

ARTS WAY MANUFACTURING CO INC
Form 10-Q
October 15, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended August 31, 2012
- or
- Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission File No. 0-5131

ART'S-WAY MANUFACTURING CO., INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

42-0920725
(I.R.S. Employer Identification No.)

5556 Highway 9
Armstrong, Iowa 50514
(Address of principal executive offices)

(712) 864-3131
(Registrant's telephone number, including area code)

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

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

Number of common shares outstanding as of October 12, 2012: 4,035,852

Art's-Way Manufacturing Co., Inc.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

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

| | (Unaudited) | |
|---|---------------------|----------------------|
| Assets | August 31, 2012 | November 30, 2011 |
| Current assets: | | |
| Cash | \$335,836 | \$118,924 |
| Accounts receivable-customers, net of allowance for doubtful accounts of \$61,832 and \$49,583 in 2012 and 2011, respectively | 6,231,666 | 2,030,369 |
| Inventories, net | 13,716,240 | 13,249,105 |
| Deferred taxes | 1,058,320 | 933,497 |
| Cost and Profit in Excess of Billings | - | 164,730 |
| Other current assets | 355,663 | 198,930 |
| Total current assets | 21,697,725 | 16,695,555 |
| Property, plant, and equipment, net | 9,554,435 | 8,085,719 |
| Assets held for lease, net | 368,844 | 452,441 |
| Assets held for sale, net | 183,200 | 186,362 |
| Covenant not to Compete, net | 15,000 | 60,000 |
| Goodwill and other Intangibles | 1,074,900 | 375,000 |
| Total assets | \$32,894,104 | \$25,855,077 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Line of credit | \$642,400 | \$1,388,965 |
| Current portion of term debt | 1,149,926 | 712,962 |
| Accounts payable | 709,881 | 341,738 |
| Customer deposits | 93,758 | 338,484 |
| Billings in Excess of Cost and Profit | 1,876,312 | 74,052 |
| Accrued expenses | 2,166,021 | 1,363,276 |
| Income taxes payable | 845,945 | 350,996 |
| Total current liabilities | 7,484,243 | 4,570,473 |
| Long-term liabilities | | |
| Deferred taxes | 901,771 | 810,904 |
| Long Term debt, excluding current portion | 7,589,442 | 5,743,159 |
| Total liabilities | 15,975,456 | 11,124,536 |
| Stockholders' equity: | | |
| Undesignated preferred stock - \$0.01 par value. Authorized 500,000 shares and 0 shares in 2012 and 2011; issued and outstanding 0 shares in 2012 and 2011. | - | - |
| Common stock – \$0.01 par value. Authorized 9,500,000 and 5,000,000 shares in 2012 and 2011; issued and outstanding 4,035,852 and 4,025,852 shares in 2012 and 2011 | 40,358 | 40,259 |
| Additional paid-in capital | 2,540,312 | 2,461,233 |
| Retained earnings | 14,337,978 | 12,229,049 |
| Total stockholders' equity | 16,918,648 | 14,730,541 |

| | | |
|--|--------------|--------------|
| Total liabilities and stockholders' equity | \$32,894,104 | \$25,855,077 |
|--|--------------|--------------|

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended | | Year-to-Date | |
|--|--------------------|--------------|---------------|---------------|
| | August 2012 | August 2011 | August 2012 | August 2011 |
| Net sales | \$ 11,533,882 | \$ 9,252,063 | \$ 29,531,268 | \$ 21,761,551 |
| Cost of goods sold | 8,109,820 | 6,544,644 | 21,473,360 | 16,622,309 |
| Gross profit | 3,424,062 | 2,707,419 | 8,057,908 | 5,139,242 |
| Expenses: | | | | |
| Engineering | 82,044 | 91,840 | 240,455 | 330,482 |
| Selling | 468,228 | 447,103 | 1,259,539 | 1,320,115 |
| General and administrative | 1,267,267 | 730,569 | 3,095,370 | 2,161,519 |
| Total expenses | 1,817,539 | 1,269,512 | 4,595,364 | 3,812,116 |
| Income (loss) from operations | 1,606,523 | 1,437,907 | 3,462,544 | 1,327,126 |
| Other income (expense): | | | | |
| Interest expense | (129,751) | (120,200) | (331,817) | (321,910) |
| Other | 18,403 | 46,523 | 58,005 | 77,821 |
| Total other income (loss) | (111,348) | (73,677) | (273,812) | (244,089) |
| Income (loss) before income taxes | 1,495,175 | 1,364,230 | 3,188,732 | 1,083,037 |
| Current tax expense (benefit) | 515,724 | 344,390 | 1,079,803 | 257,035 |
| Net income (loss) | \$ 979,451 | \$ 1,019,840 | \$ 2,108,929 | \$ 826,002 |
| Net income per share: | | | | |
| Basic net income (loss) per share | \$ 0.24 | \$ 0.25 | \$ 0.52 | \$ 0.21 |
| Diluted net income (loss) per share | \$ 0.24 | \$ 0.25 | \$ 0.52 | \$ 0.20 |
| Weighted average outstanding shares used to compute basic net income per share | 4,035,852 | 4,019,874 | 4,031,828 | 4,016,039 |
| Weighted average outstanding shares used to compute diluted net income per share | 4,052,246 | 4,042,135 | 4,049,236 | 4,049,706 |

See accompanying notes to condensed consolidated financial statements.

