18,467*
Net cash (used in) operating activities - discontinued operations	*(89,697)*	*(69,028)*
Net cash (used in) operating activities	*(859,453)*	*(50,561)*
Cash flows from investing activities:		
Purchases of property, plant, and equipment	*(265,418)*	*(472,031)*
Net proceeds from sale of assets	*52,607*	*17,156*
Net cash (used in) investing activities - continuing operations	*(212,811)*	*(454,875)*
Net cash provided by investing activities - discontinued operations	*1,418,761*	*40,936*
Net cash provided by (used in) investing activities	*1,205,950*	*(413,939)*

Cash flows from financing activities:		
Net change in line of credit	231,000	450,000
Repayment of term debt	(164,115)	(551,585)
Repurchases of common stock	(21,310)	(6,425)
Net cash provided by (used in) financing activities - continuing operations	45,575	(108,010)
Net cash (used in) financing activities - discontinued operations	(599,584)	(97,930)
Net cash (used in) financing activities	(554,009)	(205,940)
Net (decrease) in cash	(207,512)	(670,440)
Cash at beginning of period	212,400	1,063,716
Cash at end of period	$4,888	$393,276
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$225,249	$247,330
Income taxes	$3,600	$-
Supplemental disclosures of non-cash operating and investing activities:		
Transfer of inventory to assets held for lease	$808,766	$-

See accompanying notes to condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements

1) Description of the Company

Unless otherwise specified, as used in this Quarterly Report on Form *10*-Q, the terms "we," "us," "our," "Art's-Way," and the "Company," refer to Art's-Way Manufacturing Co., Inc., a Delaware corporation headquartered in Armstrong, Iowa, and its wholly-owned subsidiaries.

The Company began operations as a farm equipment manufacturer in *1956.* Since that time, it has become a major worldwide manufacturer of agricultural equipment. Its principal manufacturing plant is located in Armstrong, Iowa.

The Company has organized its business into *three* operating segments. Management separately evaluates the financial results of each segment because each is a strategic business unit offering different products and requiring different technology and marketing strategies. The agricultural products segment ("Manufacturing") manufactures farm equipment under the Art's-Way Manufacturing label and private labels. The modular buildings segment ("Scientific") manufactures modular buildings for various uses, commonly animal containment and research laboratories. The tools segment ("Metals") manufactures steel cutting tools and inserts. During the *third* quarter of fiscal *2016,* the Company discontinued its pressurized vessels segment ("Vessels") that manufactured pressurized vessels. For more information on discontinued operations, see Note *3* "Discontinued Operations." For detailed financial information relating to segment reporting, see Note *16* "Segment Information."

2) Summary of Significant Account Policies

Statement Presentation

The foregoing condensed consolidated financial statements of the Company are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's Annual Report on Form *10*-K for the fiscal year ended *November 30, 2017.* The results of operations for the *three* and *nine* months ended

August 31, 2018 are *not* necessarily indicative of the results for the fiscal year ending *November 30, 2018.*

During the *second* quarter of fiscal *2018,* the Company liquidated its investment in its Canadian subsidiary by selling off remaining inventory and filing dissolution paperwork for the Canadian entity. Prior to that liquidation and dissolution, the financial books of the Company's Canadian operations were kept in the functional currency of Canadian dollars and the financial statements were converted to U.S. Dollars for consolidation. When consolidating the financial results of the Company into U.S. Dollars for reporting purposes, the Company used the All-Current translation method. The All-Current method requires the balance sheet assets and liabilities to be translated to U.S. Dollars at the exchange rate as of quarter end. Stockholders' equity was translated at historical exchange rates and retained earnings were translated at an average exchange rate for the period. Additionally, revenue and expenses were translated at average exchange rates for the periods presented. The resulting cumulative translation adjustment was carried on the balance sheet and was recorded in stockholders' equity. Following the liquidation and dissolution of the Company's investment in its Canadian subsidiary the cumulative translation adjustment carried on the balance sheet was released into net income and the financial statements will *no* longer need translation each period. Since *no* income tax benefit will be received from the foreign equity sale, the cumulative translation adjustment has *not* been tax adjusted.

Sales-Type Leases

The Company leases modular buildings to certain customers and accounts for these transactions as sales-type leases. These leases have terms of up to *36* months and are collateralized by a security interest in the related modular building. The lessee has a bargain purchase option available at the end of the lease term. A minimum lease receivable is recorded net of unearned interest income and profit on sale at the time the Company's obligation to the lessee is complete. Profit related to the sale of the building is recorded upon fulfillment of the Company's obligation to the lessee.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the *three* and *nine* months ended *August 31, 2018.* Actual results could differ from those estimates.

***3*) Discontinued Operations**

Effective *October 31, 2016,* the Company discontinued the operations of its Vessels segment in order to focus its efforts and resources on the business segments that have historically been more successful and that are expected to present greater opportunities for meaningful long-term shareholder returns.

In *January 2018,* the Company accepted an offer on the real estate assets of its Vessels segment for *$1,500,000,* which was below the carrying value of the real estate assets at that time. Based on these facts the Company recorded an impairment of the real estate assets of approximately *$289,000* for the fiscal year ended *November 30, 2017,* which reduced the value to *$1,425,000,* which is the value the Company expected to receive after commissions on the sale of these real estate assets. On *March 29, 2018,* the remaining assets of Vessels, consisting of these real estate assets, were disposed of at a selling price of *$1,500,000.*

As Vessels was a unique business unit of the Company, its liquidation was a strategic shift. In accordance with Accounting Standard Codification Topic *360,* the Company has classified Vessels as discontinued operations for all periods presented.

