

DOUGLAS DYNAMICS, INC
Form 10-K
March 12, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2014

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. 001 34728

DOUGLAS DYNAMICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	134275891
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
7777 N 73rd Street	
Milwaukee, Wisconsin	53223
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (414) 354 2310

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

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Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No .

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 No .

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

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

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

At June 30, 2014, the aggregate market value of the voting stock of the Registrant held by stockholders who were not affiliates of the Registrant was approximately \$393 million (based upon the closing price of Registrant's Common Stock on the New York Stock Exchange on such date). At March 12, 2015, the Registrant had outstanding an aggregate of 22,361,447 shares of its Common Stock.

Documents Incorporated by Reference:

Portions of the Proxy Statement for the Registrant's Annual Meeting of Shareholders to be held on April 29, 2015, which Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended December 31, 2014, are incorporated into Parts II and III.

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PART I

Forward Looking Statements

This Annual Report on Form 10 K contains “forward looking statements” made within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as “anticipate,” “believe,” “intend,” “estimate,” “expect,” “continue,” “should,” “could,” “may,” “plan,” “project,” “predict,” “will” and similar expressions are intended to identify forward looking statements. In addition, statements covering our future sales or financial performance and our plans, performance and other objectives, expectations or intentions are forward looking statements, such as statements regarding our liquidity, debt, planned capital expenditures, and adequacy of capital resources and reserves. Factors that could cause our actual results to differ materially from those expressed or implied in such forward looking statements include, but are not limited to:

- Weather conditions, particularly lack of or reduced levels of snowfall and the timing of such snowfall;
- A significant decline in economic conditions;
- Our inability to maintain good relationships with our distributors;
- Lack of available or favorable financing options for our end users or distributors;
- Increases in the price of steel or other materials necessary for the production of our products that cannot be passed on to our distributors;
- Increases in the price of fuel;
- The inability of our suppliers to meet our volume or quality requirements;
- Inaccuracies in our estimates of future demand for our products;
- Our inability to protect or continue to build our intellectual property portfolio;
- The effects of laws and regulations and their interpretations on our business and financial conditions;
- Our inability to develop new products or improve upon existing products in response to end user needs;
- Losses due to lawsuits arising out of personal injuries associated with our products;
- Factors that could impact the future declaration and payment of dividends;
- Our inability to compete effectively against competition; and
- Our inability to achieve the projected financial performance with the assets of TrynEx, Inc. (“TrynEx”), which we acquired in 2013, or the business of Henderson Enterprises Group, Inc. (“Henderson”) which we acquired in 2014, and unexpected costs or liabilities related to such acquisitions.

We undertake no obligation to revise the forward looking statements included in this Annual Report on Form 10 K to reflect any future events or circumstances. Our actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward looking statements. Factors in addition to those listed above that could cause or contribute to such differences are discussed in Item 1A, “Risk Factors” of the Annual Report on Form 10 K.

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Item 1. Business

Overview

Home to the best selling brands in the industry, Douglas Dynamics, Inc. (the “Company,” “we,” “us,” “our”) is North America's premier manufacturer of vehicle attachments and equipment. For more than 65 years, the Company has been innovating products that enable end users to perform their jobs more efficiently and effectively, providing opportunities for businesses to increase profitability. Our commitment to continuous improvement enables us to consistently produce high quality products and drive shareholder value. The Douglas Dynamics portfolio includes snow and ice management attachments sold under the BLIZZARD®, FISHER®, SNOWEX® and WESTERN® brands, turf care equipment under the TURFEX® brand, and industrial maintenance equipment under the SWEEPEX® brand. On December 31, 2014, we completed our acquisition of Henderson by merging a wholly-owned subsidiary of the Company with and into Henderson pursuant to a merger agreement. The acquisition provides the Company with Henderson’s diverse product portfolio including ice control equipment, snow plows, dump bodies, muni-bodies, and replacement parts. Additionally, as a result of the Henderson acquisition, the Company acquired Henderson’s brands, and access to Henderson’s network of authorized dealers. We operate as a single segment.

