ARTS WAY MANUFACTURING CO INC
Form 10QSB
October 16, 2006

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

FORM 10-QSB

(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, 2006

[ ] 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 Small Business Issuer as Specified in Its Charter)

DELAWARE	42-0920725
(State or Other Jurisdiction of Incorporation or Organization)	I.R.S. Employer Identification No.

Hwy 9 West, Armstrong, Iowa
50514
(Address of Principal Executive Offices)

(712) 864-3131
Issuer's Telephone Number, Including Area Code

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Exchange Act during the past 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 is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes __ No X

Number of common shares outstanding as of October 16, 2006: 1,973,176

Transitional Small Business Disclosure Format (check one): Yes _ No X

ART'S-WAY MANUFACTURING CO., INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended		Year to Date	
	August 31, 2006	August 31, 2005	August 31, 2006	August 31, 2005
Net sales	$ 6,056,267	$ 4,190,253	$ 14,470,084	$ 11,581,969
Cost of goods sold	4,655,972	3,121,725	10,405,029	8,235,522
Gross profit	1,400,295	1,068,528	4,065,055	3,346,447

Operating expenses:				
Engineering	101,263	95,932	301,161	375,219
Selling	217,684	181,718	602,921	516,822
General and administrative	665,461	336,722	1,944,265	1,146,792
Total expenses	984,408	614,372	2,848,347	2,038,833
Income from operations	415,887	454,156	1,216,708	1,307,614
Other expenses:				
Interest expense	112,446	71,553	294,757	198,922
Other	(30,412)	(9,603)	(71,870)	(51,560)
Total other expenses	82,034	61,950	222,887	147,362
Income before income taxes	333,853	392,206	993,821	1,160,252
Income tax expense	153,488	133,365	388,317	408,761
Net income	$ 180,365	$ 258,841	$ 605,504	$ 751,491
Net income per share:				
Basic	$ 0.09	$ 0.13	$ 0.31	$ 0.39
Diluted	$ 0.09	$ 0.13	$ 0.31	$ 0.38
Common shares and equivalent outstanding:				
Basic	1,973,176	1,958,611	1,970,037	1,947,009
Diluted	1,979,701	1,974,656	1,978,092	1,968,595

See accompanying notes to condensed consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	August 31, 2006	November 30, 2005
ASSETS		
Current Assets		
Cash	$ 1,750,951	$ 1,198,238
Accounts receivable-customers, net of allowance for doubtful accounts of $47,848 and $46,385 in May and November, respectively	2,000,811	956,391
Inventories, net	6,499,928	6,525,051
Deferred taxes	684,000	673,000
Other current assets	142,864	128,877
Total current assets	11,078,554	9,481,557
Property, plant and equipment, at cost	13,107,998	12,263,478
Less accumulated depreciation	10,109,363	10,372,818
Net property, plant and equipment	2,998,635	1,890,660
Inventories, noncurrent	109,616	144,871
Deferred taxes	48,000	191,000
Other assets	100,560	74,353
Total Assets	$ 14,335,365	$ 11,782,441
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Current portion of long-term debt	$ 228,416	$ 223,946

Accounts payable	699,672	530,722
Customer deposits	476,799	569,354
Accrued expenses	1,238,544	736,464
Total current liabilities	2,643,431	2,060,486
Long-term debt, excluding current portion	3,895,528	2,558,273
Total liabilities	6,538,959	4,618,759
Stockholders' Equity		
Common stock - $.01 par value. Authorized 5,000,000 shares; issued 1,973,176 and 1,963,176 shares in May and in November	19,732	19,632
Additional paid-in capital	1,746,907	1,719,787
Retained earnings	6,029,767	5,424,263
Total stockholders' equity	7,796,406	7,163,682
Total liabilities and stockholders' equity	$ 14,335,365	$ 11,782,441

