

SHOPSMITH INC  
Form 10-Q  
November 13, 2001

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**FORM 10-Q**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

Report Under Section 13 or 15 (d)  
Of the Securities Exchange Act of 1934

For the quarter ended  
September 29 2001

Commission File Number 0-9318

**SHOPSMITH, INC.**

(Name of Registrant)

|   |                                      |
|---|--------------------------------------|
| Ohio  | 31-0811466                           |
| (State of Incorporation)                    | (IRS Employer Identification Number) |
| 6530 Poe Avenue<br>Dayton, Ohio             | 45414                                |
| (Address of Principal<br>Executive Offices) | (Zip Code)                           |

Registrant's Telephone 937-898-6070

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of October 19, 2001.

Common shares, without par value: 2,605,233 shares.

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**SHOPSMITH, INC. AND SUBSIDIARIES**

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|   | September 29<br>2001      | March 31<br>2001          |
|---|---------------------------|---------------------------|
|   | (Unaudited)               |                           |
| <b>ASSETS</b>   |                           |                           |
| Current Assets:   |                           |                           |
| Cash and equivalents  | \$ 1,225                  | \$ 651,530                |
| Restricted cash   |                           | 174,718                   |
| Accounts receivable:  |                           |                           |
| Trade, less allowance for doubtful accounts:  |                           |                           |
| \$1,056,149 on September 29 and \$924,250 on March 31   | 588,066                   | 673,689                   |
| Inventories   | 2,180,488                 | 2,168,225                 |
| Deferred income taxes (Note 2)  | 564,000                   | 498,000                   |
| Prepaid expenses  | 339,958                   | 431,912                   |
|   | <u>3,673,737</u>          | <u>4,598,074</u>          |
|   |                           |                           |
| Properties:   |                           |                           |
| Land, building and improvements   | 3,143,908                 | 3,161,199                 |
| Machinery, equipment and tooling  | 6,685,828                 | 6,627,918                 |
|   | <u>9,829,736</u>          | <u>9,789,117</u>          |
| Total cost  | 9,829,736                 | 9,789,117                 |
| Less accumulated depreciation and amortization  | 6,908,222                 | 6,782,561                 |
|   | <u>2,921,514</u>          | <u>3,006,556</u>          |
|   |                           |                           |
| Deferred income taxes (Note 2)  | 716,000                   | 782,000                   |
|   |                           |                           |
| Long term portion of accounts receivable Trade, less allowance for doubtful<br>accounts \$83,940 on September 29 and \$70,999 on March 31 | 200,236                   | 167,954                   |
|   |                           |                           |
| Other assets  | 2,303                     | 2,303                     |
|   | <u>2,303</u>              | <u>2,303</u>              |
| <b>Total assets</b>   | <b><u>\$7,513,790</u></b> | <b><u>\$8,556,887</u></b> |

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## SHOPSMITH INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEET

|  | September 29<br>2001 | March 31<br>2001    |
|--|----------------------|---------------------|
|  | (Unaudited)          |                     |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                      |                     |
| Current liabilities:   |                      |                     |
| Accounts payable   | \$ 1,007,206         | \$ 1,113,380        |
| Current portion of long-term debt and capital lease obligation   | 100,706              | 84,910              |
| Customer advances  | 102,104              | 169,003             |
| Accrued liabilities:   |                      |                     |
| Compensation, employee benefits and payroll taxes  | 168,961              | 278,443             |
| Sales taxes payable  | 107,474              | 144,606             |
| Accrued recourse liability   | 180,055              | 235,303             |
| Accrued expenses   | 260,789              | 182,804             |
| Other  | 87,279               | 93,990              |
|  | <u>2,014,574</u>     | <u>2,302,439</u>    |
| Total current liabilities  | 2,014,574            | 2,302,439           |
| Long-term debt and capital lease obligation  | 2,533,628            | 2,568,464           |
|  | <u>4,548,202</u>     | <u>4,870,903</u>    |
| Total liabilities  | 4,548,202            | 4,870,903           |
| Shareholders' equity:  |                      |                     |
| Preferred shares- without par value; authorized 500,000; none issued   |                      |                     |
| Common shares- without par value; authorized 5,000,000; issued and outstanding 2,605,233 shares on September 29 and March 31 | 2,806,482            | 2,806,482           |
| Retained earnings  | 159,106              | 879,502             |
|  | <u>2,965,588</u>     | <u>3,685,984</u>    |
| Total shareholders' equity   | 2,965,588            | 3,685,984           |
| Total liabilities and shareholders' equity   | <u>\$ 7,513,790</u>  | <u>\$ 8,556,887</u> |

