TAYLOR DEVICES INC
Form 10-Q
October 13, 2010

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, 2010

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 Number 0-3498

TAYLOR DEVICES, INC.

(Exact name of registrant as specified in its charter)

NEW YORK	16-0797789
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
90 Taylor Drive, North Tonawanda, New York	14120-0748
(Address of principal executive offices)	(Zip Code)

716-694-0800
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 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 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 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.

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

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

As of October 13, 2010, there were outstanding 3,231,671 shares of the registrant's common stock, par value $.025 per share.

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TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Balance Sheets	**(Unaudited) August 31, 2010**	May 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	**$ 2,347,948**	$ 197,587
Accounts receivable, net	**2,357,765**	5,033,395
Inventory	**6,613,689**	6,474,148
Costs and estimated earnings in excess of billings	**1,040,754**	1,051,354
Other current assets	**1,387,497**	1,485,015
Total current assets	**13,747,653**	14,241,499
Maintenance and other inventory, net	**752,234**	718,749
Property and equipment, net	**3,434,677**	3,497,800
Other assets	**143,713**	142,355
	$ 18,078,277	$ 18,600,403
Liabilities and Stockholders' Equity		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	**$ 5,485**	$ 5,485
Accounts payable	**1,069,232**	1,096,289
Accrued commissions	**196,774**	380,448
Billings in excess of costs and estimated earnings	**357,175**	367,764
Other current liabilities	**1,030,445**	1,548,655
Total current liabilities	**2,659,111**	3,398,641
Long-term liabilities	**312,255**	313,626

Stockholders' Equity:		
Common stock and additional paid-in capital	**6,646,043**	6,611,906
Retained earnings	**10,692,152**	10,507,514
	17,338,195	17,119,420
Treasury stock - at cost	**(2,231,284)**	(2,231,284)
Total stockholders' equity	**15,106,911**	14,888,136
	$ 18,078,277	$ 18,600,403

See notes to condensed consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Income

	(Unaudited)	
For the three months ended	**August 31, 2010**	August 31, 2009
Sales, net	**$ 4,276,823**	$ 5,013,673
Cost of goods sold	**3,136,086**	3,281,827
Gross profit	**1,140,737**	1,731,846
Selling, general and administrative expenses	**878,936**	1,180,338
Operating income	**261,801**	551,508
Other income (expense), net	**28,337**	(4,711)
Income before provision for income taxes	**290,138**	546,797
Provision for income taxes	**105,500**	226,000
Net income	**$ 184,638**	$ 320,797
Basic and diluted earnings per common share	**$ 0.06**	$ 0.10

See notes to condensed consolidated financial statements.

TAYLOR DEVICES, INC. AND SUBSIDIARY

Condensed Consolidated Statements of Cash Flows

	(Unaudited)	
For the three months ended	**August 31, 2010**	August 31, 2009
Cash flows from operating activities:		
Net income	**$ 184,638**	$ 320,797
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	**116,503**	110,556
Stock options issued for services	**30,463**	19,851
Changes in other assets and liabilities:		
Accounts receivable	**2,675,630**	138,349
Inventory	**(173,026)**	210,962
Costs and estimated earnings in excess of billings	**10,600**	(1,296,269)
Other current assets	**97,518**	94,052
Accounts payable	**(27,057)**	349,066
Accrued commissions	**(183,674)**	138,577
Billings in excess of costs and estimated earnings	**(10,589)**	74,884
Other current liabilities	**(518,210)**	456,959
Net cash flows from operating activities	**2,202,796**	617,784
Cash flows from investing activities:		
Acquisition of property and equipment	**(53,380)**	(79,281)
Other investing activities	**(1,358)**	36,581
Net cash flows for investing activities	**(54,738)**	(42,700)
Cash flows from financing activities:		
Net short-term borrowings and repayments on long-term debt	**(1,371)**	(590,475)
Proceeds from issuance of common stock, net	**3,674**	3,351
Net cash flows from (for) financing activities	**2,303**	(587,124)
Net increase (decrease) in cash and cash equivalents	**2,150,361**	(12,040)
Cash and cash equivalents - beginning	**197,587**	45,297
Cash and cash equivalents - ending	**$ 2,347,948**	$ 33,257

See notes to condensed consolidated financial statements.

TAYLOR DEVICES, INC.

