FreightCar America, Inc.
Form 10-Q
August 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2012

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number: 000-51237

FREIGHTCAR AMERICA, INC.

(Exact name of registrant as specified in its charter)

Delaware	**25-1837219**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
Two North Riverside Plaza, Suite 1300 Chicago, Illinois	**60606**
(Address of principal executive offices)	**(Zip Code)**

(800) 458-2235

(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 x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x 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	x
Non-accelerated filer ¨	(Do not check if a smaller reporting company)	Smaller reporting company	¨

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

As of July 24, 2012, there were 11,978,367 shares of the registrant s common stock outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

FreightCar America, Inc.

Condensed Consolidated Balance Sheets

(Unaudited)

	June 30, 2012	December 31, 2011
	(In thousands, except share and per share data)	
Assets		
Current assets		
Cash and cash equivalents	$ 107,442	$ 101,870
Restricted cash	17,004	1,815
Accounts receivable, net of allowance for doubtful accounts of $29 and $19, respectively	7,249	10,125
Inventories	72,592	72,877
Inventory on lease	23,061	
Other current assets	6,056	2,618
Deferred income taxes, net	10,982	10,982
Total current assets	244,386	200,287
Property, plant and equipment, net	36,848	35,984
Railcars available for lease, net	44,042	54,746
Goodwill	22,128	22,128
Deferred income taxes, net	19,067	28,150
Other long-term assets	3,783	4,168
Total assets	$ 370,254	$ 345,463
Liabilities and Stockholders Equity		
Current liabilities		
Account and contractual payables	$ 37,663	$ 28,110
Accrued payroll and employee benefits	5,152	5,611
Accrued postretirement benefits	5,174	5,174
Accrued warranty	7,773	7,795
Customer deposits	18,798	17,964
Other current liabilities	7,685	5,044
Total current liabilities	82,245	69,698
Accrued pension costs	12,371	14,202
Accrued postretirement benefits, less current portion	58,894	59,887
Accrued taxes and other long-term liabilities	4,296	4,342
Total liabilities	157,806	148,129
Stockholders equity		
Preferred stock, $0.01 par value; 2,500,000 shares authorized (100,000 shares each designated as Series A voting and Series B non-voting); 0 shares issued and outstanding at June 30, 2012 and December 31, 2011		
	127	127

Common stock, $0.01 par value; 50,000,000 shares authorized, 12,731,678 shares issued at June 30, 2012 and December 31, 2011		
Additional paid in capital	99,825	100,204
Treasury stock, at cost; 753,311 and 780,320 shares at June 30, 2012 and December 31, 2011, respectively	(34,616)	(35,904)
Accumulated other comprehensive loss	(21,957)	(22,302)
Retained earnings	169,069	155,209
Total stockholders equity	212,448	197,334
Total liabilities and stockholders equity	$ 370,254	$ 345,463

See Notes to Condensed Consolidated Financial Statements (Unaudited).

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FreightCar America, Inc.

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands, except share and per share data)			
Revenues	$ 181,206	$ 97,583	$ 400,272	$ 169,823
Cost of sales	164,163	93,618	359,498	163,616
Gross profit	17,043	3,965	40,774	6,207
Selling, general and administrative expenses	7,642	6,870	16,335	12,867
Gain on sale of railcars available for lease	(14)	(975)	(962)	(975)
Operating income (loss)	9,415	(1,930)	25,401	(5,685)
Interest expense, net	(96)	(54)	(186)	(117)
Income (loss) before income taxes	9,319	(1,984)	25,215	(5,802)
Income tax provision (benefit)	3,756	(2,162)	9,918	(4,708)
Net income (loss)	5,563	178	15,297	(1,094)
Less: Net (loss) income attributable to noncontrolling interest in JV		(6)		12
Net income (loss) attributable to FreightCar America	$ 5,563	$ 184	$ 15,297	$ (1,106)
Net income (loss) per common share attributable to FreightCar America basic	$ 0.47	$ 0.02	$ 1.28	$ (0.09)
Net income (loss) per common share attributable to FreightCar America diluted	$ 0.46	$ 0.02	$ 1.28	$ (0.09)
Weighted average common shares outstanding basic	11,931,565	11,914,883	11,927,992	11,911,469
Weighted average common shares outstanding diluted	11,983,901	11,994,460	11,992,808	11,911,469
Dividends declared per common share	$ 0.06	$	$ 0.12	$

See Notes to Condensed Consolidated Financial Statements (Unaudited).