We offer a broad product line of snowplows and sand and salt spreaders for light trucks that we believe to be the most complete line offered in the U.S. and Canadian markets. We also provide a full range of related parts and accessories, which generates an ancillary revenue stream throughout the lifecycle of our snow and ice control equipment. As a result of the acquisition of Henderson, we also provide customized turnkey solutions to governmental agencies such as Departments of Transportation (“DOTs”) and municipalities. We also believe that, with the addition of Henderson, we are now the market leader in the heavy-duty segment of the North American snow and ice control market which includes equipment for class 7 and class 8 truck chassis. For the years ended December 31, 2014, 2013 and 2012, 84%, 85% and 88% of our net sales were generated from sales of snow and ice control equipment, respectively, and 16%, 15% and 12% of our net sales were generated from sales of parts and accessories, respectively.

We sell our products through a distributor network primarily to professional snowplowers who are contracted to remove snow and ice from commercial, municipal and residential areas. Over the last 50 years, we have engendered exceptional customer loyalty for our products because of our ability to satisfy the stringent demands of our customers for a high degree of quality, reliability and service. As a result, we believe our installed base is the largest in the light truck market with over 500,000 snowplows and sand and salt spreaders in service. Because sales of snowplows and sand and salt spreaders are primarily driven by the need of our core end user base to replace worn existing equipment, we believe our substantial installed base provides us with a high degree of predictable sales over any extended period of time.

We believe we have the industry’s most extensive distribution network worldwide, which consists of over 2,200 points of sale including 125 independent truck equipment distributors as a result of the Henderson acquisition. Additionally we have added Henderson’s five truck equipment installation facilities located throughout the United States. Direct points of shipment are predominantly through North American truck equipment and lawn care equipment distributors. Most of our distributors are located throughout the snow belt regions in North America (primarily the Midwest, East and Northeast regions of the United States as well as all provinces of Canada). We have longstanding relationships with many of our distributors. We continually seek to grow and optimize our network by opportunistically adding high quality, well capitalized distributors in select geographic areas and by cross selling our industry leading brands within our distribution network. Beginning in 2005, we have extended our reach to international markets, establishing distribution relationships in Northern Europe and Asia, where we believe meaningful growth opportunities exist.

We believe we are the industry's most operationally efficient manufacturer due to our vertical integration, highly variable cost structure and intense focus on lean manufacturing. We continually seek to use lean principles to reduce costs and increase the efficiency of our manufacturing operations. During the year ended December 31, 2014 we manufactured our products in three facilities that we own in Milwaukee, Wisconsin, Rockland, Maine, and Madison Heights, Michigan. As a result of the December 31, 2014 acquisition of Henderson, we also have added a manufacturing facility in Manchester, Iowa. Furthermore, our manufacturing efficiency allows us to deliver desired

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products quickly to our customers during times of sudden and unpredictable snowfall events when our customers need our products immediately.

Our Industry

Both the light truck and heavy duty snow and ice control equipment industries in North America consist predominantly of domestic participants that manufacture their products in North America. The annual demand for snow and ice control equipment is driven primarily by the replacement cycle of the existing installed base, which is predominantly a function of the average life of a snowplow or spreader and is driven by usage and maintenance practices of the end user. We believe actively used snowplows are typically replaced, on average, every 9 to 12 years.

We believe that both light and heavy duty snow and ice control equipment are both driven primarily by the replacement cycle of the existing installed base, which is predominantly a function of the average life of a snowplow or spreader and is driven by usage and maintenance practices of the end user. However, we believe that demand for heavy duty trucks is less elastic than light trucks. Heavy duty truck end users typically are comprised of local governments and municipalities which plan for and execute planned replacement of equipment over time.

The primary factor influencing the replacement cycle for snow and ice control equipment for light trucks is the level, timing and location of snowfall. Sales of snow and ice control equipment in any given year and region are most heavily influenced by local snowfall levels in the prior snow season. Heavy snowfall during a given winter causes equipment usage to increase, resulting in greater wear and tear and shortened life cycles, thereby creating a need for replacement equipment and additional parts and accessories.

While snowfall levels vary within a given year and from year to year, snowfall, and the corresponding replacement cycle of snow and ice control equipment, is relatively consistent over multi year periods. The following chart depicts aggregate annual and ten year (based on the typical life of our snowplows) rolling average of the aggregate snowfall levels in 66 cities in 26 snow belt states across the Northeast, East, Midwest and Western United States where we monitor snowfall levels from 1980 to 2014. As the chart indicates, since 1984 aggregate snowfall levels in any given rolling ten year period have been fairly consistent, ranging from 2,742 to 3,318 inches.