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

| | Nine Months Ended | |
|--|--------------------|--------------------|
| | August 31, 2012 | August 31, 2011 |
| Cash flows from operations: | | |
| Net income | \$2,108,929 | \$826,002 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Stock based compensation | 34,518 | 58,311 |
| Depreciation expense | 587,792 | 560,931 |
| Amortization expense | 45,000 | 45,000 |
| Deferred income taxes | (33,956) | 115,312 |
| Changes in assets and liabilities net of Universal Harvester acquisition: | | |
| (Increase) decrease in: | | |
| Accounts receivable | (4,201,297) | (851,843) |
| Inventories | 435,454 | 659,216 |
| Other current assets | (156,733) | (52,189) |
| Increase (decrease) in: | | |
| Accounts payable | 368,143 | (309,943) |
| Contracts in progress, net | 1,966,990 | 555,649 |
| Customer deposits | (244,726) | (155,121) |
| Income taxes payable | 494,949 | (539,276) |
| Accrued expenses | 802,745 | (60,532) |
| Net cash provided by operating activities | 2,207,808 | 851,518 |
| Cash flows from investing activities: | | |
| Purchases of property, plant, and equipment | (533,123) | (730,326) |
| Net change in asset held for lease | - | (229,095) |
| Purchase of assets of Universal Harvester | (3,003,565) | - |
| Net cash (used in) investing activities | (3,536,688) | (959,421) |
| Cash flows from financing activities: | | |
| Proceeds from line of credit borrowings | 13,576,400 | 10,035,387 |
| Repayment of line of credit borrowings | (14,322,965) | (9,644,000) |
| Payments of notes payable to bank | (746,565) | (453,443) |
| Proceeds from term debt | 2,880,000 | - |
| Repayment of term debt | (596,753) | - |
| Proceeds from the exercise of stock options | 9,110 | 66,749 |
| Net cash provided by financing activities | 1,545,792 | 396,080 |
| Net increase in cash | 216,912 | 288,177 |
| Cash at beginning of period | 118,924 | 317,103 |
| Cash at end of period | \$335,836 | \$605,280 |

Supplemental disclosures of cash flow information:**Cash paid during the period for:**

| | | |
|--------------|-----------|-----------|
| Interest | \$331,818 | \$321,921 |
| Income taxes | 443,926 | 665,203 |

Universal Harvester acquisition:

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| | | |
|--|-----------|-----|
| Inventories | \$902,589 | \$- |
| Equipment, tools and dies | 364,053 | - |
| Goodwill and intangible assets | 699,900 | - |
| Land and Building | 1,072,573 | - |
| Non-Cash Activity: Stock issued for purchase of assets | (35,550) | |
| Cash paid | 3,003,565 | - |

See accompanying notes to condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Description of the Company

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

We began operations as a farm equipment manufacturer in 1956. Since that time, we have become a major worldwide manufacturer of agricultural equipment. Our principal manufacturing plant is located in Armstrong, Iowa.

We have organized our business into three operating segments. Management separately evaluates the financial results of each segment because each is a strategic business unit offering different products and requiring different technology and marketing strategies. Our agricultural products segment (“Manufacturing”), manufactures farm equipment under the Art’s-Way Manufacturing label and private labels. Our pressurized vessels segment (“Art’s-Way Vessels”), manufactures pressurized vessels and our modular buildings segment (“Art’s-Way Scientific”), manufactures modular buildings for various uses, commonly animal containment and research laboratories. For detailed financial information relating to segment reporting, see Note 13, “Segment Information.”

On May 10, 2012, the Company acquired the assets of Universal Harvester Co., Inc. consisting of inventory, equipment, land, building, goodwill, and intangible assets. Universal Harvester Co., Inc. manufactured pickup reels for combines and swathers. The existing Universal Harvester Co., Inc. operational team was hired on May 11, 2012 to continue the manufacturing of pickup reels. The acquired assets and operations are reported with our agricultural products segment. For detailed financial information related to the acquisition, see Note 10, “Acquisitions.”

(2) Summary of Significant Account Policies

Statement Presentation

The foregoing condensed consolidated financial statements of the Company are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the interim periods. The financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the fiscal year ended November 30, 2011. The results of operations for the three and nine months ended August 31, 2012 are not necessarily indicative of the results for the fiscal year ending November 30, 2012.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses during the three and nine months ended August 31, 2012. Actual results could differ from those estimates.

(3) Net Income Per Share of Common Stock

Basic net income per common share has been computed on the basis of the weighted average number of common shares outstanding. Diluted net income per share has been computed on the basis of the weighted average number of common shares outstanding plus equivalent shares assuming exercise of stock options.

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Basic and diluted earnings per common share have been computed based on the following as of August 31, 2012 and August 31, 2011:

| | For the three months ended | |
|---|----------------------------|-----------------|
| | August 31, 2012 | August 31, 2011 |
| Basic: | | |
| Numerator: Net income | \$ 979,451 | \$ 1,019,840 |
| Denominator: Average number of common shares outstanding | 4,035,852 | 4,019,874 |
| Basic earnings per common share | 0.24 | 0.25 |
| Diluted: | | |
| Numerator: Net income | \$ 979,451 | \$ 1,019,840 |
| Average number of common shares outstanding | 4,035,852 | 4,019,874 |
| Effect of dilutive stock options | 16,394 | 22,261 |
| Denominator: Dilutive average number of common shares outstanding | 4,052,246 | 4,042,135 |
| Diluted earnings per common share | 0.24 | 0.25 |

| | For the nine months ended | |
|---|---------------------------|-----------------|
| | August 31, 2012 | August 31, 2011 |
| Basic: | | |
| Numerator: Net income | \$ 2,108,929 | \$ 826,002 |
| Denominator: Average number of common shares outstanding | 4,031,828 | 4,016,039 |
| Basic earnings per common share | 0.52 | 0.21 |
| Diluted: | | |
| Numerator: Net income | \$ 2,108,929 | \$ 826,002 |
| Average number of common shares outstanding | 4,031,828 | 4,016,039 |
| Effect of dilutive stock options | 17,408 | 33,667 |
| Denominator: Dilutive average number of common shares outstanding | 4,049,236 | 4,049,706 |
| Diluted earnings per common share | 0.52 | 0.20 |

(4) Inventory

Major classes of inventory are:

| | August 31, 2012 | November 30, 2011 |
|-----------------|-----------------|-------------------|
| Raw materials | \$ 8,473,311 | \$ 7,623,095 |
| Work in process | 753,043 | 394,158 |
| Finished goods | 7,332,153 | 7,982,192 |
| | \$ 16,558,507 | \$ 15,999,445 |
| Less: Reserves | (2,842,267) | (2,750,340) |

\$ 13,716,240 \$ 13,249,105

(5) Accrued Expenses

Major components of accrued expenses are:

| | August 31, 2012 | November 30, 2011 |
|----------------------------------|-----------------|----------------------|
| Salaries, wages, and commissions | \$ 1,188,983 | \$ 672,407 |
| Accrued warranty expense | 497,798 | 201,630 |
| Other | 479,240 | 489,239 |
| | \$ 2,166,021 | \$ 1,363,276 |

(6) Product Warranty

The Company offers warranties of various lengths to its customers depending on the specific product and terms of the customer purchase agreement. The average length of the warranty period is one year from the date of purchase. The Company's warranties require it to repair or replace defective products during the warranty period at no cost to the customer. The Company records a liability for estimated costs that may be incurred under its warranties. The costs are estimated based on historical experience and any specific warranty issues that have been identified. Although historical warranty costs have been within expectations, there can be no assurance that future warranty costs will not exceed historical amounts. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the balance as necessary. The accrued warranty balance is included in accrued expenses as shown in note 5.