Income from discontinued operations, before income taxes in the accompanying Condensed Consolidated Statements of Operations is comprised of the following:

	Three Months Ended	
	August 31,	August 31, 2017

	2018	
Revenue from external customers	$-	$-
Gross profit	-	-
Operating expense	-	*17,082*
Income (loss) from operations	-	*(17,082)*
Income (loss) before taxes	-	*(26,449)*

	Nine Months Ended	
	August 31, 2018	August 31, 2017
Revenue from external customers	$-	$-
Gross profit	-	-
Operating expense	*51,133*	*40,905*
Income (loss) from operations	*(51,133)*	*(40,905)*
Income (loss) before taxes	*(67,177)*	*(49,238)*

The components of discontinued operations in the accompanying Condensed Consolidated Balance Sheets are as follows:

	August 31, 2018	**November 30, 2017**
Cash	$ -	$*2,454*
Property, plant, and equipment, net	-	*1,425,000*
Assets of discontinued operations	$ -	$*1,427,454*
Accrued expenses	-	*49,931*
Notes payable	-	*599,584*
Liabilities of discontinued operations	$ -	$*649,515*

_4_) Net Income (Loss) Per Share of Common Stock

Basic net income (loss) per share has been computed on the basis of the weighted average number of shares of common stock outstanding. Diluted net income (loss) per share of common stock has been computed on the basis of the weighted average number of shares outstanding plus equivalent shares of common stock assuming exercise of stock options. Potential shares of common stock that have an anti-dilutive effect (i.e., those that increase income per share or decrease loss per share) are excluded from the calculation of diluted net income (loss) per share of common stock.

Basic and diluted net income (loss) per share of common stock have been computed based on the following as of *August 31, 2018* and *August 31, 2017:*

	For the Three Months Ended	
	August 31, 2018	**August 31, 2017**
Numerator for basic and diluted net (loss) income per share of common stock:		
Net (loss) income from continuing operations	$*(766,716*)	$*41,648*
Net (loss) income from discontinued operations	-	*(18,441*)
Net (loss) income	$*(766,716*)	$*23,207*
Denominator:		

For basic net (loss) income per share - weighted average shares of common stock outstanding	*4,209,445*	*4,161,421*
Effect of dilutive stock options	-	-
For diluted net (loss) income per share - weighted average shares of common stock outstanding	*4,209,445*	*4,161,421*
Net income (loss) per share - Basic:		
Continuing operations	$*(0.18*)	$*0.01*
Discontinued operations	$-	$-
Net income (loss) per share	$*(0.18*)	$*0.01*
Net income (loss) per share - Diluted:		
Continuing operations	$*(0.18*)	$*0.01*
Discontinued operations	$-	$-
Net income (loss) per share	$*(0.18*)	$*0.01*

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	For the Nine Months Ended	
	August 31, 2018	August 31, 2017
Numerator for basic and diluted net (loss) income per share of common stock:		
Net (loss) income from continuing operations	$(1,948,093)	$(720,900)
Net (loss) income from discontinued operations	(50,853)	(33,482)
Net (loss) income	$(1,998,946)	$(754,382)
Denominator:		
For basic net (loss) income per share - weighted average shares of common stock outstanding	4,198,250	4,148,966
Effect of dilutive stock options	-	-
For diluted net (loss) income per share - weighted average shares of common stock outstanding	4,198,250	4,148,966
Net income (loss) per share - Basic:		
Continuing operations	$(0.46)	$(0.17)
Discontinued operations	$(0.01)	$(0.01)
Net income (loss) per share	$(0.47)	$(0.18)
Net income (loss) per share - Diluted:		
Continuing operations	$(0.46)	$(0.17)
Discontinued operations	$(0.01)	$(0.01)
Net income (loss) per share	$(0.47)	$(0.18)

5) Inventory

Major classes of inventory are:

	August 31, 2018	November 30, 2017
Raw materials	$7,959,989	$8,731,985
Work in process	376,273	460,687
Finished goods	4,721,049	5,395,353
Gross inventory	$13,057,311	$14,588,025
Less: Reserves	(2,388,544)	(2,621,303)
Net Inventory	$10,668,767	$11,966,722

***6*) Accrued Expenses**

Major components of accrued expenses are:

	August 31, 2018	**November 30, 2017**
Salaries, wages, and commissions	$*554,625*	$ *584,768*
Accrued warranty expense	*71,263*	*68,451*
Other	*608,418*	*328,339*
	$*1,234,306*	$ *981,558*

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7) Assets Held for Lease

Major components of assets held for lease are:

	August 31, 2018	**November 30, 2017**
West Union Facility	$*900,000*	$*1,118,330*
Modular Buildings	*763,855*	*98,834*
	$*1,663,855*	$*1,217,164*

During the *third* quarter of *2018,* the Company discovered mold in its West Union facility. The Company estimates the remediation will cost approximately *$252,000* and has included this amount in other accrued expense at *August 31, 2018.* The Company also scrapped approximately *$67,000* of inventory related to mold remediation. Both the remediation cost and inventory scrap have been included in other income (expense) on the statement of operations. As a result of an adverse change in physical condition of this asset, circumstances indicate that its carrying amount *may not* be recoverable. The Company recognized approximately *$199,000* related to the impairment of this asset in the *three* months ended *August 31, 2018.*

