SHOPSMITH INC
Form 10-Q
August 10, 2001

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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

For the quarter ended June 30 2001 — Commission File Number 0-9318

SHOPSMITH, INC.
(Name of Registrant)

Ohio	31-0811466
(State of Incorporation)	(IRS Employer Identification Number)

6530 Poe Avenue Dayton, Ohio	45414

(Address of Principal
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 X No __

Indicate the number of shares outstanding of each of the registrant s classes of common stock as of July 20,2001.

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

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SHOPSMITH, INC. AND SUBSIDIARIES

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SHOPSMITH INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2001	March 31, 2001
	(Unaudited)	
ASSETS		
Current assets:		
Cash and equivalents	$1,225	$651,530
Restricted cash		174,718
Accounts receivable:		
Trade, less allowance for doubtful accounts: $1,033,670 on June 30 and $924,250 on March 31	803,140	673,689
Inventories	2,366,143	2,168,225
Deferred income taxes (Note 2)	498,000	498,000
Prepaid expenses	462,152	431,912
Total current assets	4,130,660	4,598,074
Properties:		
Land, building and improvements	3,131,153	3,161,199
Machinery, equipment and tooling	6,642,199	6,627,918
Total cost	9,773,352	9,789,117
Less accumulated depreciation and amortization	6,846,871	6,782,561
Net properties	2,926,481	3,006,556
Deferred income taxes (Note 2)	782,000	782,000
Long term portion of accounts receivable trade, less allowance for doubtful accounts $86,177 on June 30, and $70,999 on March 31	187,631	167,954
Other assets	2,303	2,303
Total assets	$8,029,075	$8,556,887

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SHOPSMITH INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2001	March 31, 2001
	(Unaudited)	

LIABILITIES AND SHAREHOLDERS EQUITY

Current liabilities:Accounts payable$831,992$1,113,380Revolving loan payable237,000 Current portion of long-term debt and capital lease obligation84,91084,910Customer advances288,295169,003Accrued liabilities:Compensation, employee benefits and payroll taxes238,187278,443Sales taxes payable66,295144,606Accrued recourse liability202,044235,303Accrued expenses263,799182,804Other76,98693,990

Total current liabilities2,289,5082,302,439Long-term debt and capital lease obligation2,548,4432,568,464

Total liabilities4,837,9514,870,903

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 June 30 and on March 312,806,4822,806,482Retained earnings384,642879,502

Total shareholders equity3,191,1243,685,984

Total liabilities and shareholders equity$8,029,075$8,556,887

See notes to consolidated financial statements.

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SHOPSMITH INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

	Three Months Ended	
	June 30 2001	**July 1 2000**
	(Unaudited)	**(Unaudited)**
		(restated)
Net sales	$3,037,505	$3,669,355

Cost of products sold1,408,1931,734,043

Gross margin1,629,3121,935,312Selling expenses1,549,5131,988,348Administrative expenses538,569464,536

Total operating expenses2,088,0822,452,884Loss from operations(458,770)(517,572)Interest income19,22812,377Interest expense(59,197)(67,435)Other income, net3,8793,502

Loss before income taxes(494,860)(569,128)Income tax benefit

Net Loss(494,860)(569,128)Retained earnings:Beginning879,502995,594

Ending$384,642$426,466

Net Loss per common share
(Note 3)Basic(0.19)(0.22)

Diluted(0.19)(0.22)

See notes to consolidated financial statements.

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SHOPSMITH INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW

	Three Months Ended	
	June 30 2001	**July 1 2000**
	(Unaudited)	**(Unaudited)**
		(restated)

Cash flows from operating activities:
Net
Loss$(494,860)$(569,128)Adjustments
to reconcile net loss to cash
provided from operating
activities:Depreciation and
amortization64,31072,727Provision
for doubtful
accounts111,97986,891Deferred
income taxes Cash provided
from (required for) changes in
assets and
liabilities: Restricted
cash174,718(954) Accounts
receivable(261,107)(21,270) Inventories(197,918)93,204 Other
assets(30,240)120,720 Accounts
payable and customer
advances(162,096)(684,398) Other
current
liabilities(87,835)(264,050)

Cash provided from (used in)
operating
activities(883,049)(1,166,258)

Cash flows from investing activities:Maturity of short-term investments Property additions(16,156)(14,715)Proceeds from sale of property31,921

Cash provided from (used in) investing activities15,765(14,715)

Cash flows from financing activities:Increase in revolving loan237,000 Payments on long-term debt and capital lease obligation(20,021)(18,090)

Cash provided from (used in) financing activities216,979(18,090)

Net decrease in cash(650,305)(1,199,063)Cash:At beginning of period651,5301,301,387

At end of period$1,225$102,324

See notes to consolidated financial statements.