Changes in the Company's product warranty liability for the three and nine months ended August 31, 2012 and August 31, 2011 are as follows:

| | For the three months ended | |
|-------------------------------------|----------------------------|--------------------|
| | August 31, 2012 | August 31, 2011 |
| Balance, beginning | \$277,965 | \$199,395 |
| Settlements made in cash or in-kind | (94,065) | (123,457) |
| Warranties issued | 313,898 | 174,845 |
| Balance, ending | \$497,798 | \$250,783 |

| | For the nine months ended | |
|-------------------------------------|---------------------------|-----------------|
| | August 31, 2012 | August 31, 2011 |
| Balance, beginning | \$ 201,630 | \$ 180,549 |
| Settlements made in cash or in-kind | (270,784) | (315,621) |
| Warranties issued | 566,952 | 385,855 |
| Balance, ending | \$ 497,798 | \$ 250,783 |

(7) Loan and Credit Agreements

The Company has a \$6,000,000 revolving line of credit with West Bank (the "Line of Credit") which is scheduled to mature on April 30, 2013. The Line of Credit is renewable annually with advances funding the Company's working capital and letter of credit needs. The interest rate is West Bank's prime interest rate, adjusted daily, with a minimum rate of 4.00%. As of August 31, 2012, the interest rate was the minimum of 4.0%. Monthly interest-only payments are required and the unpaid principal is due on the maturity date. As of August 31, 2012 and November 30, 2011, the

Company had borrowed approximately \$642,000 and \$1,389,000, respectively, against the Line of Credit. The available amounts remaining on the Line of Credit were \$5,358,000 and \$4,611,000 on August 31, 2012 and November 30, 2011, respectively. The borrowing base limits advances from the Line of Credit to 60% of accounts receivable less than 90 days, 60% of finished goods inventory, 50% of raw material inventory and work-in-process inventory, plus 40% of Net Book Value of Fixed Assets as calculated at each month-end. The Company's obligations under the Line of Credit are evidenced by a Business Loan Agreement effective April 26, 2012 (the "Business Loan Agreement"), a Promissory Note dated April 26, 2012 and certain other ancillary documents.

On June 7, 2007, the Company obtained a term loan from West Bank in the amount of \$4,100,000. On April 26, 2012, the Company refinanced the existing long-term debt in the amount of \$2,659,000. The loan, which had an outstanding principal balance of \$2,532,000 as of August 31, 2012, matures on April 1, 2017 and bears fixed interest at 4.750%. Monthly principal and interest payments in the amount of \$42,500 are required, with a final payment of principal and accrued interest in the amount of \$536,000 due on April 1, 2017.

The Company obtained two additional loans from West Bank in 2007 for the purpose of financing the construction of the Company's new facilities in Monona and Dubuque. On October 9, 2007, the Company obtained a loan for \$1,330,000. On April 26, 2012, the Company refinanced the existing long-term debt in the amount of \$1,074,000. The loan, which had an outstanding principal balance of \$1,048,000 as of August 31, 2012, matures on April 1, 2017 and bears interest at a fixed interest rate of 4.750%. Monthly payments of \$11,000 are required for principal and interest, with a final payment of accrued interest and principal in the amount of \$628,000 due on April 1, 2017.

On November 30, 2007, the Company obtained a \$1,500,000 construction loan to finance construction of the Dubuque, Iowa facility. On April 26, 2012, the Company refinanced the existing long-term debt in the amount of \$1,221,000. The loan, which had an outstanding principal balance of \$1,191,000 as of August 31, 2012, matures on April 1, 2017 and bears interest at a fixed interest rate of 4.750%. Payments of \$12,550 are due monthly for principal and interest, with a final accrued interest and principal payment in the amount of \$711,000 due on April 1, 2017.

On May 1, 2012, the Company obtained \$2,000,000 in new long-term debt from West Bank to acquire the inventory, equipment, land, building, goodwill and intangible assets of Universal Harvester Co., Inc. located in Ames, Iowa. This loan had an original principal amount of \$2,000,000 and bears fixed interest at 4.50%. The payments required on this loan began June 1, 2012 and will continue until May 1, 2017. The terms of the loan require monthly payments of \$27,800 for principal and interest, with a final payment of principal and accrued interest in the amount of \$666,000 due May 1, 2017. As of August 31, 2012, the outstanding principal balance on this loan was \$1,937,000.

Each of the Company's loans from West Bank is governed by the Business Loan Agreement, which requires the Company to comply with certain financial and reporting covenants. The Company must provide monthly internally prepared financial reports, year-end audited financial statements, annual compliance certificates, and notice upon certain events, such as a change in executive or management personnel. The Company must maintain a minimum debt service coverage ratio of 1.5, a maximum debt to tangible net worth ratio of 1.25, and a minimum tangible net worth of \$12,000,000, each as measured at the Company's fiscal year-end. Further, the Company must obtain West Bank's prior written consent for any investment in, acquisition of, or guaranty relating to another business or entity. The loans are secured by a first position security interest on the assets of the Company and its subsidiaries, including but not limited to, inventories, accounts receivable, machinery, equipment and real estate, in accordance with the Business Loan Agreement, Real Estate Mortgages, Commercial Security Agreements, and Commercial Guaranties previously executed by the Company's subsidiaries. The Company and its subsidiaries were also required to execute Agreements to Provide Insurance that set forth the insurance requirements for the collateral.

If the Company or either of its subsidiaries (as guarantors) commits an event of default under the Business Loan Agreement and fails or is unable to cure that default, the interest rate on the Line of Credit would increase by 2.0%. In addition, West Bank may cease advances under the Line of Credit and has the option of causing all outstanding indebtedness to become immediately due and payable. Events of default include, without limitation: (i) becoming insolvent or subject to bankruptcy proceedings; (ii) defaulting on any obligations to West Bank; (iii) defaulting on any obligations to third parties that would materially affect the ability to perform obligations owed to West Bank; (iv) suffering a material adverse change in financial condition or the value of any collateral; (v) experiencing a change in ownership of twenty-five percent or more of outstanding common stock; and (vi) making false statements to West Bank.