8) Product Warranty

The Company offers warranties of various lengths to its customers depending on the specific product and terms of the customer purchase agreement. The average length of the warranty period is *one* year from the date of purchase. The Company's warranties require it to repair or replace defective products during the warranty period at *no* cost to the customer. The Company records a liability for estimated costs that *may* be incurred under its warranties. The costs are estimated based on historical experience and any specific warranty issues that have been identified. Although historical warranty costs have been within expectations, there can be *no* assurance that future warranty costs will *not* exceed historical amounts. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the balance as necessary. The accrued warranty balance is included in accrued expenses as shown in Note *6* "Accrued Expenses." Changes in the Company's product warranty liability for the *three* and *nine* months ended *August 31, 2018* and *August 31, 2017* are as follows:

	For the Three Months Ended	
	August 31, 2018	**August 31, 2017**

Balance, beginning	$*71,216*	$*152,964*
Settlements / adjustments	*(73,108*)	*(46,469*)
Warranties issued	*73,155*	*26,699*
Balance, ending	$*71,263*	$*133,194*

	For the Nine Months Ended	
	August 31, 2018	**August 31, 2017**
Balance, beginning	$*68,452*	$*134,373*
Settlements / adjustments	*(214,674*)	*(155,603*)
Warranties issued	*217,485*	*154,424*
Balance, ending	$*71,263*	$*133,194*

***9*) Loan and Credit Agreements**

The Company maintains a revolving line of credit and term loan with Bank Midwest as well as a term loan with The First National Bank of West Union.

Bank Midwest Revolving Line of Credit, Term Loans, and Covenants

On *September 28, 2017,* the Company entered into a credit facility with Bank Midwest, which supersedes and replaces in its entirety the Company's previous credit facility with U.S. Bank. The Bank Midwest credit facility consists of a *$5,000,000* revolving line of credit, a *$2,600,000* term loan due *October 1, 2037,* and a *$600,000* term loan due *October 1, 2019.* The proceeds of the new line of credit and the term loans were used to refinance all debt previously held by U.S. Bank in the amount of approximately *$6,562,030,* which consisted of *$6,528,223* in unpaid principal and approximately *$33,807* in accrued and unpaid interest and fees. The revolving line of credit is being used for working capital purposes. On *March 29, 2018,* the Company paid in full the *$600,000* term loan due *October 1, 2019* using proceeds from the sale of the Company's Dubuque, Iowa property. The payment consisted of *$596,563* in principal and *$2,328* in interest.

On *August 31, 2018,* the balance of the line of credit was *$2,693,530* with *$2,306,470* remaining available, limited by the borrowing base calculation. The line of credit borrowing base is an amount equal to *75%* of accounts receivable balances (discounted for aged receivables), plus *50%* of inventory, less any outstanding loan balance on the line of credit. Any unpaid principal amount borrowed on the revolving line of credit accrues interest at a floating rate per annum equal to *1.00%* above the Wall Street Journal rate published from time to time in the money rates section of the Wall Street Journal. The interest rate floor is set at *4.25%* per annum and the current interest rate is *6.00%* per annum. The revolving line of credit was renewed on *March 30, 2018.* The revolving line of credit is payable upon demand by Bank Midwest, and monthly interest-only payments are required. If *no* earlier demand is made, the unpaid principal and accrued interest is due on *March 30, 2019.*

The *$2,600,000* term loan accrues interest at a rate of *5.00%* for the *first sixty* months. Thereafter, this loan will accrue interest at a floating rate per annum equal to *0.75%* above the Wall Street Journal rate published from time to time in the money rates section of the Wall Street Journal. The interest rate floor is set at *4.15%* per annum and the interest rate *may* only be adjusted by Bank Midwest once every *five* years. Monthly payments of *$17,271* for principal and interest are required. This loan is also guaranteed by the United States Department of Agriculture ("USDA"), which requires an upfront guarantee fee of *$62,400* and an annual fee of *0.5%* of the unpaid balance. As part of the USDA guarantee requirements, shareholders owning more than *20%* are required to personally guarantee a portion of the loan as well, in an amount equal to their stock ownership percentage. J. Ward McConnell Jr., the Vice Chairman of the Board of Directors and a shareholder owning more than *20%* of the Company's stock, is guaranteeing approximately *38%* of this loan, for an annual fee of *2%* of the personally guaranteed amount. The initial guarantee fee will be amortized over the life of the loan, and the annual fees and personally guaranteed amounts are expensed monthly. Prior to repayment, the *$600,000* term loan accrued interest at a rate of *5.00%,* and monthly payments of *$3,249* for principal and interest were required.

Each of the revolving line of credit and the *$2,600,000* term loan are governed by the terms of a separate Promissory Note, dated *September 28, 2017,* entered into between the Company and Bank Midwest. The *$600,000* term loan was also governed by the terms of a separate Promissory Note, dated *September 28, 2017,* entered into between the Company and Bank Midwest.

In connection with the revolving line of credit, the Company, Art's-Way Scientific Inc. and Ohio Metal Working Products/Art's-Way Inc. each entered into a Commercial Security Agreement with Bank Midwest, dated *September 28, 2017,* pursuant to which each granted to Bank Midwest a *first* priority security interest in certain inventory, equipment, accounts, chattel paper, instruments, letters of credit and other assets to secure the obligations of the Company under the revolving line of credit. Each of Art's-Way Scientific Inc. and Ohio Metal Working Products/Art's-Way Inc. also agreed to guarantee the obligations of the Company pursuant to the revolving line of credit, as set forth in Commercial Guaranties, each dated *September 28, 2017.*