Notes to Condensed Consolidated Financial Statements

1. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of August 31, 2010 and May 31, 2010, the results of operations for the three months ended August 31, 2010 and August 31, 2009, and cash flows for the three months ended August 31, 2010 and August 31, 2009. These financial statements should be read in conjunction with the audited financial statements and notes thereto contained in the Company's Annual Report to Shareholders for the year ended May 31, 2010. There have been no updates or changes to our audited financial statements for the year ended May 31, 2010.

2. The Company has evaluated events and transactions for potential recognition or disclosure in the financial statements through October 13, 2010 (the date the financial statements were issued).

3. There is no provision nor shall there be any provisions for profit sharing, dividends, or any other benefits of any nature at any time for this fiscal year.

4. For the three month periods ended August 31, 2010 and August 31, 2009, the net income was divided by 3,230,965 and 3,222,327, respectively, which is net of the Treasury shares, to calculate the net income per share.

5. The results of operations for the three month period ended August 31, 2010 are not necessarily indicative of the results to be expected for the full year.

6. Effective September 1, 2009, the Company adopted the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") regarding Generally Accepted Accounting Principles ("GAAP"). The guidance establishes the FASB ASC as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP for SEC registrants. All guidance contained in the FASB ASC carries an equal level of authority. The FASB ASC supersedes all existing non-SEC accounting and reporting standards. The FASB now issues new standards in the form of Accounting Standards Updates ("ASUs"). The FASB will not consider ASUs as authoritative in their own right. ASUs will serve only to update the FASB ASC, provide background information about the guidance and provide the basis for conclusions on the changes in the FASB ASC. References made to FASB guidance have been updated for the FASB ASC throughout this document.

   Effective June 1, 2009, the Company adopted guidance issued by the FASB that requires disclosure about the fair value of financial instruments for interim financial statements of publicly traded companies. The adoption did not have an impact on our consolidated results of operations or financial condition.

   Effective June 1, 2008, the Company adopted the FASB ASC "Fair Value Measurements and Disclosures" guidance with respect to recurring financial assets and liabilities. Effective June 1, 2009, the Company adopted the FASB ASC "Fair Value Measurements and Disclosures" guidance as it relates to nonrecurring fair value measurement requirements for nonfinancial assets and liabilities. The ASC guidance defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosure about fair value measurements. The adoption of the standard had no impact on our consolidated financial results.

   Other recently issued ASC guidance has either been implemented or is not significant to the Company.

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

Cautionary Statement

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Information in this Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and elsewhere in this 10-Q that does not consist of historical facts, are "forward-looking statements." Statements accompanied or qualified by, or containing, words such as "may," "will," "should," "believes," "expects," "intends," "plans," "projects," "estimates," "predicts," "potential," "outlook," "forecast," "anticipates," "presume," and "assume" constitute forward-looking statements and, as such, are not a guarantee of future performance. The statements involve factors, risks and uncertainties, the impact or occurrence of which can cause actual results to differ materially from the expected results described in such statements. Risks and uncertainties can include, among others, uncertainty regarding how long the worldwide economic recession will continue and whether the recession will deepen; reductions in capital budgets by our customers and potential customers; changing product demand and industry capacity; increased competition and pricing pressures; advances in technology that can reduce the demand for the Company's products; and other factors, many or all of which are beyond the Company's control. Consequently, investors should not place undue reliance on forward-looking statements as predictive of future results. The Company disclaims any obligation to release publicly any updates or revisions to the forward-looking statements herein to reflect any change in the Company's expectations with regard thereto, or any changes in events, conditions or circumstances on which any such statement is based.

Results of Operations

A summary of the period to period changes in the principal items included in the condensed consolidated statements of income is shown below:

Summary comparison of the three months ended August 31, 2010 and August 31, 2009

		Increase / (Decrease)
Sales, net	$	(737,000)
Cost of goods sold	$	(146,000)
Selling, general and administrative expenses	$	(301,000)
Income before provision for income taxes	$	(257,000)
Provision for income taxes	$	(121,000)
Net income	$	(136,000)

Sales under certain fixed-price contracts, requiring substantial performance over several periods prior to commencement of deliveries, are accounted for under the percentage-of-completion method of accounting whereby revenues are recognized based on estimates of completion prepared on a ratio of cost to total estimated cost basis. Costs include all material and direct and indirect charges related to specific contracts.

Adjustments to cost estimates are made periodically and any losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. However, any profits expected on contracts in progress are recognized over the life of the contract.

For financial statement presentation purposes, the Company nets progress billings against the total costs incurred on uncompleted contracts. The asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. The liability, "billings in excess of costs and estimated earnings," represents billings in excess of revenues recognized.