The Company was in compliance with all covenants under the Business Loan Agreement as measured on November 30, 2011 and the Company remains in compliance with the terms of the Business Loan Agreement as of August 31, 2012. The next measurement date is November 30, 2012.

On June 1, 2009, Art's-Way Scientific received funds from two \$95,000 promissory notes in connection with an agreement signed August 7, 2007 between Art's-Way Scientific and the Iowa Department of Economic Development. The first \$95,000 promissory note was a 0% interest loan requiring 60 monthly payments of \$1,583, and an original maturity date of July 1, 2014. The second \$95,000 promissory note was a forgivable loan subject to certain contract obligations. The obligations included maintaining Art's-Way Scientific's principal place of business in Iowa, complying with certain tax and insurance requirements, and creating 16 full-time positions and retaining 21 full-time positions in Iowa for a two-year period. During the fiscal year ended November 30, 2011, the Iowa Department of Economic Development was required to audit the job attainment of Art's Way Scientific. Art's Way Scientific had obtained approximately 48% of the job retention and creation requirements and was required, during the fourth quarter of the fiscal year ending November 30, 2011, to restructure the original two promissory notes into three separate notes. The first note is now a 6% interest-bearing note requiring a monthly payment of \$2,437 that had a balance of \$48,000 as of August 31, 2012 and has a maturity date of June 1, 2014. The second note is an interest-free note requiring a monthly payment of \$813 which had a balance of \$17,000 as of August 31, 2012, with a final payment due June 1, 2014. The third note is a forgivable loan subject to contract obligations which were measured during April 2012. As of August 31, 2012, we were in compliance with all contract obligations. The forgivable loan had a balance of \$49,000 as of August 31, 2012. Art's-Way Manufacturing Co., Inc. has provided a guarantee in connection with these loans to Art's-Way Scientific.

On May 1, 2010, the Company obtained a loan to finance the purchase of an additional facility located in West Union, Iowa to be used as a distribution center, warehouse facility, and manufacturing plant for certain products under the Art's-Way brand. The funds for this loan were made available by the Iowa Finance Authority by the issuance of tax exempt bonds. This loan had an original principal amount of \$1,300,000 and bears fixed interest at 3.5%. The payments required on this loan began July 1, 2010 and will continue until June 1, 2020. The terms of the loan require monthly payments of \$12,900 for principal and interest. As of August 31, 2012, the outstanding principal balance on this loan was \$1,057,000.

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

If the Company fails to make a required payment or perform any other covenant under the IFA Loan Agreement or the West Union Mortgage, becomes subject to bankruptcy or insolvency proceedings, defaults in payment on any of our other loan obligations in excess of \$100,000, or if there is a determination that any of the Company's representations made in the IFA Loan Agreement or related documents are materially false, the Company will be deemed to have committed an event of default under the IFA Loan Agreement. If the Company does not cure the event of default within the time specified by the IFA Loan Agreement, the lender may cause the entire amount of the loan to be immediately due and payable and take any other action that it is lawfully permitted to take or in equity to enforce the Company's performance.

The Company was in compliance with all covenants under the IFA Loan Agreement as measured on November 30, 2011 and the Company remains in compliance with the terms of the IFA Loan Agreement as of August 31, 2012. The next measurement date is November 30, 2012.

On September 15, 2010, the company obtained a zero-interest loan from the West Union Community Development Corporation in the amount of \$13,000. Annual principal payments of \$4,333.33 are due September 1 of 2011, 2012, and 2013. On August 31, 2012, the outstanding principal balance on this loan was \$9,000.

On May 10, 2012, the Company obtained \$880,000 in new long-term debt from U.S. Bank issued to acquire the building and property of Universal Harvester Co., Inc. located in Ames, Iowa (the "U.S. Bank Loan"). The U.S. Bank Loan had an original principal amount of \$880,000 and bears fixed interest at 3.150%. The payments required on this loan began on June 10, 2012 in the amount of \$11,700 and continue on the same date of each consecutive month thereafter, until the maturity date May 10, 2017, with a final payment of principal and accrued interest in the amount of \$283,500 due May 10, 2017. As of August 31, 2012, the outstanding principal balance on this loan was \$852,000. This loan is secured by a mortgage on the building and property acquired from Universal Harvester Co., Inc. in Ames, Iowa, pursuant to a Mortgage, Security Agreement and Assignment of Rents between the Company and U.S. Bank, dated May 10, 2012.

If the Company fails to make a required payment or perform or observe any agreement or covenant under the U.S. Bank Loan, commits and fails to cure a default under the terms of any of our other loan obligations in excess of \$10,000, becomes subject to bankruptcy, insolvency proceedings, or a judgment in an amount exceeding \$10,000, if there is a determination that any of the representations made in the U.S. Bank Loan or ancillary documents are untrue or materially misleading or if there is a material adverse change in our business, we will be deemed to be in default under the U.S. Bank Loan. If we do not cure the default within the applicable cure period, the lender may cause the entire amount of the loan to be immediately due and payable or may increase the interest rate to a rate of 5.00% per annum, plus the interest rate otherwise payable under the U.S. Bank Loan.

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

| | August 31, 2012 | November 30, 2011 |
|--|-----------------|----------------------|
| West Bank loan payable in monthly installments of \$42,500 including interest at 4.750%, due May 1, 2017 | \$ 2,532,493 | \$ 2,804,403 |
| West Bank loan payable in monthly installments of \$11,000 including interest at 4.750%, due May 1, 2017 | 1,047,691 | 1,102,321 |
| West Bank loan payable in monthly installments of \$12,550 including interest at 4.750%, due May 1, 2017 | 1,191,007 | 1,253,507 |
| West Bank loan payable in monthly installments of \$27,800 including interest at 4.50%, due May 1, 2017 | 1,936,663 | 0.00 |
| U.S. Bank loan payable in monthly installments of \$11,700 including interest at 3.15%, due May 10, 2017 | 851,897 | 0.00 |
| | 1,056,544 | 1,143,140 |

| | | |
|---|--------------|--------------|
| Iowa Finance Authority loan payable in monthly installments of \$12,892 including interest at 3.5%, due June 1, 2020 | | |
| IDED loan payable in monthly installments of \$2,437 including interest at 6%, due June 1, 2014 | 48,485 | 70,024 |
| IDED loan payable in monthly installments of \$813 including interest at 0%, due June 1, 2014 | 17,091 | 25,229 |
| IDED loan payable in monthly installments of \$0 including interest at 0%, due July 1, 2014 | 48,830 | 48,830 |
| West Union Community Development Corporation loan payable in annual installments of \$4,333 including interest at 0%, due September 1, 2013 | 8,667 | 8,667 |
| Total term debt | \$ 8,739,368 | \$ 6,456,121 |
| Less current portion of term debt | 1,149,926 | 712,962 |
| Term debt, excluding current portion | \$ 7,589,442 | \$ 5,743,159 |