See accompanying notes to condensed consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Year to Date	
	August 31, 2006	August 31, 2005
CASH FLOW FROM OPERATIONS:		
Net income	$ 605,504	$ 751,491
Adjustment to reconcile net income to net cash provided by operating activities:		
Stock compensation expense	4,020	0
(Gain) on sale of equipment	(41,048)	0
Depreciation and amortization	222,901	184,025
Deferred income tax	132,000	386,849
Changes in working capital components:		
(Increase) decrease in:		
Accounts receivable	(718,595)	(327,745)
Inventories	508,017	341,477
Other current assets	(13,987)	43,415
Other	862	107,302
Increase (decrease) in:		
Accounts payable	168,950	(210,819)
Customer deposits	(406,808)	(31,924)
Accrued expenses	502,080	(151,894)
Net cash provided by operating activities	963,897	1,092,177
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(743,522)	(187,200)
Purchases of assets of Tech Space, Inc.	(1,137,606)	0
Proceeds from sale of property, plant and equipment	132,089	0
Net cash (used in) investing activities	(1,749,039)	(187,200)
CASH FLOW FROM FINANCING ACTIVITIES:		
Principal payments on line of credit	0	(870,071)
Proceeds from notes payable	1,500,000	1,000,000
Principal payments on long term debt	(158,275)	(279,139)
Loan origination fees paid	(27,070)	(18,550)
Proceeds from the exercises of stock options	23,200	68,650

Net cash provided by (used in) financing activities	1,337,855	(99,110)
Net increase in cash	552,713	805,867
Cash at beginning of period	1,198,238	116,001
Cash at end of period	$ 1,750,951	$ 921,868
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Interest	$ 294,758	$ 181,869
Income taxes	$ 25,217	$ 23,187
Supplemental schedule of investing activities:		
Tech Space, Inc. acquisition:		
Accounts Receivable	$ 325,825	$ 0
Inventories	447,639	0
Property, plant and equipment	678,395	0
Customer deposits	(314,253)	0
Cash paid	$ 1,137,606	$ 0

See accompanying notes to condensed consolidated financial statements.

ART'S-WAY MANUFACTURING CO., INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statement Presentation

The financial statements 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-KSB for the year ended November 30, 2005. The results of operations for the nine months ended August 31, 2006 are not necessarily indicative of the results for the fiscal year ending November 30, 2006.

2. STOCK OPTIONS

At August 31, 2006, we had two stock-based employee compensation plans, which are described more fully in Note 9 of our 2005 Annual Report to Stockholders. We adopted Statement No. 123 (Revised 2004), Share-Based Payment ("SFAS123R") which replaces SFAS No. 123, Accounting for Stock-Based Compensation and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, effective December 1, 2005. SFAS123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS No. 123 are no longer an alternative to financial statement recognition. Upon adoption, we used the prospective transition method. The prospective method requires that compensation expense be recorded for all non-vested stock options beginning with the first quarter after adoption of SFAS123R. Stock-based compensation expense for the nine months ended August 31, 2006 totaled $4,020.

Previously, we applied Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in

accounting for these plans. Accordingly, prior to December 1, 2005 no compensation cost had been recognized for stock options in the condensed consolidated financial statements when the options were issued at a price equivalent to the stock price at the time of issuance. Set forth below is a reconciliation of net income and earnings per share information for the nine months ended August 31, 2005, as if we had applied the fair value recognition provisions of SFAS 123, Accounting for Stock-based Compensation, to stock-based employee compensation for that period.

	Three months ended August 31, 2005	Nine months ended August 31, 2005
Net income, as reported	$ 258,841	$ 751,491
Deduct:		
Total stock-based compensation expense determined under the fair value method for all awards, net of tax effects	($ 1,755)	($ 5,265)
Pro forma net income	$ 257,086	$ 746,226
Pro forma basic earnings per share	.13	.38
Pro forma diluted earnings per share	.13	.38

The fair value of each option grant has been estimated using the Black-Scholes option-pricing model.

