



Art's Way Manufacturing Second Quarter Conference Call

July 9, 2009—Thursday: ARTW held their second quarter earnings conference call yesterday. Due to technical problems with our equipment we were unable to register to ask a question—but the report was very positive in our opinion. It may have been a blessing that we were unable to access the call and express our take on the company's progress and outlook with our questions—these microcaps are not well followed, not well understood, and the stocks of these firms can be extremely mis-priced due to market inefficiencies. Here is our take on developments:

First, the company reported a slight profit this quarter, which compared to last year is disappointing. But in light of the near-depression in the manufacturing sector the earnings were impressive. John Deere has shut down agricultural equipment manufacturing plants and laid off quite a few workers in Iowa due to the slump—so ARTW has a niche they have been able to profitably exploit.

Revenues increased from the first quarter but were down 7% from year earlier levels overall. Note that the drop in revenue was from Scientific division revenue—the part of the company that makes modular buildings, a division that may see a large boost in orders over the next year for reasons noted below.

Company backlogs are down, but are not a concern at current levels. Backlog was abnormally high last year due to the Miller Pro acquisition. The auger business, a new product offered this year, is doing well and demand should continue to expand. The company is tapping new markets for all of their products, with orders in Australia and the U.K. the last few months. The bank just renewed the company's line of credit, and appears pleased with company operations. Financially, everything is stable if not positive in light of the business environment—which is not to be underestimated in light of all the problems in the credit markets.

In our opinion the exciting opportunities for the future of the company rests with the Vessels and Scientific Divisions. The head of the Vessels group gave a brief presentation noting that he had only been with the company for 7 months. He has a background in the water treatment industry, and the company just got orders for vessels from a major national firm in the water treatment business. If ARTW performs well in the 'test project' the sales could ramp up from essentially nothing a year ago to \$3-4 million total sales at the existing ARTW facility, which is newly built (the existing facility can handle around \$6-7 million operating at capacity).

Right now, based on last quarter's increasing revenues, Vessels is running at around \$1 million a year—roughly 16% capacity. The head of Vessels is well connected in the water treatment industry, and the orders and contacts that are being renewed and developed could easily result in a solid business relationship and repeat orders, especially in the water treatment sector. This division is essentially a 'start-up' niche business—one that should be profitable and has the ability to ramp up or 'scale' over the next few years. The remainder of the year should proceed well for Vessels.

The Scientific division has made bids on \$70 to \$100 million over the last 5 months for 2009 "Stimulus Plan" projects—and has heard back on none of the bids, pro or con. This is an ice jam waiting to break in our opinion. Under the Stimulus Plan labs which might be ordered for the National Institute of Health projects were under the legislation which allocated \$10.5 billion.

Keep in mind this is a division that contributed roughly \$10 million in ARTW revenues to the company last year—so the amount bid to date is impressive. “Drinking from a firehose” is what the head of the Scientific division said with regard to bids—but the current modular building business has been slow with the recession as many projects planned a year ago have been delayed or cancelled.

The Scientific division is not expected to know until the fourth quarter as to what bids they get—and possibly it might be early next year until they are notified. We are optimistic, but the risk remains that the grants might be rejected, or ARTW many not be selected for the project. Keep in mind the Stimulus Plan was just passed in February—5 months ago. The scientific or research justification has to be approved by the agency before the grant, which delays the award or rejection decision.

The good news is (1) the company has very few competitors in the scientific lab area (2) the parties are approaching ARTW about building a lab for them, the company has been selectively chosen by the customer who have been quite specific as to what they want (3) ARTW buildings are generally quicker and cheaper than build-in-place facilities and are engineering certified, and (4) the modular units can be delivered anywhere in the U.S.—and overseas, although they have no international orders as of yet.

After ARTW making the bid, but before it has been accepted or approved, in some cases the contacts will approach ARTW to discuss potential issues regarding construction and building modifications—assuming that the grant will be approved. While an indirect indicator, and one that could be misleading since the grant might still be rejected, it does indicate serious interest in potential projects. The number of applications approved and ultimately rejected will be a major factor in what type of business is generated for ARTW.

In summary, we think (1) the company is well positioned (2) the company is well managed (3) the company has certain elements of a start-up in the Scientific and Vessels divisions—and the auger business (4) the management and shareholder interests are closely aligned (the Chairman owns 38% of the outstanding stock) (5) the company is reasonably undervalued (6) the agricultural equipment division is a good stable base on which to build (7) the company watches the costs closely and only bids on projects that will be accretive with a reasonable margin and (8) the company has added some real valuable managers in the last year.

Unlike some of our technology and oil and gas plays the company does not offer employees extremely large stock incentive grants either—which can be incredibly dilutive to shareholders who acquire the shares in the open market and bear the risk of such investments.

As the economy improves the company should see sales increase, which will make it easier to cover their fixed costs. ARTW should be able to 'scale up' operations and earnings per share over the next few years with the line-up in place.

We are constrained as to the size of ARTW position we can take in the LSGI Fund by our prospectus, and we are at that position limit at this time. As noted in the SEC form 13D filing (link below), as of early this month the LSGI Fund and other entities related to LSGI owned 6.8% of the company.

With the mis-pricing of the shares, and alignment of shareholder and management interest, we are reminded of a quote by Charles Munger, Warren Buffett's partner, something to the effect the good investments don't grow on trees – they are very rare and take a lot of digging to find. If, on examination, you can understand the company and the risks - and the odds are tilted in your favor, invest heavily.