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FreightCar America, Inc.

Condensed Consolidated Statements of Comprehensive Income

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands)			
Net income (loss)	$ 5,563	$ 178	$ 15,297	$ (1,094)
Other comprehensive income, net of tax:				
Pension liability adjustments, net of tax	78	57	156	114
Postretirement liability adjustments, net of tax	94	82	189	165
Change in foreign currency translation adjustments		(2)		(2)
Other comprehensive income	172	137	345	277
Comprehensive income (loss)	5,735	315	15,642	(817)
Comprehensive (loss) income attributable to non-controlling interest		(6)		12
Comprehensive income (loss) attributable to FreightCar America	$ 5,735	$ 321	$ 15,642	$ (829)

See Notes to Condensed Consolidated Financial Statements (Unaudited).

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FreightCar America, Inc.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (Unaudited)

(in thousands, except for share data)

	FreightCar America Stockholders								
	Common Stock		Additional Paid In Capital	Treasury Stock		Accumulated Other Comprehensive Loss	Retained Earnings	Noncontrolling Interest	Total Stockholders Equity
	Shares	Amount		Shares	Amount				
Balance, December 31, 2010	12,731,678	$ 127	$ 98,722	(790,486)	$ (36,539)	$ (20,000)	$ 150,274	$ (4)	$ 192,580
Net(loss) income							(1,106)	12	(1,094)
Other comprehensive income						277			277
Restricted stock awards			(792)	17,147	792				
Employee restricted stock settlement				(2,186)	(65)				(65)
Stock-based compensation expense recognized			1,093						1,093
Balance, June 30, 2011	12,731,678	$ 127	$ 99,023	(775,525)	$ (35,812)	$ (19,723)	$ 149,168	$ 8	$ 192,791
Balance, December 31, 2011	12,731,678	$ 127	$ 100,204	(780,320)	$ (35,904)	$ (22,302)	$ 155,209	$	$ 197,334
Net income							15,297		15,297
Other comprehensive income						345			345
Restricted stock awards			(1,331)	28,946	1,331				
Employee restricted stock settlement				(1,937)	(43)				(43)
Stock-based compensation expense recognized			952						952
Cash dividends							(1,437)		(1,437)
Balance, June 30, 2012	12,731,678	$ 127	$ 99,825	(753,311)	$ (34,616)	$ (21,957)	$ 169,069	$	$ 212,448

See Notes to Condensed Consolidated Financial Statements (Unaudited).

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FreightCar America, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(In thousands)	
Cash flows from operating activities		
Net income (loss)	$ 15,297	$ (1,094)
Adjustments to reconcile net income (loss) to net cash flows provided by (used in) operating activities:		
Depreciation and amortization	4,165	4,458
Gain on sale of railcars available for lease	(962)	(975)
Other non-cash items	609	303
Deferred income taxes	8,868	(4,827)
Stock-based compensation expense recognized	952	1,093
Changes in operating assets and liabilities:		
Accounts receivable	2,876	(73,514)
Inventories	304	(6,900)
Inventory on lease	(23,061)	(7,062)
Other current assets	(2,992)	2,685
Account and contractual payables	9,178	17,467
Accrued payroll and employee benefits	(459)	(55)
Income taxes receivable	(71)	416
Accrued warranty	(22)	(1,096)
Customer deposits and other current liabilities	2,851	56,895
Deferred revenue, non-current	(182)	(272)
Accrued pension costs and accrued postretirement benefits	(2,479)	(4,285)
Net cash flows provided by (used in) operating activities	14,872	(16,763)
Cash flows from investing activities		
Restricted cash deposits	(15,525)	
Restricted cash withdrawals	336	119
Proceeds from sale of property, plant and equipment, railcars available for lease and assets held for sale	10,526	6,531
Purchase price adjustment for business acquired		(166)
Purchases of property, plant and equipment	(3,157)	(367)
Net cash flows (used in) provided by investing activities	(7,820)	6,117
Cash flows from financing activities		
Employee restricted stock settlement	(43)	(65)
Cash dividends paid to stockholders	(1,437)	
Net cash flows used in financing activities	(1,480)	(65)
Net increase (decrease) in cash and cash equivalents	5,572	(10,711)
Cash and cash equivalents at beginning of period	101,870	61,780
Cash and cash equivalents at end of period	$ 107,442	$ 51,069

