DOUGLAS DYNAMICS, INC
Form 10-Q
August 07, 2012
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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, 2012

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 x 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 x
Non-accelerated filer o (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 o No x

Number of shares of registrant s common shares outstanding as of August 7, 2012 was 22,130,996.

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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, 2012 (unaudited)	December 31, 2011 (audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 3,790	$ 39,432
Accounts receivable, net	50,613	34,019
Inventories	32,825	24,005
Deferred income taxes	4,960	4,952
Prepaid and other current assets	1,194	1,054
Total current assets	93,382	103,462
Property, plant, and equipment, net	20,874	21,340
Assets held for sale	1,732	1,732
Goodwill	107,222	107,222
Other intangible assets, net	119,146	121,747
Deferred financing costs, net	2,926	3,402
Other long-term assets	582	112
Total assets	$ 345,864	$ 359,017
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 4,513	$ 5,040
Accrued expenses and other current liabilities	13,034	16,105
Income taxes payable	36	395
Short term borrowings	2,000	
Current portion of long-term debt	971	11,071
Total current liabilities	20,554	32,611
Retiree health benefit obligation	8,167	8,053
Pension obligation	13,949	14,163
Deferred income taxes	29,504	26,957
Deferred compensation	756	912
Long-term debt, less current portion	111,480	111,866
Other long-term liabilities	1,553	1,066
Stockholders equity:		
	221	220

Common Stock, par value $0.01, 200,000,000 shares authorized, 22,130,996 and 22,020,694 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively				
Additional paid-in capital		131,812		130,907
Retained earnings		35,360		39,742
Accumulated other comprehensive loss, net of tax		(7,492)		(7,480)
Total stockholders equity		159,901		163,389
Total liabilities and stockholders equity	$	345,864	$	359,017

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 June 30, 2012 (unaudited)	Three Months Ended June 30, 2011 (unaudited)	Six Months Ended June 30, 2012 (unaudited)	Six Months Ended June 30, 2011 (unaudited)
Net sales	$ 65,499	$ 71,557	$ 74,059	$ 95,047
Cost of sales	42,439	45,219	49,180	59,638
Gross profit	23,060	26,338	24,879	35,409
Selling, general, and administrative expense	5,707	6,760	10,337	12,687
Intangibles amortization	1,301	1,300	2,601	2,600
Income from operations	16,052	18,278	11,941	20,122
Interest expense, net	(2,178)	(2,142)	(4,223)	(4,347)
Loss on extinguishment of debt		(673)		(673)
Other expense, net	(155)	(74)	(233)	(187)
Income before taxes	13,719	15,389	7,485	14,915
Income tax expense	4,747	5,666	2,780	5,992
Net income	$ 8,972	$ 9,723	$ 4,705	$ 8,923
Less net income attributable to participating securities	94	114	32	110
Net income attributable to common shareholders	$ 8,878	$ 9,609	$ 4,673	$ 8,813
Weighted average number of common shares outstanding:				
Basic	21,906,622	21,661,662	21,866,662	21,536,441
Diluted	21,962,098	21,768,385	21,985,974	21,667,544
Earnings per common share:				
Basic	$ 0.41	$ 0.44	$ 0.21	$ 0.41
Diluted	$ 0.40	$ 0.44	$ 0.21	$ 0.41
Cash dividends declared and paid per share	$ 0.21	$ 0.20	$ 0.41	$ 0.77
Comprehensive income	$ 8,971	$ 9,659	$ 4,693	$ 8,859