(8) Recently Issued Accounting Pronouncements

Fair Value Measurement Update

In May 2011, the FASB issued ASU No. 2011-04, "Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs" that amends the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and disclosing information about fair value measurements. The amendments in this update achieve the objective of developing common fair value measurement and disclosure requirements, as well as improving consistency and understandability. Some of the requirements clarify the FASB's intent about the application of existing fair value measurement requirements while other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. The amendments in this ASU are effective prospectively for interim and annual periods beginning after December 15, 2011, with no early adoption permitted. The Company has not completed the adoption of this standard and the Company does not expect this standard to have a material impact on our consolidated financial statements.

Comprehensive Income

In June 2011, the FASB issued ASU NO. 2011-05, "Presentation of Comprehensive Income" that improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statements of changes in stockholders' equity. The amendments in this standard require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from other comprehensive income ("OCI") to net income, in both net income and OCI. The standard does not change the current option for presenting components of OCI gross or net of the effect of income taxes, provided that such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, the standard does not affect the calculation or reporting of earnings per share. For public entities, the amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively, with early adoption permitted. The Company has not completed the adoption of this standard and the Company does not expect this standard to have a material impact on our consolidated financial statements.

In December 2011, the FASB issued ASU (Accounting Standards Update) No. 2011-12 which stated that the new presentation requirements about reclassifications of items out of accumulated other comprehensive income would be difficult for preparers and may add unnecessary complexity to financial statements. In addition it is difficult for some stakeholders to change systems in time to gather the information for the new presentation requirements by the effective date of Update 2011-05. Given these issues, they asked the Board to reconsider whether it is necessary to require entities to present reclassification adjustments by component in both the statement where net income is presented and the statement where other comprehensive income is presented for both interim and annual financial statements. Because those pending paragraphs are effective on a retrospective basis for public entities for annual periods beginning after December 15, 2011, and interim periods within those years, those stakeholders asked the Board, at a minimum, to defer the effective date pertaining to reclassification adjustments out of accumulated other comprehensive income in Accounting Standards Update 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income, until the Board is able to reconsider those paragraphs.

In order to defer only those changes in Update 2011-05 that relate to the presentation of reclassification adjustments, the paragraphs in this Update supersede certain pending paragraphs in Update 2011-05. The amendments are being made to allow the Board time to confirm whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the Board is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before Update 2011-05. All other requirements in Update 2011-05 are not affected by this Update, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. Public entities must apply these requirements for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company has not completed the adoption of this standard and the Company does not expect this standard to have a material impact on our consolidated financial statements.

(9) Equity Incentive Plan and Stock Based Compensation

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

The 2011 Plan permits the plan administrator to award nonqualified stock options, incentive stock options, restricted stock awards, restricted stock units, performance awards, and stock appreciation rights to employees (including officers), directors, and consultants. The Board of Directors has approved a director compensation policy pursuant to which non-employee directors are automatically granted non-qualified stock options to purchase 2,000 shares of common stock annually or initially upon their election to the Board, which are fully vested.

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

Stock-based compensation expense reflects the fair value of stock-based awards measured at the grant date and recognized over the relevant vesting period. We estimate the fair value of each stock-based award on the measurement date using the Black-Scholes option valuation model which incorporates assumptions as to stock price volatility, the expected life of the options, risk-free interest rate, and dividend yield. Expected volatility is based on historical volatility of the Company's stock and other factors. The Company uses historical option exercise and termination data to estimate the expected term the options are expected to be outstanding. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected dividend yield is calculated using historical dividend amounts and the stock price at the option issuance date.

(10) Acquisitions

On May 10, 2012, the Company acquired the assets of Universal Harvester Co., Inc. consisting of inventory, equipment, land, building, goodwill, and intangible assets. The acquisition-date fair value of the total consideration transferred was approximately \$3,066,000 consisting of \$3,030,450 of current and future cash to be paid and \$35,550 of common stock. Under the terms of the purchase agreement, cash in the amount \$3,003,565 was paid on May 11, 2012 and \$27,427 of cash will be paid on real estate taxes accrued but due on the land and building in future periods. The Company issued 5,000 shares of common stock valued at \$35,550 based on the closing market price as of May 10, 2012. The Company has paid \$15,978 of the accrued real estate taxes during the third quarter of 2012.

The operating results of the acquired business are reflected in the Company's consolidated statement of operations from the acquisition date forward. The acquisition was made to continue the Company's growth strategy and diversify its product offerings inside the agricultural industry. The purchase price was determined based on an arms-length negotiated value. The transaction is being accounted for under the acquisition method of accounting, with the purchase price allocated to the individual assets acquired. The purchase price allocation is preliminary and is subject to change once a final valuation is complete.