See notes to consolidated financial statements.

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## SHOPSMITH INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF OPERATIONS AND RETAINED EARNINGS

|  | Three Months Ended   |                           | Six Months Ended     |                           |
|--|----------------------|---------------------------|----------------------|---------------------------|
|  | September 29<br>2001 | September 30<br>2000      | September 29<br>2001 | September 30<br>2000      |
|  | (Unaudited)          | (Unaudited)<br>(restated) | (Unaudited)          | (Unaudited)<br>(restated) |
| Net sales                                | \$3,288,636          | \$4,001,309               | \$6,326,141          | \$7,670,664               |
| Cost of products sold                    | 1,566,627            | 1,900,401                 | 2,974,820            | 3,634,444                 |
| Gross margin                             | 1,722,009            | 2,100,908                 | 3,351,321            | 4,036,220                 |
| Selling expenses                         | 1,517,594            | 1,651,086                 | 3,067,107            | 3,639,434                 |
| Administrative expenses                  | 382,308              | 398,650                   | 920,877              | 863,186                   |
| Total operating expenses                 | 1,899,902            | 2,049,736                 | 3,987,984            | 4,502,620                 |
| Income (loss) from operations            | (177,893)            | 51,172                    | (636,663)            | (466,400)                 |
| Interest income                          | 14,550               | 6,305                     | 33,778               | 18,682                    |
| Interest expense                         | 65,069               | 27,804                    | 124,266              | 95,239                    |
| Other income, net                        | 2,876                | 1,299                     | 6,755                | 4,801                     |
| Income (loss) before taxes               | (225,536)            | 30,972                    | (720,396)            | (538,156)                 |
| Income tax benefit                       |                      |                           |                      |                           |
| Net income (loss)                        | (225,536)            | 30,972                    | (720,396)            | (538,156)                 |
| Retained earnings:                       |                      |                           |                      |                           |
| Beginning                                | 384,642              | 426,466                   | 879,502              | 995,594                   |
| Ending                                   | \$ 159,106           | \$ 457,438                | \$ 159,106           | \$ 457,438                |
| Net loss per common share (Note 3) Basic | \$ (0.09)            | \$ 0.01                   | \$ (0.28)            | \$ (0.21)                 |
| Diluted                                  | \$ (0.09)            | \$ 0.01                   | \$ (0.28)            | \$ (0.21)                 |

See notes to consolidated financial statements

**Table of Contents****SHOPSMITH INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENT OF CASH FLOW**

|   | Six Months Ended     |                           |
|---|----------------------|---------------------------|
|   | September 29<br>2001 | September 30<br>2000      |
|   | (Unaudited)          | (Unaudited)<br>(restated) |
| Cash flows from operating activities:   |                      |                           |
| Net loss  | \$ (720,396)         | \$ (538,156)              |
| Adjustments to reconcile net loss to cash provided from operating activities: |                      |                           |
| Depreciation and amortization   | 125,661              | 146,211                   |
| Provision for doubtful accounts   | 134,416              | 150,196                   |
| Cash provided from (required for) changes in assets and liabilities:          |                      |                           |
| Restricted cash   | 174,718              | (66,129)                  |
| Accounts receivable   | (81,075)             | (162,771)                 |
| Inventories   | (12,263)             | 168,872                   |
| Other assets  | 91,954               | 182,703                   |
| Accounts payable and customer advances  | (173,073)            | (488,359)                 |
| Other current liabilities   | (130,588)            | (323,239)                 |
| Cash used in operating activities   | (590,646)            | (930,672)                 |
| Cash flows from investing activities:   |                      |                           |
| Property additions  | (40,619)             | (37,052)                  |
| Cash used in investing activities   | (40,619)             | (37,052)                  |
| Cash flows from financing activities:   |                      |                           |
| Payments on long-term debt and capital lease obligation                       | (19,040)             | (136,400)                 |
| Cash used in financing activities   | (19,040)             | (136,400)                 |
| Net decrease in cash  | (650,305)            | (1,104,124)               |
| Cash:   |                      |                           |
| At beginning of period  | 651,530              | 1,301,387                 |
| At end of period  | \$ 1,225             | \$ 197,263                |