For the three months ended August 31, 2010 (All figures discussed are for the three months ended August 31, 2010 as compared to the three months ended August 31, 2009.)

	Three months ended		Change	
	August 31, 2010	August 31, 2009	Increase / (Decrease)	Percent Change
Net Revenue	$ 4,277,000	$ 5,014,000	$ (737,000)	*-15%*
Cost of sales	3,136,000	3,282,000	(146,000)	*-4%*
Gross profit	$ 1,141,000	$ 1,732,000	$ (591,000)	*-34%*
...as a percentage of net revenues	*27%*	*35%*		

The Company's consolidated results of operations showed a 15% decrease in net revenues and a decrease in net income of 42%. Revenues recorded in the current period for long-term construction projects were 32% lower than the level recorded in the prior year. Revenues recorded in the current period for other-than long-term construction projects (non-projects) were higher by 17% from the level recorded in the prior year. The gross profit as a percentage of net revenues for the current and prior year periods was 27% and 35%. This fluctuation is attributable primarily to a.) three large export projects in the prior year period had higher than average margins, b.) one large project in the prior year with an aerospace / defense customer that had higher margin than average projects for construction customers, and c.) in the current period, there were more Projects sold directly to representatives in two different Asian countries, net of their normal commission. This resulted in lower sales, gross margins and commission expense.

Sales of the Company's products are made to three general groups of customers: industrial, construction and aerospace / defense. A breakdown of sales to the three general groups of customers is as follows:

	First Quarter Fiscal Year 2011	First Quarter Fiscal Year 2010
Industrial	7%	6%
Construction	49%	40%
Aerospace / Defense	44%	54%

At August 31, 2009, we had 110 open sales orders in our backlog with a total sales value of $11.3 million. At August 31, 2010, we have 11% fewer open sales orders in our backlog (98 orders) but the total sales value is $13.5 million or approximately 19% higher than the prior year.

The Company's revenues and net income fluctuate from period to period. The fluctuations in comparing the current period to the prior period are not necessarily representative of future results.

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Selling, General and Administrative Expenses

	Three months ended		Change	
	August 31, 2010	August 31, 2009	Increase / (Decrease)	Percent Change
Outside Commissions	$ 105,000	$ 276,000	$ (171,000)	*-62%*
Other SG&A	774,000	904,000	(130,000)	*-14%*
Total SG&A	$ 879,000	$1,180,000	$ (301,000)	*-26%*
...as a percentage of net revenues	*21%*	*24%*		

Selling, general and administrative expenses decreased by 26% from the prior year. Outside commission expense decreased by 62% from last year's level. This fluctuation was primarily due to a single, high value, non-project, commissionable sales order recorded in the prior year period as well as three Projects in an Asian country that included higher than average commissions in the prior year period. Additionally, of the 17 Projects in process during the quarter ended August 31, 2010, only three had related outside commissions recorded. This compares with 10 of 17 Projects having related outside commissions recorded in the prior year period. The primary reason for this is, in the current period, there were more Projects sold to representatives in two different Asian countries net of their normal commission. Other selling, general and administrative expenses decreased 14% from last year to this. This decrease is primarily due to a decrease in incentive compensation expense in the current period related to the lower level of operating results and lower level of aerospace sales.

The above factors resulted in operating income of $262,000 for the three months ended August 31, 2010, down 53% from the $552,000 in the same period of the prior year.

Stock Options

The Company has a stock option plan which provides for the granting of nonqualified or incentive stock options to officers, key employees and non-employee directors. Options granted under the plan are exercisable over a ten year term. Options not exercised at the end of the term expire.

The Company expenses stock options using the fair value recognition provisions of the ASC. The Company recognized $30,000 and $20,000 of compensation cost for the three month periods ended August 31, 2010 and August 31, 2009.

The fair value of each stock option grant has been determined using the Black-Scholes model. The model considers assumptions related to exercise price, expected volatility, risk-free interest rate, and the weighted average expected term of the stock option grants. Expected volatility assumptions used in the model were based on volatility of the Company's stock price for the thirty month period ending on the date of grant. The risk-free interest rate is derived from the U.S. treasury yield. The Company used a weighted average expected term. The following assumptions were used in the Black-Scholes model in estimating the fair market value of the Company's stock option grants:

	2010	2009
Risk-free interest rate:	2.75%	4.875%
Expected life of the options:	2.5 years	2.5 years
Expected share price volatility:	60.27%	57.57%
Expected dividends:	zero	zero

These assumptions resulted in:

Estimated fair-market value per stock option:	$2.00	$1.37

The ultimate value of the options will depend on the future price of the Company's common stock, which cannot be forecast with reasonable accuracy.