The consideration has been allocated as follows:

| | |
|--------------------------------|-------------|
| Inventories | \$902,589 |
| Equipment, tools and dies | 364,053 |
| Goodwill and intangible assets | 699,900 |
| Land and Building | 1,100,000 |
| Total | \$3,066,542 |

The unaudited pro forma information for the periods set forth below gives effect to the acquisition as if it had occurred at the beginning of fiscal year starting December 1, 2011. The pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time or that may result in the future:

| | Three Months Ended August 31, 2012 | Three Months Ended August 31, 2011 | Nine Months Ended August 31, 2012 | Nine Months Ended August 31, 2011 |
|---|--|--|---|---|
| Net Sales from continuing operations: | | | | |
| As Reported | \$ 11,533,882 | \$ 9,252,063 | \$ 29,531,268 | \$ 21,761,551 |
| Pro Forma | \$ 11,533,882 | \$ 10,496,635 | \$ 31,785,360 | \$ 25,043,715 |
| Net Income from continuing: | | | | |
| As Reported | \$ 979,451 | \$ 1,019,840 | \$ 2,108,929 | \$ 826,002 |
| Pro Forma | \$ 979,451 | \$ 1,075,354 | \$ 2,623,389 | \$ 960,796 |
| Basic net income per share from continuing operations: | | | | |
| As Reported | \$ 0.24 | \$ 0.25 | \$ 0.52 | \$ 0.21 |
| Pro Forma | \$ 0.24 | \$ 0.27 | \$ 0.65 | \$ 0.24 |
| Diluted net income per share from continuing operations: | | | | |
| As Reported | \$ 0.24 | \$ 0.25 | \$ 0.52 | \$ 0.20 |
| Pro Forma | \$ 0.24 | \$ 0.27 | \$ 0.65 | \$ 0.22 |
| Weighted average number of shares outstanding: | | | | |
| Basic | 4,035,852 | 4,019,874 | 4,031,828 | 4,016,039 |
| Diluted | 4,052,246 | 4,042,135 | 4,049,236 | 4,049,706 |

(11) Disclosures About the Fair Value of Financial Instruments

The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged in a current transaction between willing parties. At August 31, 2012, and November 30, 2011, the carrying amount approximated fair value for cash, accounts receivable, accounts payable, notes payable to bank, and other current and long-term liabilities. The carrying amounts approximate fair value because of the short maturity of these instruments. The fair value of the Company's installment term loans payable also approximate recorded value because the interest rates charged under the loan terms are not substantially different than current interest rates.

(12) Related Party Transactions

The financial statements of the Company include purchases by our Manufacturing division from Bauer Corporation for a total of \$1,700 and \$1,400 during the nine-months ended August 31, 2012 and 2011, respectively. The terms of this purchase were consistent with those of an arm's length transaction. Bauer Corporation is wholly-owned and operated by J. Ward McConnell Jr., the Chairman of the Board of Directors.

The financial statements of the Company include a sale by our Vessels division to Adamson Global Technology in the amount of \$17,000 during the nine-months ended August 31, 2011. The terms of this sale were consistent with those of an arm's length transaction. Adamson Global Technology is wholly-owned and operated by J. Ward McConnell, Jr., the Chairman of the Board of Directors.

(13) Segment Information

There are three reportable segments: agricultural products, pressurized vessels and modular buildings. The agricultural products segment fabricates and sells farming products as well as replacement parts for these products in the United States and worldwide. The pressurized vessels segment produces pressurized tanks. The modular buildings segment manufactures and installs modular buildings for animal containment and various laboratory uses.

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

Approximate financial information with respect to the reportable segments is as follows.

| | Three Months Ended August 31, 2012 | | | |
|---------------------------------|------------------------------------|---------------------|-------------------|--------------|
| | Agricultural Products | Pressurized Vessels | Modular Buildings | Consolidated |
| Revenue from external customers | \$8,176,000 | \$566,000 | \$2,792,000 | \$11,534,000 |
| Income (loss) from operations | 1,027,000 | 10,000 | 570,000 | 1,607,000 |
| Income (loss) before tax | 988,000 | (47,000) | 554,000 | 1,495,000 |
| Total Assets | 24,082,000 | 2,722,000 | 6,090,000 | 32,894,000 |
| Capital expenditures | 289,000 | 0 | 5,000 | 294,000 |
| Depreciation & Amortization | 137,000 | 29,000 | 52,000 | 218,000 |

| | Three Months Ended August 31, 2011 | | | |
|---------------------------------|------------------------------------|---------------------|-------------------|--------------|
| | Agricultural Products | Pressurized Vessels | Modular Buildings | Consolidated |
| Revenue from external customers | \$7,771,000 | \$403,000 | \$1,078,000 | \$9,252,000 |
| Income (loss) from operations | 1,358,000 | (11,000) | 91,000 | 1,438,000 |
| Income (loss) before tax | 1,351,000 | (65,000) | 78,000 | 1,364,000 |
| Total Assets | 20,527,000 | 2,843,000 | 3,658,000 | 27,028,000 |
| Capital expenditures | 207,000 | 2,000 | 87,000 | 296,000 |
| Depreciation & Amortization | 123,000 | 26,000 | 54,000 | 203,000 |

| | Nine Months Ended August 31, 2012 | | | |
|---------------------------------|-----------------------------------|-------------|-------------|--------------|
| | Agricultural | | Pressurized | Modular |
| | Products | Vessels | Buildings | Consolidated |
| Revenue from external customers | \$20,170,000 | \$1,512,000 | \$7,849,000 | \$29,531,000 |
| Income (loss) from operations | 2,202,000 | (108,000) | 1,369,000 | 3,463,000 |
| Income (loss) before tax | 2,149,000 | (278,000) | 1,318,000 | 3,189,000 |
| Total Assets | 24,082,000 | 2,722,000 | 6,090,000 | 32,894,000 |
| Capital expenditures | 1,929,000 | 5,000 | 27,000 | 1,961,000 |
| Depreciation & Amortization | 390,000 | 86,000 | 158,000 | 634,000 |

| | Nine Months Ended August 31, 2011 | | | |
|---------------------------------|-----------------------------------|-------------|-------------|--------------|
| | Agricultural Pressurized | | Modular | Consolidated |
| | Products | Vessels | Buildings | |
| Revenue from external customers | \$18,091,000 | \$1,368,000 | \$2,302,000 | \$21,761,000 |
| Income (loss) from operations | 1,830,000 | (332,000) | (171,000) | 1,327,000 |
| Income (loss) before tax | 1,804,000 | (500,000) | (221,000) | 1,083,000 |
| Total Assets | 20,527,000 | 2,843,000 | 3,658,000 | 27,028,000 |
| Capital expenditures | 473,000 | 89,000 | 397,000 | 959,000 |
| Depreciation & Amortization | 375,000 | 78,000 | 152,000 | 605,000 |

(14) Subsequent Event

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

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

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of Part I of this report and the audited consolidated financial statements and related notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended November 30, 2011. Some of the statements in this report may contain forward-looking statements that reflect our current view on future events, future business, industry and other conditions, our future performance, and our plans and expectations for future operations and actions. In some cases you can identify forward-looking statements by the use of words such as "may," "should," "anticipate," "believe," "expect," "plan," "future," "intend," "could," "estimate," "predict," "hope," "potential," "continue," these terms or other similar expressions. Many of these forward-looking statements are located in this report under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" but they may appear in other sections as well. Forward-looking statements in this report generally relate to: (i) expected total revenue from the January and April 2012 contracts procured by Scientific; (ii) our order backlog; (iii) our beliefs regarding the sufficiency of working capital and our continued ability to renew or obtain financing on reasonable terms when necessary; (iv) expected future expenses and operating results; (v) growth strategy and expected benefits from acquisitions, and (vi) our ability to capture additional sales and retain repeat customers in Vessels.