Supplemental cash flow information:				
Interest paid	$	125	$	104
Income taxes paid	$	1,147	$	
Income tax refunds received	$		$	128
Non-cash transactions:				
Lease incentive for leasehold improvements	$	624	$	

See Notes to Condensed Consolidated Financial Statements (Unaudited).

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FreightCar America, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(In thousands, except share and per share data)

Note 1 Description of the Business

FreightCar America, Inc. (America) operates primarily in North America through its direct and indirect subsidiaries, JAC Operations, Inc. (Operations), Johnstown America Corporation (JAC), Freight Car Services, Inc. (FCS), JAIX Leasing Company (JAIX), JAC Patent Company (JAC Patent), FreightCar Roanoke, Inc. (FCR), Titagarh FreightCar Private Limited, Inc. (JV), FreightCar Mauritius Ltd. (Mauritius), FreightCar Rail Services, LLC (FCRS) and FreightCar Short Line, Inc. (Short Line) (herein collectively referred to as the Company), manufactures railroad freight cars, supplies railcar parts, leases freight cars and provides railcar maintenance, repairs and management. The Company designs and builds coal cars, bulk commodity cars, flat cars, mill gondola cars, intermodal cars, coil steel cars and motor vehicle carriers. The Company is headquartered in Chicago, Illinois and has facilities in the following locations: Clinton, Indiana; Danville, Illinois; Grand Island, Nebraska; Hastings, Nebraska; Johnstown, Pennsylvania; Lakewood, Colorado; and Roanoke, Virginia.

The Company s operations comprise two reportable segments, Manufacturing and Services. The Company and its direct and indirect subsidiaries are all Delaware corporations except JV, which is incorporated in India, Mauritius, which is incorporated in Mauritius, and FCRS, which is a Delaware limited liability company. The Company s direct and indirect subsidiaries are all wholly owned except JV, in which the Company (through Mauritius) has a 51% ownership interest.

On August 1, 2011, the Company terminated the term of the Joint Venture Agreement (the JV Agreement) that it entered into on January 22, 2008 with Titagarh Wagons Limited (Titagarh) to develop railcars for the Indian market. Pursuant to the JV Agreement, the Company and Titagarh formed JV to initially develop prototype cars based on the Company s designs and to assess the market opportunity for railcar production in India. On August 1, 2011, due to Titagarh s failure to cure its non-compliance with the JV Agreement, the Company notified Titagarh that the Company was exercising its unilateral right under the JV Agreement to terminate the term of the JV Agreement, effective immediately and as a result the net book value of JV on the Company s financial statements, which was not material, was written down to zero in 2011.

Note 2 Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of America, Operations, JAC, FCS, JAIX, JAC Patent, FCR, JV, Mauritius, FCRS and Short Line. All intercompany accounts and transactions have been eliminated in consolidation. The financial information has been prepared in accordance with the accounting principles generally accepted in the United States of America (GAAP) and rules and regulations of the Securities and Exchange Commission (the SEC) for interim financial reporting. The preparation of the financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full year. The accompanying interim financial information is unaudited; however, the Company believes the financial information reflects all adjustments (consisting of items of a normal recurring nature) necessary for a fair presentation of financial position, results of operations and cash flows in conformity with GAAP. The 2011 year-end balance sheet data was derived from the audited financial statements as of December 31, 2011. Certain information and note disclosures normally included in the Company s annual financial statements prepared in accordance with GAAP have been condensed or omitted. These interim financial statements should be read in conjunction with the audited financial statements contained in the Company s annual report on Form 10-K for the year ended December 31, 2011.