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## SHOPSMITH, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- In the opinion of management, all adjustments (consisting of only normal and recurring adjustments) have been made as of September 29, 2001 and September 30, 2000 to present the financial statements fairly. However, the results of operations for the six months then ended are not necessarily indicative of results for the fiscal year. The financial statements and notes are presented as permitted by Form 10-Q, and do not contain certain information included in the annual financial statements. The financial statements accompanying this report should be read in conjunction with the financial statements and notes thereto included in the Annual Report to Shareholders for the year ended March 31, 2001.
- The provision for income taxes is as follows:

|  | Three Months Ended   |                      | Six Months Ended     |                      |
|--|----------------------|----------------------|----------------------|----------------------|
|  | September 29<br>2001 | September 30<br>2000 | September 29<br>2001 | September 30<br>2000 |
| Income (loss) before income taxes            | \$ (225,536)         | \$ 30,972            | \$ (720,396)         | \$ (538,156)         |
| Provision for (recoverable) income taxes:    |                      |                      |                      |                      |
| Current                                      |                      |                      |                      |                      |
| Deferred                                     | (71,000)             | 28,000               | (235,000)            | (171,000)            |
| Change in valuation allowance                | 71,000               | (28,000)             | 235,000              | 171,000              |
| Net provision for (recoverable) income taxes | \$                   | \$                   | \$                   | \$                   |

The Company has deferred tax assets amounting to \$1,280,000 at September 29, 2001 and March 31, 2001 which reflect the impact of temporary differences between the amount of assets and liabilities recorded for financial reporting purposes and such amounts as measured by tax laws and regulations. The Company believes that it is more likely than not that these assets are realizable and represent its best estimate based on the available evidence as prescribed in SFAS 109. For the current year through September 29, 2001 the Company has established a \$235,000 valuation allowance against its provision for recoverable income taxes because of the uncertainty of realizing its benefit.

- Basic loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share reflects per share amounts that would have resulted if stock options had been converted into common stock. The following reconciles amounts reported in the financial statements:

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|                                 | Three Months Ended   |                      | Six Months Ended     |                      |
|---------------------------------|----------------------|----------------------|----------------------|----------------------|
|                                 | September 29<br>2001 | September 30<br>2000 | September 29<br>2001 | September 30<br>2000 |
| Net income (loss)               | \$ (225,536)         | \$ 30,972            | \$ (720,396)         | \$ (538,156)         |
| Weighted average shares         | 2,605,233            | 2,605,233            | 2,605,233            | 2,605,233            |
| Additional dilutive shares      |                      |                      |                      |                      |
| Total dilutive shares           | 2,605,233            | 2,605,233            | 2,605,233            | 2,605,233            |
| Basic income (loss) per share   | \$ (0.09)            | \$ 0.01              | \$ (0.28)            | \$ (0.21)            |
| Diluted income (loss) per share | \$ (0.09)            | \$ 0.01              | \$ (0.28)            | \$ (0.21)            |

There were no additional dilutive shares included in the computation at September 29, 2001 and September 30, 2000 because the stock options were anti-dilutive.