You should read this report thoroughly with the understanding that our actual results may differ materially from those set forth in the forward-looking statements for many reasons, including events beyond our control and assumptions that prove to be inaccurate or unfounded. We cannot provide any assurance with respect to our future performance or results. Our actual results or actions could and likely will differ materially from those anticipated in the forward-looking statements for many reasons, including but not limited to: (i) the impact of tightening credit markets on our ability to continue to obtain financing on reasonable terms; (ii) our ability to continue to meet debt obligations and comply with financial covenants; (iii) obstacles related to integration of Universal Harvester Co., Inc.; (iv) the effect of general economic conditions on the demand for our products and the cost of our supplies and materials; (v) unforeseen costs or delays in implementing production of new products; (vi) unexpected effects from changes to our production schedule; (vii) an inability to retain new customers for our modular buildings and pressurized vessels; (viii) unforeseen delays in production or installation of modular buildings pursuant to the January and April 2012 contracts procured by Scientific, or breaches by counter parties; and (ix) other factors described from time to time in our reports to the SEC. We do not intend to update the forward-looking statements contained in this report other than

as required by law. We caution you not to put undue reliance on any forward-looking statements, which speak only as of the date of this report. You should read this report and the documents that we reference in this report and have filed as exhibits completely and with the understanding that our actual future results may be materially different from what we currently expect. We qualify all of our forward-looking statements by these cautionary statements.

Critical Accounting Policies

Our critical accounting policies involving the more significant judgments and assumptions used in the preparation of the financial statements as of August 31, 2012 have remained unchanged from November 30, 2011. These policies include revenue recognition, inventory valuation, income taxes and stock-based compensation. Disclosure of these critical accounting policies is incorporated by reference from Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended November 30, 2011.

Results of Operations

Net Sales and Cost of Sales

On May 10, 2012, we acquired the assets of Universal Harvester Co., Inc. ("UHC") consisting of inventory, equipment, land, building, goodwill and intangible assets. UHC manufactured pickup reels for combines and swathers. We hired the existing UHC operational team on May 11, 2012 to continue the manufacturing of pickup reels. The acquired assets and operations are included in our agricultural products segment. We believe that the acquisition will be accretive to earnings for the fiscal year ending November 30, 2012.

Our consolidated corporate sales for the three- and nine-month periods ended August 31, 2012 were \$11,534,000 and \$29,531,000, respectively, compared to \$9,252,000 and \$21,762,000 during the same respective periods in 2011, a \$2,282,000, or 24.7%, increase for the quarter and a \$7,769,000, or 35.7% increase, year-to-date. The agricultural products segment ("Manufacturing") had three- and nine-month sales increases of \$405,000 and \$2,079,000, respectively. The modular buildings segment ("Scientific") had three- and nine-month sales increases of \$1,714,000 and \$5,547,000, respectively. The pressurized vessels segment ("Vessels") had a three-month sales increase of \$163,000 and a nine-month sales increase of \$144,000.

Consolidated gross profit margin for the third fiscal quarter of 2012 was 29.7% compared to 29.3% during the third fiscal quarter of 2011. Year-to-date gross margin was 27.3% in fiscal year 2012, compared to 23.6% in fiscal year 2011.

Our third fiscal quarter sales at Manufacturing were \$8,176,000, compared to \$7,771,000 during the same period of 2011, an increase of \$405,000, or 5.2%. Year-to-date sales were up to \$20,170,000, from \$18,091,000 as of August 31, 2011, an increase of \$2,079,000, or 11.5%. The year over year increase in revenue was primarily due to the additional sales of 2,011,000 attributable to the recent acquisition of UHC. Gross margin for the quarter ended August 31, 2012 was 28.1%, compared to 30.7% for the same period in 2011. The year-to-date gross margin was 28.8%, compared to 26.9% as of August 31, 2011.

Our third fiscal quarter sales at Vessels were \$566,000, compared to \$403,000 for the same period in 2011, an increase of \$163,000, or 40.4%. Year-to-date sales were \$1,512,000, compared to \$1,368,000 for the nine-month period ending August 31, 2011, an increase of \$144,000, or 10.5%. We have been working diligently to improve the consistency of our quality of goods and delivery of product. These improvements have helped us to capture additional sales as well as retain repeat customers. Gross margin for the quarter ended August 31, 2012 was 14.4% compared to 16.7% for the same period in 2011. Year-to-date gross margin was 5.9% compared to (6.0%) as of August 31, 2011. The production manager hired during Q1 of 2011 has improved our ability to track cost and revenue on a per-job basis.

Our third fiscal quarter sales at Scientific were \$2,792,000, compared to \$1,078,000 for the same period in fiscal 2011, an increase of \$1,714,000, or 159.0%. The increase was primarily attributable to revenue from an approximately \$7 million fabrication and delivery contract executed in January 2012 and an approximately \$1.7 million installation contract executed in April 2012. Scientific was hired to design, fabricate, and install twenty-four modular units over the course of approximately one year for one of the world's leading research and teaching institutions. Scientific uses percent complete accounting to calculate revenue and gross margins for all contracts. Gross margin for the quarter ended August 31, 2012 was 37.4% compared to 23.9% for the same period in 2011. Year-to-date gross margin was 27.6% compared to 15.6% as of August 31, 2011. The gross margin increase was primarily due to the \$7 million contract.

Expenses

Our third fiscal quarter consolidated selling expenses were \$468,000 compared to \$447,000 for the same period in 2011. Year-to-date selling expenses were \$1,260,000 in 2012 compared to \$1,320,000 for the same period in 2011. The third fiscal quarter increase was primarily due to increases in commissions related to our Manufacturing segment. Revenue increases were in product lines that were subject to commissions. Selling expenses as a percentage of sales were 4.1% and 4.8% for the three- and nine-month periods ended August 31, 2012, compared to 4.3% and 6.1% for the same respective periods in 2011.