Note 3 Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued changes to Accounting Standards Codification (ASC) 220, *Presentation of Comprehensive Income,* to require companies to present the components of net income and other comprehensive income either in a single continuous statement of comprehensive income or two separate but consecutive statements. The changes eliminated the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. The items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income were not changed. The amended guidance was effective for interim and annual periods beginning after December 15, 2011, with earlier adoption permitted. The Company

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retrospectively adopted these changes on January 1, 2012 and management elected to use the two-statement option. Other than the change in presentation, the adoption of the changes to ASC 220 had no impact on the Company s condensed consolidated financial statements.

Note 4 Segment Information

The Company s operations comprise two reportable segments, Manufacturing and Services. The Company s Manufacturing segment includes new railcar manufacturing, used railcar sales, railcar leasing and major railcar rebuilds. The Company s Services segment includes general railcar repair and maintenance, inspections, parts sales and railcar fleet management services. Corporate includes selling, general and administrative expenses not related to production of goods and services, retiree pension and other postretirement benefit costs related to closed facilities, and all other non-operating activity.

Segment operating income is an internal performance measure used by the Company s Chief Operating Decision Maker to assess the performance of each segment in a given period. Segment operating income includes all external revenues attributable to the segments as well as operating costs and income that management believes are directly attributable to the current production of goods and services. The Company s management reporting package does not include interest revenue, interest expense or income taxes allocated to individual segments and these items are not considered as a component of segment operating income. Segment assets represent operating assets and exclude intersegment receivables, deferred tax assets and income tax receivables. The Company does not allocate cash and cash equivalents to its operating segments as the Company s treasury function is managed at the corporate level. Intersegment revenues were not material in any period presented.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues:				
Manufacturing	$ 171,771	$ 88,291	$ 382,220	$ 151,460
Services	9,435	9,292	18,052	18,363
Consolidated revenues	$ 181,206	$ 97,583	$ 400,272	$ 169,823
Operating income (loss):				
Manufacturing	$ 15,253	$ 2,107	$ 37,942	$ 2,323
Services	726	1,161	1,379	2,256
Corporate	(6,564)	(5,198)	(13,920)	(10,264)
Consolidated operating income (loss)	$ 9,415	$ (1,930)	$ 25,401	$ (5,685)
Depreciation and amortization:				
Manufacturing	$ 1,173	$ 1,563	$ 2,450	$ 2,963
Services	551	498	1,045	963
Corporate	344	273	670	532
Consolidated depreciation and amortization	$ 2,068	$ 2,334	$ 4,165	$ 4,458
Capital expenditures:				
Manufacturing	$ 1,362	$ 135	$ 1,788	$ 135
Services	486		1,005	
Corporate	145	47	364	232
Consolidated capital expenditures	$ 1,993	$ 182	$ 3,157	$ 367

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	June 30, 2012	December 31, 2011
Assets:		
Manufacturing	$ 172,259	$ 167,972
Services	26,460	25,430
Corporate	140,285	112,177
Total operating assets	339,004	305,579
Consolidated income taxes receivable	1,201	752
Consolidated deferred income taxes, current	10,982	10,982
Consolidated deferred income taxes, long-term	19,067	28,150
Consolidated assets	$ 370,254	$ 345,463

Note 5 Fair Value Measurements

The Company s current investment policy is to invest in cash and securities backed by the U.S. government. The carrying amounts of cash equivalents approximate fair value because of the short maturity of these instruments.

The following table sets forth by level within the ASC 820 fair value hierarchy the Company s financial assets and liabilities that were recorded at fair value on a recurring basis.