3. INVENTORIES

Major classes of inventory are:	August 31, 2006	November 30, 2005
Raw material	$ 2,850,073	$ 2,820,591
Work-in-process	569,748	455,077
Finished goods	3,189,723	3,394,254
Total	$ 6,609,544	$ 6,669,922
Less inventories classified as noncurrent	109,616	144,871
Inventories, current	$ 6,499,928	$ 6,525,051

4. ACCRUED EXPENSES

Major components of accrued expenses are:	August 31, 2006	November 30, 2005
Salaries, wages and commissions	$ 465,153	$ 371,680
Accrued warranty expense	234,687	131,832
Income taxes	230,474	5,702
Other	308,230	227,250
Total	$ 1,238,544	$ 736,464

5. PRODUCT WARRANTY

The Company offers limited 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 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.

Changes in the Company's product warranty liability for the three and nine months ended August 31, 2006 and 2005 are as follows:

	hree Months Ended		Nine Months Ended	
	August 31, 2006	August 31, 2005	August 31, 2006	August 31 2005
Balance, beginning	$167,487	$115,993	$131,832	$119,912
Settlements made in cash or in-kind	(76,898)	(127,684)	(224,216)	(375,937)
Warranties issued	144,098	94,620	327,071	338,954
Balance, ending	$234,687	$ 82,929	$234,687	$82,929

6. LOAN AND CREDIT AGREEMENTS

The Company has a revolving line of credit for $3,500,000 with advances funding the working capital, letter of credit and corporate credit card needs that will mature on April 30, 2007. The interest rate is West Bank's prime interest rate, adjusted daily. Monthly interest only payments are required and the unpaid principal is due on the maturity date. Collateral consists of a first position on assets owned by the Company including, but not limited to inventories, accounts receivable, machinery and equipment. As of August 31, 2006 and November 30, 2005, the Company had no borrowings against the line of credit. Other terms and conditions of the debt with West Bank include providing monthly internally prepared financial reports including accounts receivable aging schedules and borrowing base certificates and year-end audited financial statements. The borrowing base shall limit advances from the line of credit to 60% of accounts receivable less than 90 days old, 60% of finished goods inventory, 50% of raw material inventory and 50% of work-in-process inventory plus 40% of appraisal value of machinery and equipment.

J. Ward McConnell, Jr. was required to personally guarantee the debt with West Bank on an unlimited and unconditional basis. The guarantee of the term debt is to be reduced after the first three years to a percentage representing his ownership of the Company. Mr. McConnell's guarantee shall be removed from the term debt in the event that his ownership interest in the Company is reduced to a level less than 20% after the first three years of the loan. The Company compensates Mr. McConnell for his personal guarantee. On the loans due to mature March 2015 and Aprl 2016 Mr. McConnell is compensated at an annual percentage rate of 2% of the outstanding balance to be paid monthly. On the first Westbank loan his guarantee portion has dropped to his pecent ownership. Guarantee fee payments to Mr. McConnell were approximately $45,000 and $38,000, for the nine months ended August 31, 2006 and 2005, respectively.

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

	August 31, 2006	November 30, 2005
West Bank loan payable in monthly installments of $17,776 including interest at Bank's prime rate plus 1.5%, due March 31, 2023 (A) (B)	$ 1,713,151	$ 1,754,866
West Bank loan payable in monthly installments of $10,000 including interest at Bank's prime rate plus 1.5%, due March 31, 2015 (A) (B)	$ 949,994	$ 974,356
West Bank loan payable in monthly installments of $22,000 including interest at Bank's prime		

rate plus 1.0%, due April 30, 2016 (A) (B)	$1,460,799	$0
State of Iowa Community Development Block Grant promissory notes at zero percent interest, maturity September 2006, with quarterly principal payments of $11,111	$ 0	$ 33,334
State of Iowa Community Development Block Grant local participation promissory notes at 4% interest, maturity September 2006, with quarterly payments of $7,007	$ 0	$ 19,663
Total term debt	$ 4,123,944	$ 2,782,219
Less current portion of term debt	$ 228,416	$ 223,946
Term debt, excluding current portion	$ 3,895,528	$ 2,558,273

(A) Notes are supported by a guarantee issued by the United States Department of Agriculture (USDA) for 75% of the loan amount outstanding. Collateral for these loans are primarily real estate with a second position on assets securing the line of credit. The USDA subordinates collateral rights in all assets other than real estate in an amount equal to West Bank's other credit commitments.