To further secure the line of credit, the Company has granted Bank Midwest a *second* mortgage on its West Union, Iowa property and Ohio Metal Working Products/Art's-Way Inc. has granted Bank Midwest a mortgage on its property located in Canton, Ohio. The *$2,600,000* term loan is secured by a mortgage on the Company's Armstrong, Iowa and Monona, Iowa properties, and the *$600,000* term loan was secured by a mortgage on the Company's Dubuque, Iowa property. Each mortgage is governed by the terms of a separate Mortgage, dated *September 28, 2017,* and each property is also subject to a separate Assignment of Rents, dated *September 28, 2017.*

If the Company or its subsidiaries (as guarantors pursuant to the Commercial Guaranties) commits an event of default with respect to the promissory notes and fails or is unable to cure that default, Bank Midwest *may* immediately terminate its obligation, if any, to make additional loans to the Company and *may* accelerate the Company's obligations under the promissory notes. Bank Midwest shall also have all other rights and remedies for default provided by the Uniform Commercial Code, as well as any other applicable law and the various loan agreements. In addition, in an event of default, Bank Midwest *may* foreclose on the mortgaged property.

Compliance with Bank Midwest covenants is measured annually at *November 30.* The terms of the Bank Midwest loan agreements require the Company to maintain a minimum working capital ratio of *1.75,* while maintaining a minimum of *$5,100,000* of working capital. Additionally, a maximum debt to worth ratio of *1* to *1* must be maintained, with a minimum of *40%* tangible balance sheet equity, with variations subject to mutual agreement. The Company is also required to maintain a minimum debt service coverage ratio of *1.25,* with a *0.10* tolerance. The Company was in compliance with all covenants as of *November 30, 2017* other than the debt service coverage ratio. Bank Midwest issued a waiver forgiving the noncompliance, and *no* event of default has occurred. The next measurement date is *November 30, 2018.* The Company is also required to provide audited financial statements within *120* days of its fiscal year end.

<u>Iowa Finance Authority Term Loan and Covenants</u>

On *May 1, 2010,* the Company obtained a loan to finance the purchase of an additional facility located in West Union, Iowa to be used as a distribution center, warehouse facility, and manufacturing plant for certain products under the Art's-Way brand. The funds for this loan were made available by the Iowa Finance Authority by the issuance of tax exempt bonds. This loan had an original principal amount of *$1,300,000,* an interest rate of *3.5%* per annum and a maturity date of *June 1, 2020.* On *February 1, 2013,* the interest rate was decreased to *2.75%* per annum. The other terms of the loan remain unchanged.

This loan from the Iowa Finance Authority, which has been assigned to The First National Bank of West Union (n/k/a Bank *1st*), is governed by a Manufacturing Facility Revenue Note dated *May 28, 2010* as amended *February 1, 2013* and a Loan Agreement dated *May 1, 2010* and a First Amendment to Loan Agreement dated *February 1, 2013* (collectively, "the IFA Loan Agreement"), which requires the Company to provide quarterly internally prepared financial reports and year-end audited financial statements and to maintain a minimum debt service coverage ratio of *1.5* to *1.0,* which is measured at *November 30* of each year. Among other covenants, the IFA Loan Agreement also requires the Company to maintain proper insurance on, and maintain in good repair, the West Union Facility, and continue to conduct business and remain duly qualified to do business in the State of Iowa. The loan is secured by a mortgage on the Company's West Union Facility, pursuant to a Mortgage, Security Agreement, Assignment of Leases and Rents and Fixture Financing Statement dated *May 1, 2010* between the Company and The First National Bank of West Union (the "West Union Mortgage").

If the Company commits an event of default under the IFA Loan Agreement or the West Union Mortgage and does *not* cure the event of default within the time specified by the IFA Loan Agreement, the lender *may* cause the entire amount of the loan to be immediately due and payable and take any other action that it is lawfully permitted to take or in equity to enforce the Company's performance.

The Company was in compliance with all covenants except for the debt service coverage ratio covenant as measured on *November 30, 2017.* The First National Bank of West Union issued a waiver and the next measurement date is *November 30, 2018.*

A summary of the Company's term debt is as follows:

	August 31, 2018	**November 30, 2017**
Bank Midwest loan payable in monthly installments of $17,271 including interest at 5.00%, due October 1, 2037	$*2,536,987*	$*2,595,007*
Bank Midwest loan payable in monthly installments of $3,249 including interest at 5.00%, paid in full	-	*599,584*
Iowa Finance Authority loan payable in monthly installments of $12,500 including interest at 2.75%, due June 1, 2020	*268,805*	*374,900*
Total term debt	$*2,805,792*	$*3,569,491*
Less current portion of term debt	*225,405*	*221,230*
Term debt of discontinued operations	-	*599,584*
Term debt, excluding current portion	$*2,580,387*	$*2,748,677*

***10*) Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating losses.

On *December 22, 2017,* the Tax Cuts and Job Act of *2017* was enacted, which reduced the top corporate income tax rate from *35%* to *21%.* This law is generally effective for tax years beginning after *December 31, 2017.* The application of this new rate was recognized in the *first* quarter of fiscal *2018.* Tax expense from continuing operations includes an adjustment of approximately *$300,000* related to the revaluation of the Company's net deferred tax asset at the new statutory rate.

***11*) Related Party Transactions**

During the *three* and *nine* months ended *August 31, 2018,* the Company recognized expenses of *$5,957* and *$17,986* respectively, for transactions with related parties, compared to *$385* and *$3,691* for the same periods in *2017.* The accrued expenses balance as of *August 31, 2018* contains *$1,633* due to a related party, compared to *$0* for the same period in *2017.*

***12*) Sales-Type Leases**

The components related to sales-type leases at *August 31, 2018* are as follows:

	August 31, 2018
Minimum lease receivable, current	$*194,225*
Unearned interest income, current	*(51,983*)
Net investment in sales-type leases, current	$*142,242*
Minimum lease receivable, long-term	$*211,777*
Unearned interest income, long-term	*(24,998*)
Net investment in sales-type leases, long-term	$*186,779*

The profit recognized in continuing operations on the condensed consolidated statements of operations from commencement of sales-type leases in the *three* and *nine* months ended *August 31, 2018* was *$0* and *$129,104,* respectively.