Recurring Fair Value Measurements		**As of June 30, 2012**		
	Level 1	**Level 2**	**Level 3**	**Total**
ASSETS:				
Cash equivalents	$ 93,904	$	$	$ 93,904

Recurring Fair Value Measurements		**As of December 31, 2011**		
	Level 1	**Level 2**	**Level 3**	**Total**
ASSETS:				
Cash equivalents	$ 77,004	$	$	$ 77,004

Note 6 Inventories

Inventories are stated at the lower of first-in, first-out cost or market and include material, labor and manufacturing overhead. The components of inventories are as follows:

	June 30, 2012	December 31, 2011
Work in progress	$ 64,653	$ 66,713
Finished new railcars	3,132	1,061
Used railcars acquired upon trade-in	105	558
Parts and service inventory	4,702	4,545
Total inventories	$ 72,592	$ 72,877

Note 7 Leased Railcars

Leased railcars at June 30, 2012 included *Railcars available for lease* classified as long-term assets of $44,042 (cost of $48,234 and accumulated depreciation of $4,192) and *Inventory on lease* of $23,061. Leased railcars at December 31, 2011 included *Railcars available for lease* classified as long-term assets of $54,746 (cost of $59,217 and accumulated depreciation of $4,471). The Company s lease utilization rate for railcars in its lease fleet, including those classified as *Inventory on lease* and those classified as *Railcars available for lease* was 100% at each of June 30, 2012 and December 31, 2011.

Leased railcars at June 30, 2012 are subject to lease agreements with external customers with terms of up to nine years and are accounted for as operating leases.

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Future minimum rental revenues on leased railcars at June 30, 2012 are as follows:

Six months ending December 31, 2012	$ 3,555
Year ending December 31, 2013	6,588
Year ending December 31, 2014	5,879
Year ending December 31, 2015	4,187
Year ending December 31, 2016	3,825
Thereafter	3,431
	$ 27,465

Note 8 Property, Plant and Equipment

Property, plant and equipment consists of the following:

	June 30, 2012	December 31, 2011
Buildings and improvements	$ 25,368	$ 23,957
Machinery and equipment	30,146	29,169
Software	8,382	8,352
Leasehold improvements	5,565	4,726
Cost of buildings and improvements, leasehold improvements, machinery, equipment and software	69,461	66,204
Less: Accumulated depreciation and amortization	(36,289)	(33,269)
Buildings and improvements, leasehold improvements, machinery, equipment and software, net of accumulated depreciation and amortization	33,172	32,935
Land (including easements)	2,203	2,203
Construction in process	1,473	846
Total property, plant and equipment, net	$ 36,848	$ 35,984

Note 9 Intangible Assets and Goodwill

Intangible assets consist of the following:

	June 30, 2012	December 31, 2011
Patents	$ 13,097	$ 13,097
Accumulated amortization	(10,672)	(10,376)
Patents, net of accumulated amortization	2,425	2,721
Customer-related intangibles	1,300	1,300
Accumulated amortization	(139)	(64)

Customer-related intangibles, net of accumulated amortization	1,161	1,236
Total amortizing intangibles	$ 3,586	$ 3,957
Manufacturing segment goodwill	$ 21,521	$ 21,521
Services segment goodwill	607	607
Total goodwill	$ 22,128	$ 22,128

Patents are being amortized on a straight-line method over their remaining legal life from the date of acquisition. The weighted average remaining life of the Company s patents is 5 years. Amortization expense related to patents, which is included in cost of sales, was $148 for each of the three months ended June 30, 2012 and 2011, and $295 for each of the six months ended June 30, 2012 and 2011. Customer-related intangibles are being amortized from the date of acquisition and have a remaining life of 18 years. Amortization expense related to customer intangibles, which is included in selling, general and administrative expenses, was $37 and $10 for the three months ended June 30, 2012 and 2011, respectively, and $74 and $21 for the six months ended June 30, 2012 and 2011, respectively.

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The estimated intangible amortization at June 30, 2012 is as follows:

Six months ending December 31, 2012	$ 367
Year ending December 31, 2013	739
Year ending December 31, 2014	744
Year ending December 31, 2015	720
Year ending December 31, 2016	476
Thereafter	540
	$ 3,586

The Company evaluates its patent and customer-related intangibles for impairment at least annually and has identified no impairment during 2012 or 2011.