(B) Covenants include, but are not limited to, restrictions on payment of dividends, debt service coverage ratio, debt/tangible net worth ratio, current ratio, limitation on capital expenditures, and tangible net worth. During the third quarter ended August 31, 2006, the Company did not comply with covenant limitations on capital expenditures and the disposal of assets. The bank waived the limitations.

7. RELATED PARTY TRANSACTIONS

J. Ward McConnell, Jr. owns and operates Adamson Global Technology Corp. During the nine months ended August 31, 2006 Adamson sold Art's-Way Vessels, Inc., certain raw material and equipment for an aggregate price of approximately $172,000. Adamson also purchased pressurized vessels from Art's-Way Vessels, Inc. in the first nine months, for an aggregate price of approximately $104,000. The Company believes that the transactions were done in accordance with prevailing market terms and conditions.

8. SEGMENT INFORMATION

On October 4, 2005, we purchased certain assets of Vessels Systems, Inc. which created a separate operating segment.

On August 3, 2006, Art's-Way Manufacturing Co., Inc., acquired substantially all of the assets of TechSpace, Inc. of Monona, Iowa. We purchased the inventory, fixed assets and accounts receivable for the purchase price of $1,138,000, paid in cash. The assets will be utilized through a wholly owned subsidiary, Art's-Way Scientific, Inc. Art's-Way Scientific Inc. is a manufacturer of modular buildings for disaster recovery, testing and diagnostic labortories, animal research laboratories, biocontainment laboratories, triage/sorting facilities and swing space to limit disruption. This purchase created a third operating segment.

Prior to October 4, 2005 the Company operated in one reportable segment.

Our reportable segments are strategic business units that offer

different products. They are managed separately because each business requires different technology and marketing strategies.

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 throughout the United States. The pressurized vessel segment produces pressurized tanks. The modular building segment manufactures modular buildings for swine and scientific laboratories.

The accounting policies applied to determine the segment information are the same as those described in the summary of significant accounting policies. Intersegment sales and transfers, if any, are accounted for at historical cost.

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. The agricultural products, pressurized vessels, and modular segment information is for the three and nine months ended August 31, 2006.

Three Months Ended August 31, 2006

	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	$4,804,000	$1,151,000	$101,000	$6,056,000
Income from operations	316,000	170,000	(70,000)	416,000
Income before tax	253,000	151,000	(70,000)	334,000
Total Assets	13,169,000	714,000	452,000	14,335,000
Capital expenditures	26,000	6,000	0	32,000
Depreciation & Amortization	68,000	17,000	6,000	91,000

Nine Months Ended August 31, 2006

	Agricultural Products	Pressurized Vessels	Modular Buildings	Consolidated
Revenue from external customers	$11,733,000	$2,636,000	$101,000	$14,470,000
Income from operations	900,000	387,000	(70,000)	1,217,000
Income before tax	686,000	378,000	(70,000)	994,000
Total Assets	13,169,000	714,000	452,000	14,335,000
Capital expenditures	707,000	37,000	0	744,000
Depreciation & Amortization	179,000	38,000	6,000	223,000

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion and analysis should be read in conjunction with the condensed consolidated financial statements and notes thereto appearing elsewhere in this report. Management's discussion and analysis contains forward-looking statements that involve risks and uncertainties, including but not limited to, quarterly fluctuations in results; customer demand for our products; economic conditions; the achievement of lower costs and expenses; the continued availability of financing in the amount and on the terms required to support future business; and other risks detailed from time to time in our other Securities and Exchange Commission filings. Actual results may differ

materially from management's expectations.

(a) Plan of Operation

In the current fiscal year we plan to continue growth through new product development and when appropriate acquisition. We continue to look for new and better ways to improve our product offerings for our end users. We persist in our attempt to improve our efficiencies, through the implementation of lean manufacturing processes.