A summary of changes in the stock options outstanding during the three month period ended August 31, 2010 is presented below:

	Number of Options	Weighted-Average Exercise Price
Options outstanding and exercisable at May 31, 2010:	193,750	$ 5.11
Options granted:	15,250	$ 5.15
Options outstanding and exercisable at August 31, 2010:	209,000	$ 5.11
Closing value per share on NASDAQ at August 31, 2010:		$ 4.88

Capital Resources, Line of Credit and Long-Term Debt

The Company's primary liquidity is dependent upon the working capital needs. These are mainly inventory, accounts receivable, costs and estimated earnings in excess of billings, accounts payable, accrued commissions, billings in excess of costs and estimated earnings, and debt service. The Company's primary sources of liquidity have been operations and bank financing.

Capital expenditures for the three months ended August 31, 2010 were $53,000 compared to $79,000 in the same period of the prior year. As of August 31, 2010, the Company has no commitments for capital expenditures during the next twelve months.

Effective August 7, 2009, the Company replaced its bank credit facility with a $6,000,000 bank demand line of credit, with interest payable at the Company's option of 30, 60, 90 or 180 day LIBOR rate plus 2.5%, or the bank's prime rate less ..25%. There is an interest rate floor of 3.5%. The line is secured by accounts receivable, equipment, inventory, and general intangibles, and a negative pledge of the Company's real property. This line of credit is subject to the usual terms and conditions applied by the bank, is subject to renewal annually, and is not subject to an express requirement on the bank's part to lend. There is no balance outstanding as of August 31, 2010, or as of May 31, 2010. The outstanding balance on the line of credit fluctuates as the Company's various long-term projects progress. The Company is in compliance with restrictive covenants under the line of credit. In these covenants, the Company agrees to maintain the following minimum levels of the stated item:

Covenant	Minimum per Covenant	Current Actual	When Measured
Minimum level working capital	$3,000,000	$11,089,000	Quarterly
Minimum debt service coverage ratio	1.5:1	n/a	Fiscal Year-end

All of the $6,000,000 unused portion of our line of credit is available without violating any of our debt covenants.

Principal maturities of long-term debt for the remainder of the current fiscal year and the subsequent five years are as follows: 2011 - $4,000; 2012 - $5,000; and 2013 - $4,000.

Inventory and Maintenance Inventory

	August 31, 2010		May 31, 2010		Increase / (Decrease)	
Raw Materials	$ 551,000		$ 569,000		$ (18,000)	*-3%*
Work in process	5,290,000		5,247,000		43,000	*1%*
Finished goods	773,000		658,000		115,000	*17%*
Inventory	6,614,000	*91%*	6,474,000	*90%*	140,000	*2%*
Maintenance and other inventory	752,000	*9%*	719,000	*10%*	33,000	*5%*
Total	$7,366,000	*100%*	$7,193,000	*100%*	$ 173,000	*2%*
Inventory turnover	1.7		1.6			

NOTE: Inventory turnover is annualized for the three month period ended August 31, 2010.

Inventory, at $6,614,000 as of August 31, 2010, is $140,000 or two percent higher than the prior year-end level of $6,474,000. Of this, approximately 80% is work in process, 12% is finished goods, and 8% is raw materials.

Maintenance and other inventory represent stock that is estimated to have a product life cycle in excess of twelve months. This stock represents certain items the Company is required to maintain for service of products sold and items that are generally subject to spontaneous ordering. This inventory is particularly sensitive to technological obsolescence in the near term due to its use in industries characterized by the continuous introduction of new product lines, rapid technological advances and product obsolescence. The maintenance inventory increased slightly since May 31, 2010. Management of the Company has recorded an allowance for potential inventory obsolescence. The provision for potential inventory obsolescence was $45,000 for each of the three month periods ended August 31, 2010 and August 31, 2009. The Company continues to rework slow-moving inventory, where applicable, to convert it to product to be used on customer orders.

Accounts Receivable, Costs and Estimated Earnings in Excess of Billings ("CIEB"),
and Billings in Excess of Costs and Estimated Earnings ("BIEC")

	August 31, 2010	**May 31, 2010**	**Increase /(Decrease)**
Accounts receivable	$ 2,358,000	$ 5,033,000	$ (2,675,000)