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Note: The 10 year rolling average snowfall is not presented prior to 1984 for purposes of the calculation due to lack of snowfall data prior to 1975. Snowfall data in this chart is not adjusted for snowfall outside of the 66 cities in the 26 states reflected.

Source: National Oceanic and Atmospheric Administration's National Weather Service.

The demand for snow and ice control equipment can also be influenced by general economic conditions in the United States, as well as local economic conditions in the snow belt regions in North America. In stronger economic conditions, our end users may choose to replace or upgrade existing equipment before its useful life has ended, while in weak economic conditions, our end users may seek to extend the useful life of equipment, thereby increasing the sales of parts and accessories. However, since snow and ice control management is a non discretionary service necessary to ensure public safety and continued personal and commercial mobility in populated areas that receive snowfall, end users cannot extend the useful life of snow and ice control equipment indefinitely and must replace equipment that has become too worn, unsafe or unreliable, regardless of economic conditions. While our parts and accessories yield slightly higher gross margins than our snow and ice control equipment, they yield significantly lower revenue than equipment sales, which adversely affects our results of operations.

Sales of parts and accessories for 2014 were approximately 89% higher than average annual parts and accessories sales over the preceding ten years. The higher than average parts and accessories sales were partially due primarily driven by above average snowfall, in addition to TrynEx parts and accessory sales being sold for a full year in 2014 versus only a partial year in 2013. TrynEx parts and accessories sales contributed approximately 18% of increased parts and accessory sales in 2014 compared to 2013. The remaining 47% increase can be attributed to the timing, location and amount of the snowfall for the six month snow season ended March 31, 2014.

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Long term growth in the overall snow and ice control equipment market also results from geographic expansion of developed areas in the snow belt regions of North America, as well as consumer demand for technological enhancements in snow and ice control equipment and related parts and accessories that improves efficiency and reliability. Continued construction in the snow belt regions in North America increases the aggregate area requiring snow and ice removal, thereby growing the market for snow and ice control equipment. In addition, the development and sale of more reliable, more efficient and more sophisticated products have contributed to an approximate 2% to 4% average unit price increase in each of the past five years.

Our Competitive Strengths

We compete solely with other North American manufacturers who do not benefit from our extensive distributor network, manufacturing efficiencies and depth and breadth of products. As the market leader in snow and ice control equipment for light trucks and following the Henderson acquisition, heavy duty trucks, we enjoy a set of competitive advantages versus smaller equipment providers, which allows us to generate robust cash flows in all snowfall environments and to support continued investment in our products, distribution capabilities and brand regardless of annual volume fluctuations. We believe these advantages are rooted in the following competitive strengths and reinforces our industry leadership over time.

Exceptional Customer Loyalty and Brand Equity. Our brands enjoy exceptional customer loyalty and brand equity in the snow and ice control equipment industry with both end users and distributors, which have been developed through over 50 years of superior innovation, productivity, reliability and support, consistently delivered season after season. We believe past brand experience, rather than price, is the key factor impacting snowplow purchasing decisions.

Broadest and Most Innovative Product Offering. We provide the industry's broadest product offering with a full range of snowplows, sand and salt spreaders and related parts and accessories. We believe we maintain the industry's largest and most advanced in house new product development program, historically introducing several new and redesigned products each year. Our broad product offering and commitment to new product development is essential to maintaining and growing our leading market share position as well as continuing to increase the profitability of our business.

Extensive North American Distributor Network. With over 2,200 points of sale, we benefit from having the most extensive distributor network in the industry, providing a significant competitive advantage over our peers. Our distributors function not only as sales and support agents (providing access to parts and service), but also as industry partners providing real time end user information, such as retail inventory levels, changing consumer preferences or desired functionality enhancements, which we use as the basis for our product development efforts.

Leader in Operational Efficiency. We believe we are a leader in operational efficiency in our industry, resulting from our application of lean manufacturing principles and a highly variable cost structure. By utilizing lean principles, we are able to adjust production levels easily to meet fluctuating demand, while controlling costs in slower periods. This operational efficiency is supplemented by our highly variable cost structure, driven in part by our access to a sizable temporary workforce (comprising approximately 10-15% of our total workforce during average snowfall years), which we can quickly adjust, as needed. These manufacturing efficiencies enable us to respond rapidly to urgent customer demand during times of sudden and unpredictable snowfalls, allowing us to provide exceptional service to our existing customer base and capture new customers from competitors that we believe cannot service their customers' needs with the same speed and reliability.