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, 2012 (unaudited)	Six Months Ended June 30, 2011 (unaudited)
Operating activities		
Net income	$ 4,705	$ 8,923
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	4,003	4,102
Amortization of deferred financing costs and debt discount	565	342
Loss on extinguishment of debt		673
Stock-based compensation	906	746
Provision for losses on accounts receivable	227	408
Deferred income taxes	2,539	2,415
Changes in operating assets and liabilities:		
Accounts receivable	(16,821)	(19,749)
Inventories	(8,820)	(7,424)
Prepaid and other assets and prepaid income taxes	(610)	300
Accounts payable	(527)	2,119
Accrued expenses and other current liabilities	(3,430)	5,064
Deferred compensation	(156)	(120)
Benefit obligations and other long-term liabilities	375	(666)
Net cash used in operating activities	(17,044)	(2,867)
Investing activities		
Capital expenditures	(1,016)	(840)
Proceeds from sale of equipment	80	49
Net cash used in investing activities	(936)	(791)
Financing activities		
Proceeds from exercise of stock options		1,277
Collection of stockholders notes receivable		482
Payments of financing costs		(3,454)
Dividends paid	(9,087)	(16,868)
Revolver borrowings	2,000	
Borrowings on long-term debt		123,750
Repayment of long-term debt	(10,575)	(121,513)
Net cash used in financing activities	(17,662)	(16,326)
Change in cash and cash equivalents	(35,642)	(19,984)
Cash and cash equivalents at beginning of period	39,432	20,149
Cash and cash equivalents at end of period	$ 3,790	$ 165

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 the Annual Report on Form 10-K (Commission File No. 1-34728) for the year ended December 31, 2011 of Douglas Dynamics, Inc. (the Company, we, us, our) filed with the Securities and Exchange Commission.

We operate as a single business unit.

Certain reclassifications have been made to the prior period financial statements to conform to the 2012 presentation.

Interim Consolidated Financial Information

The accompanying consolidated balance sheet as of June 30, 2012 and the consolidated statements of operations for the three and six months ended June 30, 2012 and 2011 and cash flows for the six months ended June 30, 2012 and 2011 have been prepared by the Company and have not been audited.

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.

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).

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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 6/30/2012	Fair Value at 12/31/2011
Assets:		
Assets (a)	$	$
Total Assets	$	$
Liabilities:		
Long term debt (b)	$ 110,393	$ 122,709
Other non-current liabilities - Interest rate swap (c)	642	621
Total Liabilities	$ 111,035	$ 123,330

(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 the 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 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, 2012	December 31, 2011
Finished goods and work-in-process	$ 31,440	$ 22,630
Raw material and supplies	1,385	1,375
	$ 32,825	$ 24,005

4. Property, plant and equipment

Property, plant and equipment are summarized as follows:

	June 30, 2012	December 31, 2011
Land	$ 960	$ 960
Land improvements	1,768	1,768
Buildings	12,852	12,660
Machinery and equipment	23,337	23,253
Furniture and fixtures	7,244	7,255
Mobile equipment and other	1,230	1,216
Construction-in-process	1,168	748
Total property, plant and equipment	48,559	47,860
Less accumulated depreciation	(27,685)	(26,520)
Net property, plant and equipment	$ 20,874	$ 21,340

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5. Long-Term Debt

Long-term debt is summarized below:

	June 30, 2012	December 31, 2011
Term Loan	$ 112,451	$ 122,937
Total long-term debt	112,451	122,937
Less current maturities	971	11,071
	$ 111,480	$ 111,866

The Company entered into its current term loan agreement on April 18, 2011. The Company s senior credit facilities consist of a $125,000 term loan facility and a $70,000 revolving credit facility with a group of banks. The agreement for the 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 (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 term loan amortizes in nominal amounts quarterly with the balance payable on April 18, 2018.

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

At June 30, 2012, the Company had borrowings of $2,000 on the revolving credit facility and remaining borrowing availability of $59,754.

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, 2012, 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, 2012, the Company was not required to make an excess cash flow payment.

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Each of the senior secured facilities entered into in the second quarter of 2011 includes a hedge provision, which required 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, 2012 of $642 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, effective as of July 18, 2011, the Company either receives or makes payments on a monthly basis 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.

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other liabilities are summarized as follows:

	June 30, 2012	December 31, 2011
Payroll and related costs	$ 2,808	$ 4,756
Employee benefits	1,998	2,645
Accrued warranty	3,965	4,188
Other	4,263	4,516
	$ 13,034	$ 16,105

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 June 30, 2012	Six months ended

	June 30, 2011	June 30, 2012	June 30, 2011	
Balance at the beginning of the period	$ 3,506	$ 2,270	$ 4,188	$ 3,399
Warranty provision	643	1,244	773	1631
Claims paid/settlements	(184)	(444)	(996)	(1,960)
Balance at the end of the period	$ 3,965	$ 3,070	$ 3,965	$ 3,070