On August 3, 2006 Art's-Way acquired the operating assets of TechSpace Inc. for a cash purchase price of approximately $1,138,000. The acquisition was made to continue the Company's growth strategy and diversify its product offerings outside the agricultural industry. The purchase price was determined based on an arms-length negotiated value. The transaction was accounted for under the purchase method of accounting, with the purchase price allocated to the individual assets acquired. (See cash flow statement supplemental disclosure)

(b) Management's Discussion and Analysis of Financial Condition and Results of Operations

(i) 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, 2006 have remained unchanged from November 30, 2005. These policies involve revenue recognition, inventory valuation and income taxes. Disclosure of these critical accounting policies is incorporated by reference under Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation" in our Annual Report on Form 10-KSB for the year ended November 30, 2005.

On September 15, 2006, the FASB issued FASB Statement No. 157, Fair Value Measurements (FAS 157), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). As a result of FAS 157 there is now a common definition of fair value to be used throughout GAAP. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. FAS 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of this standard on its Consolidated Financial Statements.

In June 2006, the Financial Accounting Standards Board ("FASB") issue FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, ("FIN 48") an interpretation of FASB Statement No. 109, Accounting for Income Taxes. FIN 48 requires that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (i.e. a likelihood of more than fifty percent) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. Upon adoption, the cumulative effect of applying the recognition and measurement provisions of FIN 48, if any, shall be reflected as an adjustment to the opening balance of retained earnings. FIN 48 requires that subsequent to initial adoption a change in judgment that results in subsequent recognition, derecognition or change in a measurement of a tax position taken in a prior annual period (including any related interest and penalties) be recognized as a discrete item in

the period in which the change occurs. Currently, we record such changes in judgment, including audit settlements, as a component of the Company's income tax provision. Thus, the Company's reported quarterly income tax rate may become more volatile upon adoption of FIN 48. This change will not impact the manner in which we record income tax expense on an annual basis. FIN 48 also requires expanded disclosures including identification of tax positions for which it is reasonably possible that total amounts of unrecognized tax benefits will significantly change in the next twelve months, a description of tax years that remain subject to examination by major tax jurisdiction, a tabular reconciliation of the total amount of unrecognized tax benefits at the beginning and end of each annual reporting period, the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate and the total amounts of interest and penalties recognized in the statements of operations and financial position. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact of this standard on its Consolidated Financial Statements.

(ii) Results of Operations

The third quarter and year to date net sales were 45% and 25% respectively, higher than for the comparable periods one year ago. In addition to the sales from our two new subsidiaries, we experienced a shift in sales in 2006. Art's Way Manufacturing's sales of grinder mixers were spread more evenly in 2006 compared to 2005 when we shipped a large amount of grinders in the first quarter.

Consolidated revenues increased $1,866,000 for the third quarter of 2006. Art's-Way Manufacturing's revenues increased $614,000, Art's-Way Vessel's (acquired in October of 2005) revenues increased $1,151,000, and Art's-Way Scientific's (acquired in August of 2006) revenues increased $101,000. Year to date revenues of $14,470,000 for 2006 represent an increase of $2,888,000 over the same period in 2005. Sales increased by $151,000 for Art's-Way Manufacturing, $2,636,000 for Art's-Way Vessels and $101,000 for Art's-Way Scientific.

Art's-Way Manufacturing's consolidated gross profit of 28% year to date has remained stable compared to the same period one year ago of 29%. Art's-Way Manufacturing's gross profit is down from 29% to 26% year to date. Quarterly gross profit is down 2.4%. This decline is due to a reduction in sales of grinder mixers which have a slightly higher margin than some of our other product offerings. Art's-Way Vessel's had a gross profit of 40% year to date.

Consolidated operating expenses as a percent of sales increased by 1% for the quarter ended August 2006. Year to date operating expenses increased $810,000 compared to 2005 or by 2% of sales. Of this amount $667,000 relates directly to the addition of Art's-Way Vessels and $77,000 relates directly to the addition of Art's-Way Scientific.

Art's-Way Manufacturing's consolidated engineering expenses were down $74,000 for the first nine months of 2006 as compared to 2005. In 2005 we hired an outside engineering firm to aid in the development of an exportable beet harvester.