Strong Cash Flow Generation. We are able to generate significant cash flow as a result of relatively consistent high profitability, low capital spending requirements and predictable timing of our working capital requirements. Our cash flow results will also benefit substantially from approximately \$19.0 million of annual tax deductible intangible and

goodwill expense over the next four years, which has the impact of reducing our corporate taxes owed by approximately \$7.3 million on an annual basis during this period, in the event we have sufficient taxable income to utilize such benefit. Our significant cash flow has allowed us to reinvest in our business, pay down long term debt, and pay substantial dividends on a pro rata basis to our stockholders.

Experienced Management Team. We believe our business benefits from an exceptional management team that is responsible for establishing our leadership in the snow and ice control equipment industry for light trucks.

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Our senior management team, consisting of four officers, has an average of approximately 24 years of weather related industry experience and an average of over fourteen years with our company. James Janik, our Chairman, President and Chief Executive Officer, has been with us for over 22 years and in his role as President and Chief Executive Officer since 2000, and through his strategic vision, we have been able to expand our distributor network and grow our market leading position.

Our Business Strategy

Our business strategy is to capitalize on our competitive strengths to maximize cash flow to pay dividends, reduce indebtedness and reinvest in our business to create stockholder value. The building blocks of our strategy are:

Continuous Product Innovation. We believe new product innovation is critical to maintaining and growing our market leading position in the snow and ice control equipment industry. We will continue to focus on developing innovative solutions to increase productivity, ease of use, reliability, durability and serviceability of our products and on incorporating lean manufacturing concepts into our product development process, which has allowed us to reduce the overall cost of development and, more importantly, to reduce our time to market by nearly one half.

Distributor Network Optimization. We will continually seek opportunities to continue to expand our extensive distribution network by adding high quality, well capitalized distributors in select geographic areas and by cross selling our industry leading brands within our distribution network to ensure we maximize our ability to generate revenue while protecting our industry leading reputation, customer loyalty and brands. We will also focus on optimizing this network by providing in depth training, valuable distributor support and attractive promotional and incentive opportunities. As a result of these efforts, we believe a majority of our distributors choose to sell our products exclusively. We believe this sizable high quality network is unique in the industry, providing us with valuable insight into purchasing trends and customer preferences, and would be very difficult to replicate.

Aggressive Asset Management and Profit Focus. We will continue to aggressively manage our assets in order to maximize our cash flow generation despite seasonal and annual variability in snowfall levels. We believe our ability is unique in our industry and enables us to achieve attractive margins in all snowfall environments. Key elements of our asset management and profit focus strategies include:

- employment of a highly variable cost structure, which allows us to quickly adjust costs in response to real time changes in demand;
- use of enterprise wide lean principles, which allow us to easily adjust production levels up or down to meet demand;
- implementation of a pre season order program, which incentivizes distributors to place orders prior to the retail selling season and thereby enables us to more efficiently utilize our assets; and
- development of a vertically integrated business model, which we believe provides us cost advantages over our competition.

Additionally, although modest, our capital expenditure requirements and operating expenses can be temporarily reduced in response to anticipated or actual lower sales in a particular year to maximize cash flow.

Flexible, Lean Enterprise Platform. We will continue to utilize lean principles to maximize the flexibility, efficiency and productivity of our manufacturing operations while reducing the associated costs, enabling us to increase distributor and end user satisfaction. For example, in an environment where shorter lead times and near perfect order fulfillment are important to our distributors, we believe our lean processes have helped us to improve our shipping performance and build a reputation for providing industry leading shipping performance.

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Our Growth Opportunities

Opportunistically Seek New Products and New Markets. On December 31, 2014 the Company completed its acquisition of Henderson, which gave the Company Henderson's full line of product offerings and access to its network of dealers. Previously, on May 6, 2013, the Company acquired substantially all of the assets of TrynEx, including its full line of product offerings and access to its network of authorized dealers. We expect to continue to consider external growth opportunities within the snow and ice control industry and other equipment or component markets. We plan to continue to evaluate other acquisition opportunities within our industry that can help us expand our distribution reach, enhance our technology and as a consequence improve the breadth and depth of our product lines. We also consider diversification opportunities in adjacent markets that complement our business model and could offer us the ability to leverage our core competencies to create stockholder value.