Future minimum lease receipts are as follows:

Year Ending November 30,	Amount
2018	$*63,725*
2019	*174,000*
2020	*162,425*
2021	*5,852*
2022	-
Thereafter	-
Total	$*406,002*

***13*) Recently Issued Accounting Pronouncements**

Accounting Pronouncements *Not* Yet Adopted

Revenue from Contracts with Customers (Topic *606*)

In *May 2014,* the Financial Accounting Standards Board ("FASB") issued ASU *No. 2014-09,* "Revenue from Contracts with Customers (Topic *606*)" which supersedes the guidance in "Revenue Recognition (Topic *605*)." The core principle of ASU *2014-09* requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU *2014-09* is effective for annual reporting periods beginning after *December 15, 2017,* including interim periods within that reporting period, and is to be applied retrospectively, with early application *not* permitted.

The Company has evaluated the new standard and applied the core principle to its contract revenue streams. To be consistent with this core principle, an entity is required to apply the following *five*-step approach:

1. Identify the contract(s) with a customer;
2. Identify each performance obligation in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to each performance obligation; and
5. Recognize revenue when or as each performance obligation is satisfied.

The Company's revenues primarily result from contracts with customers. The agricultural products and tools segments are generally short-term contracts and contain a single performance obligation – the delivery of product to the common carrier. The Company recognizes revenue for the sale of agriculture parts, equipment and tools upon shipment of the good. The modular buildings segment executes contracts with customers that can be short or long-term in nature. These contracts can have multiple performance obligations and revenue from these can be recognized over time or at a point in time depending on the nature of the contracts. Payment terms generally are short-term and vary by customer and segment. The implementation process will include modifications to the contracts of the modular buildings segment.

The Company intends to adopt ASU *2014-09* using the modified retrospective method. Once adopted, the Company has determined that amounts reported under ASC *606* will *not* be materially different than amounts that would have been reported under the previous revenue guidance of ASC *605* and would *not* require an adjustment to retained earnings.

The Company, upon adoption of ASU *2014-09,* will increase the amount of required disclosures, including but *not* limited to:

Disaggregation of revenue that depicts how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors;
The opening and closing balances of receivables, contract assets, and contract liabilities from contracts with customers, if *not* otherwise separately presented or disclosed;

Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period;
Information about performance obligations in contracts with customers; and
Judgments that significantly affect the determination of the amount and timing of revenue from contracts with customers, including the timing satisfaction of performance obligation, and the transaction price and the amounts allocated to performance obligations.

Leases

In *February 2016,* the FASB issued ASU *2016-02,* "Leases (Topic *842*)," which requires a lessee to recognize a right-of-use asset and a lease liability on its balance sheet for all leases with terms of *twelve* months or greater. This guidance is effective for fiscal years beginning after *December 15, 2018,* including interim periods within those years. The Company will adopt this guidance for its fiscal year ending *November 30, 2020,* including interim periods within that reporting period. The Company has a moderate amount of leasing activity and is currently evaluating the impact of this guidance on its consolidated financial statements.

_14_) Equity Incentive Plan and Stock Based Compensation

On *January 27, 2011,* the Board of Directors of the Company authorized and approved the Art's-Way Manufacturing Co., Inc. *2011* Equity Incentive Plan (the *"2011* Plan"). The *2011* Plan was approved by the stockholders on *April 28, 2011.* It replaced the Employee Stock Option Plan and the Directors' Stock Option Plan (collectively, the "Prior Plans"), and *no* further stock options will be awarded under the Prior Plans. Awards to directors and executive officers under the *2011* Plan are governed by the forms of agreement approved by the Board of Directors.

The *2011* Plan permits the plan administrator to award nonqualified stock options, incentive stock options, restricted stock awards, restricted stock units, performance awards, and stock appreciation rights to employees (including officers), directors, and consultants. The Board of Directors has approved a director compensation policy pursuant to which non-employee directors are automatically granted restricted stock awards of *1,000* shares of fully-vested common stock annually upon their election to the Board and another *1,000* shares of fully-vested common stock on the last business day of each fiscal quarter. Additionally, directors can elect to receive their board compensation as restricted stock. During the *first nine* months of fiscal *2018,* restricted stock awards of *46,200* shares were issued to various employees, directors, and consultants, which vest over the next *three* years, and restricted stock awards of *28,478* shares were issued to directors as part of the compensation policy, which vested immediately upon grant. During the *first nine* months of fiscal *2018, 17,000* shares of restricted stock were forfeited upon the departure of certain employees.

Stock options granted prior to *January 27, 2011* are governed by the applicable Prior Plan and the forms of agreement adopted thereunder.