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SHOPSMITH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. In the opinion of management, all adjustments (consisting of only normal and recurring adjustments) have been made as of June 30, 2001 and July 1, 2000 to present the financial statements fairly. However, the results of operations for the three 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.

2. The provision for income taxes is as follows:

	June 30 2001	July 1 2000
Loss before income taxes	$ (494,860)	$ (569,128)

Provision for (recoverable) income taxes:
Current$ $ Deferred(164,000)(199,000)Change in valuation allowance164,000199,000

Net provision for (recoverable) income taxes$ $

The Company has deferred tax assets amounting to $1,280,000 at June 30, 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 quarter ended June 30, 2001, the Company has reduced its provision for recoverable income taxes by a $164,000 valuation allowance because of the uncertainty of realizing its benefit.

3. 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:

	Three months ended	
	June 30, 2001	July 1, 2000
Net loss	$ (494,860)	$ (569,128)
Weighted average shares	2,605,233	2,605,233
Additional dilutive shares		
Total dilutive shares	2,605,233	2,605,233
Basic loss per share	$(0.19)	$(0.22)
Diluted loss per share	$(0.19)	$(0.22)

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There were no additional dilutive shares included in the computation at June 30, 2001 and July 1, 2000 because the stock options were anti-dilutive.

4. A revolving credit

agreement has been renewed and will now expire on January 31, 2002. The agreement provides for maximum short-term borrowing of $500,000 with interest charged at three percent over the Bank s prime rate. The agreement requires compliance with certain minimum net worth, working capital and other miscellaneous covenants. Substantially all tangible assets except for land and building are pledged as collateral.

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

Results of Operations

First quarter sales declined to $3,038,000 or 17.2% from $3,669,000 generated a year ago. This decrease in volume is primarily in our demonstration sales channel.

Gross margin rates increased by one percentage point compared to last year. Operating expenses were reduced to $2,088,000 in the current fiscal year from $2,453,000 last year.

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

Because of the factors above, a net loss of $495,000 or $.19 per diluted share was experienced in the quarter ended June 30, 2001 compared to a restated net loss of $569,000 or $.22 per diluted share for the same period of last year.

Liquidity and Financial Position

Cash used in operations totaled $883,000 in the current year compared with $1,166,000 for the first quarter of the preceding year. Net losses of $495,000, together with increases in receivables and inventory, 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. If this venture goes as anticipated (with an October commencement time), it will result in additional cash requirements for both receivables and for startup costs.

Our bank, Huntington National has informed the Company that it is terminating our relationship. They have given the Company six months to transition to another bank. As of August 8, 2001, the Company had drawn $365,000 on the $500,000 line of credit presently provided by the bank.

The Company s assets include $1,280,000 of deferred income tax assets at June 30, 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. For the quarter ended June 30, 2001, the Company has reduced its provision for recoverable income taxes by a $164,000 valuation allowance because of the uncertainty of realizing its benefit. Management will continue to evaluate these assets and the need for additional valuation allowances based on near-term operating results and longer-term projections. If the Company is unable to generate sufficient operating income in the future, the valuation allowance will have to be increased by means of a charge against operating results.

The current ratio was 1.80 to 1 at June 30, 2001 compared to 2.00 to 1 at the beginning of the current fiscal year. The debt to equity ratio increased to 1.52 to 1 from 1.32 to 1 at March 31, 2001.

The Company has now experienced operating losses in the last three fiscal years as well as the current quarter. Continuation of operating losses will negatively affect the Company s liquidity both (a) as a result of negative cash flow caused by the losses, and (b) by putting the Company in the position of failing to satisfy the conditions applicable to drawing under the Company s line of credit. The Loan and Security Agreement between the Company and the bank includes among other financial covenants, the requirement that the Company maintain shareholders equity of not less than $3,100,00 until December 30, 2001 and $3,200,00 thereafter.

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 6.

(a) Exhibits:

(4.13) Tenth Amendment to Loan and Security Agreement dated July 31, 2001 between Huntington National Bank and Shopsmith, Inc.

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

Date: August 10, 2001