Art's-Way Manufacturing's selling expenses were up for the first nine months of 2006 by $86,000 over the same period one year ago. This increase is mainly due to an increase in commission, advertising and trade show expenses. Commission expense increased $42,000 as our sales increased 23%. Advertising expenses were up by approximately $10,000 as we have tried to reach new customers. Trade show expense was also up by

approximately $34,000 due to machine enhancement for show purposes.

We experienced an increase in interest expense of $96,000 in the first nine months of 2006 as a result of the rising prime interest rate over the past 21 months and an additional borrowing of $1,500,000 during the second quarter of fiscal 2006.

The order backlog at the end of September 2006 was $ 4,210,000 compared to $2,629,000 one year ago. Art's-Way Manufacturing's order backlog as of September 22, was $980,000 while Art's-Way Vessel's was $1,894,000 and Art's-Way Scientific's was $1,336,000.

In 2005 our backlog included approximately $1,850,000 in blower orders for Art's-Way Manufacturing's OEM dealers. This year, CNH has extended its order writing period to its dealers and has not submitted a firm purchase order. We estimate Art's-Way Manufacturing's backlog will increase by approximately $1,300,000 once we receive a firm purchase orders. This estimate is based on preliminary forecasts by CNH and H&S Manufacturing.

Gehl, one of our main competitors in the grinder mixer market, announced in April, that it was ceasing operation of its agricultual product lines. We feel that we are in an excellent position to capture some of this market share and are optimistic that this will increase our grinder mixer sales.

(iii) Liquidity and Capital Resources

On August 3, 2006 Art's-Way acquired substantially all the assets of TechSpace Inc. for a cash purchase price of approximately $1,138,000. There were no liabilities purchased or assumed in this transaction. The acquisition was made to continue the Company's growth strategy and diversify its product offerings outside the agricultural industry. The purchase price was determined based on an arms-length negotiated value. The transaction was accounted for under the purchase method of accounting, with the purchase price allocated to the individual assets acquired. (See cash flow statement supplemental disclosure)

Accounts receivable increased $719,000 during the first nine months of 2006. This is due primarily to sales of our beet harvesting equipment.

Our customer deposits have decreased by $407,000 as our beet equipment, on which we offer discounts to our customers for making down payments on their orders, has now started shipping.

Our inventory level decreased $508,000 over November 2005. This is due to the completed production and sale of the majority our beet harvesting equipment. We are also working on a continuous flow line for our grinder mixers. This will allow us to reduce our whole goods and work in process inventory, while maximzing product quality.

In late 2005 we entered into an agreement to purchase a new Bystronic laser, used to cut metal, which called for three payments totaling approximately $627,000. We made the second and third payments in the first half of 2006. In May we completed our new whole goods paint booth for $47,000.

In April of 2006 we obtained additional long term financing through West Bank of $1,500,000.

See footnote 6 of the notes to the condensed consolidated financial statements for further discussion of our credit facilities.

Item 3
CONTROLS AND PROCEDURES

Senior management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (a) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure; and (b) recorded, processed, summarized and reported, within the time specified in the SEC's rules and forms. Since that evaluation process was completed there have been no significant changes in our disclosure controls or in other factors that could significantly affect these controls.

There were no changes in our internal control over financial reporting, identified in connection with this evaluation that occurred during the period covered by this report that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II - Other Information

ITEM 1. LEGAL PROCEEDINGS

During the period covered by this report, we were not a party to any legal action or claim which was other than routine litigation incidental to our business.

ITEM 6. EXHIBITS

See exhibit index on page 15.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ART'S-WAY MANUFACTURING CO., INC.

By: ______________________________
Michael B. Hilderbrand
Chief Executive Officer
Date: ______________________________

By: ______________________________
Carrie L. Majeski
Chief Financial Officer
Date: ______________________________

Exhibits Index

10.10	Puchase Agreement with TechSpace, Inc.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a).
32.1	Certification of Chief Executive Officer under 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer under 18 U.S.C. Section 1350.