Increase Our Industry Leading Market Share. We plan to leverage our industry leading position, distribution network and new product innovation capabilities to capture market share in the North American snow and ice control equipment market, focusing our primary efforts on increasing penetration in those North American markets where we believe our overall market share is less than 50% and of Henderson, the heavy duty truck market. We also plan to continue growing our presence in the snow and ice control equipment market outside of North America, particularly in Asia and Europe, which we believe could provide significant growth opportunities in the future.

Employees

As of December 31, 2014, we employed 993 employees on a full time basis, including 363 employees at the newly acquired Henderson business. None of our employees are represented by a union and we are not party to any collective bargaining agreements.

Financing program

We are party to a financing program in which certain distributors may elect to finance their purchases from us through a third party financing company. We provide the third party financing company recourse against us regarding the collectability of the receivable under the program due to the fact that if the third party financing company is unable to collect from the distributor the amounts due in respect of the product financed, we would be obligated to repurchase any remaining inventory related to the product financed and reimburse any legal fees incurred by the financing company. During the years ended December 31, 2014, 2013 and 2012, distributors financed purchases of \$5.6 million, \$2.9 million and \$1.6 million through this financing program, respectively. At both December 31, 2014 and December 31, 2013, there was \$0 of uncollectible outstanding receivables related to sales financed under the financing program. The amount owed by our distributors to the third party financing company under this program at December 31, 2014 and 2013 was \$1.9 million and \$1.3 million, respectively. We were required to repurchase repossessed inventory of \$0, \$0, and \$0.2 million for the years ended December 31, 2014, 2013 and 2012, respectively.

In the past, minimal losses have been incurred under this agreement. However, an adverse change in distributor retail sales could cause this situation to change and thereby require us to repurchase repossessed units. Any repossessed units are inspected to ensure they are current, unused product and are restocked and resold.

Intellectual Property

We maintain patents relating to snowplow mounts, assemblies, hydraulics, electronics and lighting systems, brooms as well as sand, salt and fertilizer spreader assemblies and our patent applications relate to each of the foregoing except for hydraulics. Patents are valid for the longer period of 17 years from issue date or 20 years from filing date. The

duration of the patents we currently possess range between two years and 19 years of remaining life. Our patent applications date from 1996 through 2014.

We rely on a combination of patents, trade secrets and trademarks to protect certain of the proprietary aspects of our business and technology. We hold approximately 36 U.S. registered trademarks (including the

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trademarks WESTERN®, FISHER® BLIZZARD®, SNOWEX®, TURFEX®, SWEEPEX®, HENDERSON® and BRINEXTREME®) 11 Canadian registered trademarks, 5 European trademarks, 58 U.S. issued patents, 11 Canadian patents and two Chinese and Mexican trademarks.

Raw Materials

During 2014, we experienced slightly unfavorable commodity costs compared to the slightly favorable prices paid for commodities in 2013. Historically, we have mitigated, and we currently expect to continue to mitigate, commodity cost increases in part by engaging in proactive vendor negotiations, reviewing alternative sourcing options, substituting materials, engaging in internal cost reduction efforts, and increasing prices on some of our products, all as appropriate.

Most of the components of our products are also affected by commodity cost pressures and are commercially available from a number of sources. In 2014, we experienced no significant work stoppages because of shortages of raw materials or commodities. The highest raw material and component costs are generally for steel, which we purchase from several suppliers.

Other Information

We were formed as a Delaware corporation in 2004. We maintain a website with the address www.douglasdynamics.com. We are not including the information contained on our website as part of, or incorporating it by reference into, this report. We make available free of charge (other than an investor's own Internet access charges) through our website our Annual Report on Form 10 K, quarterly reports on Form 10 Q and current reports on Form 8 K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission ("SEC").

Item 1A. Risk Factors

The Company operates in an environment that involves numerous known and unknown risks and uncertainties. Our business, prospects, financial condition and operating results could be materially adversely affected by any of these risks, as well as other risks not currently known to us or that we currently consider immaterial. The risks described below highlight some of the factors that have affected, and in the future could affect our operations.

Our results of operations depend primarily on the level, timing and location of snowfall. As a result, a decline in snowfall levels in multiple regions for an extended time could cause our results of operations to decline and adversely affect our ability to pay dividends.