The Company performs the goodwill impairment test required by ASC 350, *Intangibles Goodwill and Other*, as of January 1 of each year. Management estimates the valuation of the Company (which consists of two reporting units) using a combination of methods, appropriate to the circumstances, including discounted future cash flows, and the Company s market capitalization. There was no adjustment required based on the annual impairment tests for 2012 or 2011.

Note 10 Product Warranties

Warranty terms are based on the negotiated railcar sales contracts and typically are for periods of one to five years. The changes in the warranty reserve for the three and six months ended June 30, 2012 and 2011, are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Balance at the beginning of the period	$ 7,757	$ 7,085	$ 7,795	$ 7,932
Provision for warranties issued during the period	848	377	1,838	615
Reductions for payments, cost of repairs and other	(131)	(53)	(218)	(595)
Adjustments to prior warranties	(701)	(573)	(1,642)	(1,116)
Balance at the end of the period	$ 7,773	$ 6,836	$ 7,773	$ 6,836

Note 11 Revolving Credit Facility

On July 29, 2010, the Company entered into a $30,000 senior secured revolving credit facility pursuant to a Loan and Security Agreement dated as of July 29, 2010 (the Revolving Loan Agreement) among America, JAC, FCS, Operations and FCR, as borrowers (collectively, the Borrowers), and Fifth Third Bank, as lender. The proceeds of the revolving credit facility can be used for general corporate purposes, including working capital. As of June 30, 2012 and December 31, 2011, the Company had no borrowings and therefore had $30,000 available under the revolving credit facility. The Revolving Loan Agreement also contains a sub-facility for letters of credit not to exceed $20,000. The Company had no outstanding letters of credit under the revolving credit facility as of each of June 30, 2012 and December 31, 2011.

The Revolving Loan Agreement has a term ending on July 29, 2013 and revolving loans outstanding thereunder will bear interest at a rate of LIBOR plus an applicable margin of 2.50% or at prime, as selected by the Company. The Company is required to pay a non-utilization fee of 0.35% on the unused portion of the revolving loan commitment. Borrowings under the Revolving Loan Agreement are secured by the Company s accounts receivable, inventory and certain other assets of the Company, and borrowing availability is tied to a borrowing base of eligible accounts receivable and inventory. The Revolving Loan Agreement has both affirmative and negative covenants, including, without limitation, a minimum tangible net worth covenant and limitations on indebtedness, liens and investments. The minimum tangible net worth covenant in the Revolving Loan Agreement effectively limits potential dividends to $67,847 as of June 30, 2012. The Revolving Loan Agreement also provides for customary events of default. As of June 30, 2012, the Company was in compliance with all of the covenants contained in the agreement.

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Note 12 Stock-Based Compensation

On January 12, 2012, the Company awarded 179,500 non-qualified stock options to certain employees of the Company pursuant to its 2005 Long Term Incentive Plan. The stock options will vest in three equal annual installments beginning on January 12, 2013 and have a contractual term of 10 years. The exercise price of each option is $23.40, which was the fair market value of the Company s stock on the date of the grant. The Company recognizes stock-based compensation expense based on the fair value of the award on the grant date using the Black-Scholes option valuation model. The estimated fair value of $11.23 per option will be recognized over the period during which an employee is required to provide service in exchange for the award, which is usually the vesting period. The following assumptions were used to value the January 12, 2012 stock options: expected lives of the options of 6 years; expected volatility of 50.86%; risk-free interest rate of 0.84%; and expected dividend yield of 0%.

Expected life in years was determined using the simplified method. The Company believes that it is appropriate to use the simplified method in determining the expected life for options granted after 2007 because the Company does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate the expected term for stock options awarded after 2007 and due to the limited number of stock option grants to date. Expected volatility was based on the historical volatility of the Company s stock. The risk-free interest rate was based on the U.S. Treasury bond rate for the expected life of the option. The expected dividend yield was based on the latest annualized dividend rate and the current market price of the underlying common stock on the date of the grant.