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant vesting period. The Company estimates the fair value of each stock-based option award on the measurement date using the Black-Scholes option valuation model which incorporates assumptions as to stock price volatility, the expected life of the options, risk-free interest rate, and dividend yield. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses historical option exercise and termination data to estimate the expected term the options are expected to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield is calculated using historical dividend amounts and the stock price at the option issuance date. *No* stock options were granted during the *nine* months ended *August 31, 2018* or in the same respective period of fiscal *2017.* The Company incurred a total of *$46,654* and *$158,090* of stock-based compensation expense for restricted stock awards during the *three* and *nine* months ended *August 31, 2018* compared to *$19,266* and *$92,225* of stock-based compensation expense for restricted stock awards for the same respective periods of fiscal *2017.*

_15_) Disclosures About the Fair Value of Financial Instruments

The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties. At *August 31, 2018,* and *November 30, 2017,* the carrying amount approximated fair value for cash, accounts receivable, net investment in sale-type leases, accounts payable, notes payable to bank, and other current and long-term liabilities. The carrying amounts approximate fair value because of the short maturity of these instruments. The fair value of the net investment in sales-type leases also approximates recorded value as that is based on discounting future cash flows at rates implicit in the lease. The rates implicit in the lease do *not* materially differ from current market rates. The fair value of the Company's installment term loans payable also approximates recorded value because the interest rates charged under the loan terms are *not* substantially different than current interest rates.

_16_) Segment Information

There are *three* reportable segments: agricultural products, modular buildings and tools. The agricultural products segment fabricates and sells farming products as well as related equipment and replacement parts for these products in the United States and worldwide. The modular buildings segment manufactures and installs modular buildings for animal containment and various laboratory uses. The tools segment manufactures steel cutting tools and inserts.

The accounting policies applied to determine the segment information are the same as those described in the summary of significant accounting policies. Management evaluates the performance of each segment based on profit or loss from operations before income taxes, exclusive of nonrecurring gains and losses.

Approximate financial information with respect to the reportable segments is as follows. The tables below exclude income and balance sheet data from discontinued operations. See Note *3* "Discontinued Operations."

	Three Months Ended August 31, 2018			
	Agricultural Products	Modular Buildings	Tools	Consolidated
Revenue from external customers	$*3,913,000*	$*773,000*	$*594,000*	$*5,280,000*
Income (loss) from operations	*(450,000*)	*(141,000*)	*32,000*	$*(559,000*)
Income (loss) before tax	*(835,000*)	*(136,000*)	*22,000*	$*(949,000*)
Total Assets	*15,999,000*	*3,692,000*	*2,484,000*	$*22,175,000*

Capital expenditures	92,000	13,000	-	$105,000
Depreciation & Amortization	126,000	116,000	31,000	$73,000

	Three Months Ended August 31, 2017			
	Agricultural Products	Modular Buildings	Tools	Consolidated
Revenue from external customers	$5,065,000	$767,000	$718,000	$6,550,000
Income (loss) from operations	118,000	(37,000)	28,000	$109,000
Income (loss) before tax	123,000	(45,000)	15,000	$93,000
Total Assets	18,941,000	3,094,000	2,721,000	$24,756,000
Capital expenditures	61,000	117,000	-	$178,000
Depreciation & Amortization	125,000	17,000	32,000	$174,000

	Nine Months Ended August 31, 2018			
	Agricultural Products	Modular Buildings	Tools	Consolidated
Revenue from external customers	$11,778,000	$2,346,000	$1,816,000	$15,940,000
Income (loss) from operations	(988,000)	(347,000)	9,000	$(1,326,000)
Income (loss) before tax	(1,681,000)	(329,000)	(24,000)	$(2,034,000)
Total Assets	15,999,000	3,692,000	2,484,000	$22,175,000
Capital expenditures	163,000	99,000	4,000	$266,000
Depreciation & Amortization	391,000	196,000	95,000	$682,000

	Nine Months Ended August 31, 2017			
	Agricultural Products	Modular Buildings	Tools	Consolidated
Revenue from external customers	$11,595,000	$2,043,000	$2,022,000	$15,660,000
Income (loss) from operations	(758,000)	(209,000)	3,000	$(964,000)
Income (loss) before tax	(743,000)	(237,000)	(30,000)	$(1,010,000)
Total Assets	18,941,000	3,094,000	2,721,000	$24,756,000
Capital expenditures	265,000	117,000	90,000	$472,000
Depreciation & Amortization	376,000	46,000	95,000	$517,000

*The consolidated total in the table is a sum of segment figures and *may not* tie to actual figures in the condensed consolidated financial statements due to rounding.

17) Subsequent Events

Management evaluated all other activity of the Company and concluded that *no* subsequent events have occurred that would require recognition in the condensed consolidated financial statements.

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

Forward-Looking Statements

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of Part I of this Quarterly Report on Form 10-Q and the audited consolidated financial statements and related notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in our Annual Report on Form 10-K for the fiscal year ended November 30, 2017. Some of the statements in this report may contain forward-looking statements that reflect our current view on future events, future business, industry and other conditions, our future performance, and our plans and expectations for future operations and actions. In some cases you can identify forward-looking statements by the use of words such as "may," "should," "anticipate," "believe," "expect," "plan," "future," "intend," "could," "estimate," "predi "potential," "continue," or the negative of these terms or other similar expressions. Many of these forward-looking statements are located in this report under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" but they may appear in other sections as well. Forward-looking statements in this report generally relate to: (i) our warranty costs and order backlog; (ii) our beliefs regarding the sufficiency of working capital and cash flows; (iii) our expectation that we will continue to be able to renew or obtain financing on reasonable terms when necessary; (iv) the impact of recently issued accounting pronouncements and changes to tax laws; (v) our intentions and beliefs relating to our costs, business strategies, and future performance; (vi) our expected financial results; and (vii) our expectations concerning our primary capital and cash flow needs.