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8. Employee Retirement Plans

The components of net periodic pension cost consist of the following:

	Three months ended		Six months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Component of net periodic pension cost:				
Service cost	$ 67	$ 240	$ 134	$ 480
Interest cost	370	385	740	770
Expected return on plan assets	(318)	(339)	(636)	(678)
Amortization of net loss	192	113	384	226
Net periodic pension cost	$ 311	$ 399	$ 622	$ 798

The Company estimates its total required minimum contributions to its pension plans in 2012 will be $2,512. Through June 30, 2012, the Company has made $838 of cash contributions to the pension plans in 2012 versus $1,222 through the same period in 2011.

Components of net periodic other postretirement benefit cost consist of the following:

	Three months ended		Six months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Components of net periodic other postretirement benefit cost				
Service cost	$ 70	$ 66	$ 140	$ 131
Interest cost	90	102	180	204
Amortization of net gain	(4)	(15)	(8)	(31)
Net periodic other postretirement benefit cost	$ 156	$ 153	$ 312	$ 304

9. Earnings Per Share

Basic earnings per share of common stock is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed by dividing net income by the weighted average number of common shares and common stock equivalents related to the assumed exercise of stock options, using the two-class method. Stock options for which the exercise price exceeds the average fair value have an anti-dilutive effect on earnings per share and are excluded from the calculation.

As restricted shares participate in dividends, in accordance with Accounting Standards Codification Topic (ASC) 260, the Company has calculated earnings per share pursuant to the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends.

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	Three months ended		Six months ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
Basic earnings per common share				
Net income	$ 8,972	$ 9,723	$ 4,705	$ 8,923
Less income allocated to participating securities	94	114	32	110
Net income allocated to common shareholders	$ 8,878	$ 9,609	$ 4,673	$ 8,813
Weighted average common shares outstanding	21,906,622	21,661,662	21,866,662	21,536,441
	$ 0.41	$ 0.44	$ 0.21	$ 0.41
Earnings per common share assuming dilution				
Net income	$ 8,972	$ 9,723	$ 4,705	$ 8,923
Less income allocated to participating securities	94	114	32	110
Net income allocated to common shareholders	$ 8,878	$ 9,609	$ 4,673	$ 8,813
Weighted average common shares outstanding	21,906,622	21,661,662	21,866,662	21,536,441
Incremental shares applicable to stock based compensation	55,476	106,723	119,312	131,103
Weighted average common shares assuming dilution	21,962,098	21,768,385	21,985,974	21,667,544
	$ 0.40	$ 0.44	$ 0.21	$ 0.41

10. Employee Stock Plans

Amended and Restated 2004 Stock Incentive Plan

As of June 30, 2012, 37,240 shares of common stock are reserved for issuance upon the exercise of outstanding options under the Company s Amended and Restated 2004 Stock Incentive Plan (the A&R 2004 Plan). All outstanding options are fully vested. All options expire 10 years from the date of grant. No further awards are permitted to be issued under the A&R 2004 Plan.

Stock Options

There were no stock options exercised with respect to the Company s stock under the A&R 2004 Plan for either the three or six months ended June 30, 2012.

2010 Stock Incentive Plan

In May 2010, the Company s Board of Directors and stockholders adopted the 2010 Stock Incentive Plan (the 2010 Plan). The 2010 Plan provides for the issuance of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock awards and restricted stock units, any of which may be performance-based, and for incentive bonuses, which may be paid in cash or stock or a combination of both, to eligible employees, officers, non-employee directors and other service providers to the Company and its subsidiaries. A maximum of 2,130,000 shares of common stock may be issued pursuant to all awards under the 2010 Plan.

Restricted Stock Awards

A summary of restricted stock activity for the six months ended June 30, 2012 is as follows:

	Shares (In thousands)		Weighted Average Grant Date Fair value	Weighted Average Remaining Contractual Term
Unvested at December 31, 2011	235,667	$	12.27	2.83 years
Granted	42,077	$	14.57	2.50 years
Vested	(68,921)	$	12.61	
Cancelled and forfeited				
Unvested at June 30, 2012	208,823	$	12.63	2.44 years