During the six months ended June 30, 2012, the Company awarded 15,650 shares of restricted stock to certain employees of the Company pursuant to its 2005 Long Term Incentive Plan. Each restricted stock award will vest in three equal annual installments beginning on the first anniversary of the award, with continued vesting of the award subject to the recipient s continued employment with the Company. Stock compensation expense will be recognized over the vesting period based on the fair market value of the stock on the date of the award, calculated as the average of the high and low trading prices for the Company s common stock on the award date.

During the six months ended June 30, 2012, the Company awarded 13,296 shares of restricted stock to certain individuals for service on the Company s board of directors pursuant to its 2005 Long Term Incentive Plan. Each restricted stock award will vest on the earlier of May 24, 2013 or the last trading day before the date of the Company s 2013 annual meeting of stockholders. Stock compensation expense will be recognized over the vesting period based on the fair market value of the stock on the date of the award, calculated as the average of the high and low trading prices for the Company s common stock on the award date.

As of June 30, 2012, there was $3,173 of unearned compensation expense related to stock options and restricted stock awards, which will be recognized over the remaining requisite service period of 35 months.

Note 13 Employee Benefit Plans

The Company has qualified, defined benefit pension plans that were established to cover certain employees. The Company also provides certain postretirement health care benefits for certain of its salaried and hourly retired employees. Generally, employees may become eligible for health care benefits if they retire after attaining specified age and service requirements. These benefits are subject to deductibles, co-payment provisions and other limitations.

A substantial portion of the Company s postretirement benefit plan obligation relates to a settlement with the union representing employees at the Company s and its predecessors Johnstown manufacturing facilities. The terms of that settlement require the Company to pay until November 30, 2012 certain monthly amounts toward the cost of retiree health care coverage. The Company s current postretirement benefit plan obligation assumes for accounting purposes a continuation of those monthly payments indefinitely after November 30, 2012 (as would be permitted under the settlement). However, the Company s postretirement benefit plan obligation could significantly increase or decrease if payments were to cease, if litigation should ensue or if the parties should agree on a modified settlement.

Generally, contributions to the plans are not less than the minimum amounts required under the Employee Retirement Income Security Act of 1974 (ERISA) and not more than the maximum amount that can be deducted for federal income tax purposes. The plans assets are held by independent trustees and consist primarily of mutual fund securities.

Table of Contents

The components of net periodic benefit cost (benefit) for the three and six months ended June 30, 2012 and 2011, are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Pension Benefits				
Interest cost	$ 725	$ 784	$ 1,450	$ 1,568
Expected return on plan assets	(862)	(949)	(1,724)	(1,898)
Amortization of unrecognized net loss	126	91	252	182
	$ (11)	$ (74)	$ (22)	$ (148)

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

ARTISANAL BRANDS, INC.
Consolidated Financial Statements

ARTISANAL BRANDS, INC.
CONSOLIDATED BALANCE SHEETS

See notes to the unaudited consolidated financial statements.

ARTISANAL BRANDS, Inc.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

See notes to the unaudited consolidated financial statements.

ARTISANAL BRANDS, Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

See notes to the unaudited consolidated financial statements.

ARTISANAL BRANDS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
NINE MONTHS ENDED FEBRUARY 29, 2012
(UNAUDITED)

ring such period.

corded in the current period. Equity-based compensation for the nine months ended February 29, 2012 and February 28, 2011 was $1,

During the

e Company may not incur any debt or issue any additional common stock without KeHE’s consent, which consent shall not be unreason nder") for a loan of $2.5 million (the "Long Term Loan"). On specified dates since then, the Long Term Loan has been increased by a to

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

ARTISANAL BRANDS, INC.
CONSOLIDATED BALANCE SHEETS

See notes to the consolidated financial statements.

ARTISANAL BRANDS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

See notes to the consolidated financial statements.

ARTISANAL BRANDS, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

See notes to the consolidated financial statements.

ARTISANAL BRANDS, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
YEARS ENDED MAY 31, 2010 and 2011

)	$	2,951,246
		85
		220
		463,750
		(200,000
		(500,000
		151,401
		100,000
		0
		107,288
)		(2,291,614
)	$	782,376
		75,386
		0
		132,511
)		(2,539,667
)	$	(1,549,394

See notes to the consolidated financial statements.