Consolidated engineering expenses were \$82,000 for the three months ended August 31, 2012, compared to \$92,000 for the same period in 2011. Year-to-date engineering expenses were \$240,000 for fiscal 2012 compared to \$330,000 in fiscal 2011. These decreases were primarily due to the reduction of engineering staff at the Armstrong, Iowa facility. Engineering expenses as a percentage of sales were 0.7% and 0.8% for the three- and nine-month periods ended August 31, 2012, compared to 1.0% and 1.5% for the same respective periods in 2011. We have been actively working on filling open positions in our engineering department, and we filled two positions during the third fiscal quarter of 2012.

Consolidated administrative expenses for the three months ended August 31, 2012 were \$1,267,000 compared to \$731,000 for the same period in 2011. Year-to-date administrative expenses were \$3,095,000 compared to \$2,162,000 in 2011. The increase is mainly due to management bonus expense accruals, which are tied to key performance measures. Administrative expenses as a percentage of sales were 11.0% and 10.5% for the three- and nine-month periods ending August 31, 2012, compared to 7.9% and 9.9% for the same respective periods in 2011.

Net Income

Consolidated net income was \$979,000 and \$2,109,000 for the three- and nine-months ended August 31, 2012, compared to \$1,020,000 and \$826,000 for the same respective periods in 2011. The changes to net income for the nine-months were primarily attributable to an increase in consolidated sales and improved gross profit in our Manufacturing and Scientific divisions.

Order Backlog

The consolidated order backlog net of discounts as of August 31, 2012 was \$4,717,525 compared to \$2,647,698 as of August 31, 2011 mainly due to increased orders from our modular buildings segment. The agriculture products segment order backlog was \$1,489,797 as of August 31, 2012, compared to \$1,693,014 in fiscal 2011. The backlog for the pressurized vessels segment was \$441,789 as of August 31, 2012, compared to \$380,864 in fiscal 2011. The backlog for the modular buildings segment was \$2,786,539 as of August 31, 2012, compared to \$574,030 in fiscal 2011. Our order backlog is not necessarily indicative of future revenue to be generated from such orders due to the possibility of order cancellations and dealer discount arrangements we may enter into from time to time.

Liquidity and Capital Resources

Our primary sources of funds for the nine months ended August 31, 2012 were income from operations, borrowings on our line of credit, and proceeds from term debt. Those funds were primarily used to pay down our line of credit, finance working capital needs, and acquire the assets of Universal Harvester Co., Inc. We have a \$6,000,000 revolving Line of Credit with West Bank, pursuant to which we had borrowed \$642,000 and \$1,389,000 as of August 31, 2012 and November 30, 2011, respectively. The Line of Credit is renewable annually and is scheduled to mature on April 30, 2013. In addition, we have four term loans from West Bank, which had outstanding principal balances of approximately \$2,532,000, \$1,048,000, \$1,191,000, and \$1,937,000 as of August 31, 2012, respectively. We have one term loan from U.S. Bank, which had an outstanding principal balance of approximately \$852,000 as of August 31, 2012. We have also received funds pursuant to three promissory notes from the Iowa Department of Economic Development. These notes had outstanding principal balances of approximately \$48,000, \$18,000, and \$49,000 as of August 31, 2012, respectively. In May 2010, the Iowa Finance Authority extended us a loan to finance the purchase of a facility. As of August 31, 2012, the outstanding principal balance on this loan was approximately \$1,057,000. In September 2010, we obtained an interest-free \$13,000 loan from the West Union Community Development Corporation, which requires annual principal payments of \$4,333 on September 1 of 2011, 2012, and 2013. On August 31, 2012, the outstanding principal balance on this loan was approximately \$9,000.

Our loans require us to comply with various covenants, including maintaining certain financial ratios. We were in compliance with all financial ratio covenants as of November 30, 2011, our last measurement date.

For additional information about our financing activities, please refer to note 8 to the audited consolidated financial statements and the discussion entitled "Liquidity and Capital Resources," each contained in our Annual Report on Form 10-K for the fiscal year ended November 30, 2011, as well as note 7 to the unaudited condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report.

We believe that our current financing arrangements provide sufficient cash to finance operations for the next twelve months. We expect to continue to rely on cash from financing activities to supplement our cash flows from operations in order to meet our liquidity and capital expenditure needs in the near future. We expect to continue to be able to procure financing upon reasonable terms.

Off Balance Sheet Arrangements

None.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

Changes to Internal Control over Financial Reporting

Effective September 5, 2012, Jason D. Feucht resigned as Chief Financial Officer of the Company and Carrie L. Majeski, the Company's President and Chief Executive Officer, was appointed as interim Chief Financial Officer. Although having a separate Chief Financial Officer enhances internal controls over financing reporting, we have hired a separate Director of Finance and do not believe that having a combined Chief Executive Officer and interim Chief Financial Officer has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

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

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information.

None.

Item 6. Exhibits.

See "Exhibit Index" on page 20 of this report.

SIGNATURES

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

ART'S-WAY MANUFACTURING CO., INC.

Date: October 15, 2012

By: /s/ Carrie L. Majeski
Carrie L. Majeski
President Chief Executive Officer
and interim Chief Financial Officer

Art's-Way Manufacturing Co., Inc.
Exhibit Index
Form 10-Q for the Quarterly Period Ending August 31, 2012

Exhibit

| No. | Description |
|------|--|
| 10.1 | Employment Agreement, by and between the Company and Dean Droegemueller, dated effective as of September 12, 2012 – incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K filed September 14, 2012 |
| 31.1 | Certificate of Chief Executive Officer and interim Chief Financial Officer pursuant to 17 CFR 13a-14(a) – filed herewith |
| 32.1 | Certificate of Chief Executive Officer and interim Chief Financial Officer pursuant to 18 U.S.C. Section 1350 – filed herewith |
| 101* | The following materials from this report, formatted in XBRL (Extensible Business Reporting Language) are filed herewith: (i) condensed consolidated balance sheets, (ii) condensed consolidated statement of operations, (iii) condensed consolidated statements of cash flows, and (iv) the notes to the condensed consolidated financial statements. |

* Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.