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

**Results of Operations**

Second quarter sales declined to \$3,289,000 or 17.8% from \$4,001,000 generated a year ago. This decrease in volume is primarily in our demonstration sales channel.

Gross margin rates decreased by two tenths of a percentage point compared to last year. Operating expenses were reduced to \$1,900,000 in the current fiscal year from \$2,050,000 last year.

Provisions for recoverable Federal income taxes (\$0 in FY2002 and FY 2001) are based on estimated annual effective rates, less a valuation reserve.

A net loss of \$226,000 or \$.09 per diluted share was experienced in the quarter ended September 29, 2001 compared to a restated net income of \$31,000 or \$.01 per diluted share for the same period of last year.

**Liquidity and Financial Position**

Cash used in operations totaled \$591,000 in the current year compared with \$931,000 for the preceding year. Net losses of \$720,000 were the main reasons for the cash usage in the current quarter.

Shopsmith has concluded arrangements with Lowe's to do Mark V sales demonstration events within Lowe's stores. This venture (which started at the end of October) will result in additional cash requirements for both receivables and for startup costs.

Our bank, Huntington National has informed Shopsmith that it is terminating our relationship on January 31, 2002. The Huntington National line of credit agreement includes among other financial covenants, a minimum net worth requirement of \$3,100,000 through December 31, 2001 and \$3,200,000 thereafter. Shopsmith was not in compliance with the minimum net worth covenant at September 29, 2001. Huntington National has modified the minimum net worth covenant of the agreement to \$2,838,583 until November 21, 2001, at which time it is anticipated that Shopsmith will not be in compliance and will have failed to satisfy the conditions applicable to drawing under the Company's line of credit. The Company plans to replace the Huntington National line of credit agreement with an arrangement to borrow up to \$500,000 from John Folkerth, the Company's CEO.

The Company's assets include \$1,280,000 of deferred income tax assets at September 29, 2001. Presently, the Company believes that these assets are realizable and represent management's best estimate based on the weight of available evidence as prescribed in SFAS 109. If the Company is unable to generate sufficient operating income in the future, a valuation allowance will have to be established by means of a charge against operating results.

The current ratio was 1.82 to 1 at September 29, 2001 compared to 2.00 to 1 at the beginning of the current fiscal year. The debt to equity ratio increased to 1.53 to 1 from 1.32 to 1 at March 31, 2001.

The company has now experienced losses in the last three fiscal years as well as the year to date in the current year. Continuation of operating losses will negatively affect the Company's liquidity as a result of negative cash flow caused by the losses.

**Forward Looking Statements**

The foregoing discussion and the Company's consolidated financial statements contain certain forward-looking statements that involve risks and uncertainties, including but not limited to the following: (a) the adequacy of operating cash flows together with currently available working capital to finance the operating needs of the Company and (b) generation of future taxable income to utilize existing deferred tax assets.

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**Item 3. Quantitative and qualitative disclosures about market risk.**

Not applicable.

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**PART II. OTHER INFORMATION**

**Item 4.**

The company held its Annual Meeting of Shareholders on July 25, 2001. At the meeting, shareholders (a) elected messrs. Robert L. Folkerth and Brady L. Skinner as directors of the Company and (b) approved the appointment of Crowe, Chizek and Company LLP as independent public accountants for the Company. Votes were tabulated as follows:

| Issue                                     | For       | Against | Withheld | Broker<br>Non<br>votes |
|---|-----------|---------|----------|------------------------|
| Election of directors:                    |           |         |          |                        |
| Robert L. Folkerth                        | 2,316,967 |         | 76,766   |                        |
| Brady L. Skinner                          | 2,336,441 |         | 57,292   |                        |
| Appointment Crowe, Chizek and Company LLP | 2,385,900 | 3,697   | 4,136    |                        |

**Item 6.**

(a) Exhibits:

None

(b) Reports on Form 8-K:

None

**SIGNATURES**

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

SHOPSMITH, INC

By /s/ Mark A. May

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Mark A. May  
Vice President of Finance (Principal Financial  
and Accounting Officer)

Date: November 12, 2001