ARTISANAL BRANDS, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED MAY 31, 2011 AND 2010

ntly different from what we have recorded in the current period. Equity-based compensation for the years ended May 31, 2011 and Ma

00, respectively (the "Sellers' Notes"). The note for $130,000 bore interest at 5% per annum and was payable in consecutive monthly p n the bank agreed to forbear until November 9, 2009, in exchange for a $10,000 forbearance fee, a limitation on the loan against invento

bruary 2010, the company had secured from existing shareholders a $150,000 bridge loan at an annual interest rate of nine percent (9%)

any additional common stock without KeHE's consent, which consent shall not be unreasonably withheld; except that the Company is p riority security interest of Terrence Brennan and Marvin Numeroff in certain intellectual property of the Company. This required the as

mpany has entered into a five-year Preferred Vendor Agreement with two restaurant establishments owned by the former member of Ar

Product Development Agreement pursuant to which the Company shall have a “first-look” right and 30-day exclusivity period to evalu

Upon closing the acquisition of Artisanal Cheese LLC in August 2007, the Company negotiated a new five-year lease for approxin

ceedings that are incidental to its operations. None of these proceedings may have, or have had in the 12 months preceding the date of t

PART II - INFORMATION NOT REQUIRED IN PROSPECTUS

Certificate of Incorporation of Artisanal Brands, Inc., as amended and filed with the Secretary of State of the S

By-Laws

icate of Designation for Series A Redeemable Convertible Preferred Stock (incorporated by reference to Exhibit 4.7 of our Report on Fo

Stock Subscription and Investment Representation Agreement Stock (incorporated by reference to Exhibit 4.8 of our Report on Form 1

Form of Subscription Agreement relating to this Offering

Opinion of Janet L. Dowe, Counsel for the Registrant, as to the legality of the Securities being regi

$150,000 Bridge Note dated July 10, 2009 (incorporated by reference to Exhibit 10.21 of our Report on Form 10-KSB for the

ecurity Agreement relating to Bridge Note dated July 10, 2009 (incorporated by reference to Exhibit 10.22 of our Report on Form 10-K

$850,000 Promissory Note dated July 10, 2009 (incorporated by reference to Exhibit 10.23 of our Report on Form 10-KSB for

Security Agreement relating to Term Loan dated July 10, 2009 (incorporated by reference to Exhibit 10.24 of our Report on Form 10-K

Restated Employment Agreement between Registrant and Daniel W. Dowe (incorporated by reference to Exhibit 10.27 of our Report o

Loan Agreement (incorporated by reference to Exhibit 10.23 of our Report on Form 10-KSB for the period ende

Security Agreement (incorporated by reference to Exhibit 10.24of our Report on Form 10-KSB for the period end

Promissory Note (incorporated by reference to Exhibit 10.25 of our Report on Form 10-KSB for the period ende

First Supplemental Promissory Note dated September 1, 2010 (incorporated by reference to Exhibit 10.31 of our Report on Form 10

Second Supplementary Promissory Note dated November 1, 2010 (incorporated by reference to Exhibit 10.32 of our Report on Form

Third Supplemental Promissory Note dated November 2, 2010 (incorporated by reference to Exhibit 10.33 of our Report on Form 10

Marketing and Distribution Agreement dated February 11, 2011 and Addendum dated May 9, 2011 (incorporated by reference to Exhibit 10.34 of our Report on Form 10-K for the period ended M

Fourth Supplemental Promissory Note dated May 27, 2011 (incorporated by reference to Exhibit 10.35 of our Report on Form 10-K

Fifth Supplemental Promissory Note dated August 8, 2011

Sixth Supplemental Promissory Note dated February 2, 2012

Subsidiaries of Registrant

Consent of Sherb & Co., LLP., Certified Public Accountants

Consent of Janet L. Dowe, Esq., Counsel to Registrant (included in Exhibit 5.4 of this Registration St

Signatures