You should read this report thoroughly with the understanding that our actual results may differ materially from those set forth in the forward-looking statements for many reasons, including events beyond our control and assumptions that prove to be inaccurate or unfounded. We cannot provide any assurance with respect to our future performance or results. Our actual results or actions could and likely will differ materially from those anticipated in the forward-looking statements for many reasons, including but not limited to: (i) the impact of changing credit markets on our ability to continue to obtain financing on reasonable terms; (ii) our ability to repay current debt, continue to meet debt obligations and comply with financial covenants; (iii) obstacles related to liquidation of product lines and segments; (iv) the effect of general economic conditions, including consumer and governmental spending, on the demand for our products and the cost of our supplies and materials; (v) fluctuations in seasonal demand and our production cycle; and (vi) other factors described from time to time in our reports to the Securities and Exchange Commission. We do not intend to update the forward-looking statements contained in this report other than as required by law. We caution you not to put undue reliance on any forward-looking statements, which speak only as of the date of this report. You should read this report and the documents that we reference in this report and have filed as exhibits completely and with the understanding that our actual future results may be materially different from what we currently expect. We qualify all of our forward-looking statements by these cautionary statements.

Critical Accounting Policies

Our critical accounting policies involving the more significant judgments and assumptions used in the preparation of the financial statements as of August 31, 2018 remain unchanged from November 30, 2017, with the exception of the addition of a critical accounting policy regarding sales-type lease activity. Other than this new policy regarding sales-type lease activity, which is set forth below, disclosure of these critical accounting policies is incorporated by reference from Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended November 30, 2017.

Sales-Type Lease Activity

We lease modular buildings to certain customers and account for these transactions as sales-type leases. These leases have terms of up to 36 months and are collateralized by a security interest in the related modular building. The lessee has a bargain purchase option available at the end of the lease term. A minimum lease receivable is recorded net of unearned interest income and profit on sale at the time the building is substantially complete. Profit related to the sale of the building is recorded upon substantial completion.

Results of Operations – Continuing Operations

Net Sales and Cost of Goods Sold

Our consolidated corporate sales for continuing operations for the three- and nine-month periods ended August 31, 2018 were $5,280,000 and $15,940,000 compared to $6,550,000 and $15,660,000 during the same respective periods in 2017, a $1,270,000 or 19.4%, decrease for the three months and a $280,000, or 1.8%, increase for the nine months. The decrease for the three months is primarily due to a decrease in revenue from our agricultural products and tools segments. Consolidated gross margin for the three-month period ended August 31, 2018 was 22.3% compared to 22.1% for the same period in fiscal 2017. Consolidated gross margin for the nine-month period ended August 31, 2018 was 21.6% compared to 21.5% for the same period in fiscal 2017. These increased gross margins are largely attributable to increased efficiency in our agricultural products segment, as discussed below, as margins have decreased in our modular buildings and tools segments.

Our third quarter sales at Manufacturing were $3,913,000 compared to $5,065,000 during the same period of 2017, a decrease of $1,152,000, or 22.7%. Our year-to-date sales at Manufacturing were $11,778,000 compared to $11,595,000 during the same period in 2017, an increase of $183,000, or 1.6%. The three-month decrease in revenue is due to decreased demand for forage box equipment and the absence of pass-through self-propelled beet equipment that was sold in 2017. The year-to-date increase in sales is due to increased demand for portable feed equipment, manure spreaders and UHC reels. Gross margin for Manufacturing for the three-month period ended August 31, 2018 was 21.6% compared to 20.9% for the same period in 2017. Gross margin for Manufacturing for the nine-month period ended August 31, 2018 was 21.8% compared to 20.2% for the same period in 2017. The increase in gross margin in 2018 is due to increased efficiency from our direct labor as a part of recently-launched lean initiatives. Although our gross margin is up we did receive downward pressure from rising costs of goods sold, which have been impacted by steel tariffs.

Our third quarter sales at Scientific were $773,000 compared to $767,000 for the same period in 2017, an increase of $6,000, or 0.8%. Our year-to-date sales at Scientific were $2,346,000 compared to $2,043,000 for the same period in 2017, an increase of $303,000, or 14.8%. Our year-to-date increase in revenue is largely attributable to using sales-type and operating leases to expand our customer base. Gross margin for the three- and nine-month periods ended August 31, 2018 was 15.8% and 13.7% compared to 21.4% and 18.5% for the same respective periods in 2017. The decrease in gross margin is due to added depreciation from buildings out on lease and the production of leased assets in the third quarter, which don’t provide immediate revenue.

Metals had sales of $594,000 and $1,816,000 during the three- and nine-month periods ended August 31, 2018 compared to $718,000 and $2,022,000 for the same respective periods in 2017, a 17.3% and 10.2% decrease, respectively. The decrease is mainly due to the loss of a large volume customer. Gross margin was 34.7% and 30.1% for the three- and nine-month periods ended August 31, 2018 compared to 30.9% and 32.1% for the same respective periods in 2017. The increased gross margin for the three-months is due mainly to price increases and better margins on our sales. Our decreased gross margin for the nine-months is largely due to lower revenues with less variable margin to absorb fixed costs.

Expenses

Our third quarter consolidated selling expenses were $476,000 compared to $433,000 for the same period in 2017. Our year-to-date selling expenses were $1,448,000 compared to $1,401,000 for the same period in 2017. The increase in selling expenses is due to increased commissions as a result of higher sales and the reclassification of an employee to an independent sales representative. Selling expenses as a percentage of sales were 9.0% and 9.1% for the three- and nine-month periods ended August 31, 2018 compared to 6.6% and 8.9% for the same respective periods in 2017.

Consolidated engineering expenses were $202,000 and $458,000 for the three- and nine-month periods ended August 31, 2018 compared to $108,000 and $373,000 for the same respective periods in 2017. The increase in engineering expenses is directly related to research and development of new agricultural products and modular building engineering. Engineering expenses as a percentage of sales were 3.8% and 2.9% for the three- and nine-month periods ended August 31, 2018 compared to 1.6% and 2.4% for the same respective periods in 2017.

Consolidated administrative expenses for the three- and nine-month periods ended August 31, 2018 were $858,000 and $2,656,000 compared to $795,000 and $2,561,000 for the same respective periods in 2017. These increases are largely related to increased stock compensation expense and the addition of a general manager at the modular buildings segment. Administrative expenses as a percentage of sales were 16.3% and 16.7% for the three- and nine-month periods ended August 31, 2018 compared to 12.1% and 16.4% for the same respective periods in 2017.

(Loss) from Continuing Operations

Consolidated net (loss) from continuing operations was $(767,000) for the three-month period and $(1,948,000) for the nine-month period ended August 31, 2018 compared to net income (loss) of $42,000 and $(721,000) for the same respective periods in 2017. The increased net loss for the three months ended August 31, 2018 was due to the discovery of mold in one of our facilities. We estimate approximately $253,000 for mold remediation and $67,000 in damaged inventory, and we recognized an impairment of approximately $199,000 of this asset held for lease. The increased net loss from continuing operations for the nine-months was largely due to the revaluing of our deferred tax asset at the new income tax rates for the 2018 tax year, which resulted in a loss of approximately $300,000. We also recognized a loss of approximately $253,000 from the liquidation of our Canadian subsidiary related to the cumulative translation adjustment in the second quarter of fiscal 2018. These expenses were non-cash expenses and one-time adjustments. Our margins are generally depressed from historic levels because low volumes caused by market conditions continue to impact our ability to cover our fixed costs. Margins are also impacted as we continue to right-size our inventories to focus on products we feel our customers will want to purchase in the future.

Income Tax Adjustment

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 was enacted, which reduced the top corporate income tax rate from 35% to 21%. We have assessed the impact of the law on our reported assets, liabilities, and results of operations, and we believe that, going forward, the overall rate reduction will have a positive impact on our net earnings in the long run. However, during the first quarter of fiscal 2018, we substantially reduced our net deferred tax asset using the new lower rates. Based on our recorded deferred tax asset at November 30, 2017, we reduced the deferred tax asset by approximately $300,000, which was recorded as an adjustment to our tax provision in the first quarter of fiscal 2018.

Order Backlog

The consolidated order backlog net of discounts for continuing operations as of October 2, 2018 was $1,405,000 compared to $1,638,000 as of October 2, 2017. The agricultural products segment order backlog was $715,000 as of October 2, 2018 compared to $1,069,277 in fiscal 2017. The backlog for the modular buildings segment was $609,000 as of October 2, 2018, compared to $456,000 in fiscal 2017. The backlog for the tools segment was $81,000 as of October 2, 2018, compared to $113,000 in fiscal 2017. Our order backlog is not necessarily indicative of future revenue to be generated from such orders due to the possibility of order cancellations and dealer discount arrangements we may enter into from time to time.

Results of Operations – Discontinued Operations

During the third quarter of fiscal 2016, we made the decision to exit the pressurized vessels industry. On March 29, 2018 we disposed of the remaining assets of our Vessels segment at a selling price of $1,500,000.

Liquidity and Capital Resources

Our primary sources of funds for the nine months ended August 31, 2018 were funds received from the sale of real estate from discontinued operations and the reduction of inventory. Our primary uses of cash were costs of operation, the execution of sales-type leases, the fulfillment of customer deposits and retirement of debt related to discontinued operations. We expect our primary capital needs for the remainder of fiscal 2018 to relate to costs of operation, including production.

We have a $5,000,000 revolving line of credit with Bank Midwest that, as of August 31, 2018, had an outstanding principal balance of $2,693,530. The revolving line of credit was renewed on March 30, 2018 and is scheduled to mature on March 30, 2019.

We believe that our cash flows from operations and current financing arrangements will provide sufficient cash to finance operations and pay debt when due during the next twelve months. We expect to continue to be able to procure financing upon reasonable terms.

Off Balance Sheet Arrangements

None.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a smaller reporting company, we are not required to provide disclosure pursuant to this item.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

The person serving as our principal executive officer and principal financial officer has evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e) and Rule 15d-15(e), as of the end of the period subject to this report. Based on this evaluation, the person serving as our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective and provide reasonable assurance that information required to be disclosed by us in the periodic and current reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the periods specified by the Securities and Exchange Commission’s rules and forms.

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

We are currently not a party to any material pending legal proceedings.

Item 1A. Risk Factors.

As a smaller reporting company, we are not required to provide disclosure pursuant to this item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit No.	**Description**
31.1	Certificate of Chief Executive Officer and Interim Chief Financial Officer pursuant to 17 CFR 13a-14(a) – filed herewith.
32.1	Certificate of Chief Executive Officer and Interim Chief Financial Officer pursuant to 18 U.S.C. Section 1350 - filed herewith.
101	The following materials from this report, formatted in XBRL (Extensible Business Reporting Language) are filed herewith: (i) condensed consolidated balance sheets, (ii) condensed consolidated statement of operations, (iii) condensed consolidated statements of cash flows, and (iv) the notes to the condensed consolidated financial statements.

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.

ART'S-WAY MANUFACTURING CO., INC.

Date: October 8, 2018 By: /s/ Carrie L. Gunnerson
Carrie L. Gunnerson
President, Chief Executive Officer and Interim

Chief Financial Officer