

DOUGLAS DYNAMICS, INC  
Form 10-Q  
November 03, 2015  
Table of Contents

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 September 30, 2015

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 number: 001-34728

DOUGLAS DYNAMICS, INC.

(Exact name of registrant as specified in its charter)

|   |   |
|---|---|
| Delaware  | 134275891                               |
| (State or other jurisdiction of<br>incorporation or organization) | (I.R.S. Employer<br>Identification No.) |

7777 North 73rd Street

Milwaukee, Wisconsin 53223

(Address of principal executive offices) (Zip code)

(414) 354-2310

(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. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Edgar Filing: DOUGLAS DYNAMICS, INC - Form 10-Q

(Do not check if a 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

Number of shares of registrant's common shares outstanding as of November 3, 2015 was 22,387,797.

---

Table of Contents

DOUGLAS DYNAMICS, INC.

Table of Contents

|   |    |
|---|----|
| <u>PART I. FINANCIAL INFORMATION</u>  | 3  |
| <u>Item 1. Financial Statements</u>   | 3  |
| <u>Unaudited Consolidated Balance Sheet as of September 30, 2015 and audited Consolidated Balance Sheet as of December 31, 2014</u>             | 3  |
| <u>Unaudited Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2015 and 2014</u> | 4  |
| <u>Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014</u>                                    | 5  |
| <u>Notes to Unaudited Consolidated Financial Statements</u>   | 6  |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>  | 19 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>   | 29 |
| <u>Item 4. Controls and Procedures</u>  | 29 |
| <u>PART II. OTHER INFORMATION</u>   | 31 |
| <u>Item 1. Legal Proceedings</u>  | 31 |
| <u>Item 1A. Risk Factors</u>  | 31 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 31 |
| <u>Item 3. Defaults Upon Senior Securities</u>  | 31 |
| <u>Item 4. Mine Safety Disclosures</u>  | 31 |
| <u>Item 5. Other Information</u>  | 31 |
| <u>Item 6. Exhibits</u>   | 32 |
| <u>Signatures</u>   | 33 |

Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

Douglas Dynamics, Inc.

## Consolidated Balance Sheets

(In thousands except share data)

|  | September<br>30,<br>2015<br>(unaudited) | December<br>31,<br>2014<br>(audited) |
|--|---|--------------------------------------|
| Assets   |   |                                      |
| Current assets:                                |   |                                      |
| Cash and cash equivalents                      | \$ 3,873                                | \$ 24,195                            |
| Accounts receivable, net                       | 118,538                                 | 60,918                               |
| Inventories                                    | 55,245                                  | 48,248                               |
| Deferred income taxes                          | 5,829                                   | 7,004                                |
| Prepaid and other current assets               | 2,104                                   | 2,156                                |
| Total current assets                           | 185,589                                 | 142,521                              |
| Property, plant, and equipment, net            | 41,073                                  | 37,546                               |
| Goodwill                                       | 160,661                                 | 160,962                              |
| Other intangible assets, net                   | 129,399                                 | 135,009                              |
| Deferred financing costs, net                  | 2,487                                   | 2,485                                |
| Other long-term assets                         | 2,634                                   | 1,920                                |
| Total assets                                   | \$ 521,843                              | \$ 480,443                           |
| Liabilities and stockholders' equity           |   |                                      |
| Current liabilities:                           |   |                                      |
| Accounts payable                               | \$ 13,467                               | \$ 9,753                             |
| Accrued expenses and other current liabilities | 24,773                                  | 33,670                               |
| Income taxes payable                           | 3,169                                   | 642                                  |
| Short term borrowings                          | 27,000                                  | -                                    |
| Current portion of long-term debt              | 1,629                                   | 1,629                                |
| Total current liabilities                      | 70,038                                  | 45,694                               |
| Retiree health benefit obligation              | 7,036                                   | 6,774                                |
| Pension obligation                             | 11,831                                  | 12,316                               |

Edgar Filing: DOUGLAS DYNAMICS, INC - Form 10-Q

|  |            |            |
|--|------------|------------|
| Deferred income taxes  | 51,754     | 49,853     |
| Long-term debt, less current portion   | 185,250    | 186,471    |
| Other long-term liabilities  | 6,645      | 6,046      |
| Stockholders' equity:  |            |            |
| Common Stock, par value \$0.01, 200,000,000 shares authorized, 22,387,797 and 22,282,628 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively | 224        | 223        |
| Additional paid-in capital   | 141,091    | 138,268    |
| Retained earnings  | 54,730     | 40,826     |
| Accumulated other comprehensive loss, net of tax   | (6,756)    | (6,028)    |
| Total stockholders' equity   | 189,289    | 173,289    |
| Total liabilities and stockholders' equity   | \$ 521,843 | \$ 480,443 |

See the accompanying notes to consolidated financial statements

Table of Contents

Douglas Dynamics, Inc.

## Consolidated Statements of Operations and Comprehensive Income

(In thousands, except share and per share data)

|  | Three Months Ended                      |                          | Nine Months Ended                       |                          |
|--|---|--------------------------|---|--------------------------|
|  | September<br>30,<br>2015<br>(unaudited) | September<br>30,<br>2014 | September<br>30,<br>2015<br>(unaudited) | September<br>30,<br>2014 |
| Net sales  | \$ 120,565                              | \$ 78,836                | \$ 281,598                              | \$ 203,457               |
| Cost of sales  | 79,700                                  | 49,746                   | 187,286                                 | 125,827                  |
| Gross profit   | 40,865                                  | 29,090                   | 94,312                                  | 77,630                   |
| Selling, general, and administrative expense             | 12,506                                  | 9,006                    | 35,227                                  | 25,824                   |
| Intangibles amortization                                 | 1,803                                   | 1,439                    | 5,610                                   | 4,348                    |
| Income from operations                                   | 26,556                                  | 18,645                   | 53,475                                  | 47,458                   |
| Interest expense, net                                    | (2,824)                                 | (2,037)                  | (8,057)                                 | (6,007)                  |
| Other expense, net                                       | (60)                                    | (53)                     | (189)                                   | (136)                    |
| Income before taxes                                      | 23,672                                  | 16,555                   | 45,229                                  | 41,315                   |
| Income tax expense                                       | 8,124                                   | 5,793                    | 16,194                                  | 14,385                   |
| Net income   | \$ 15,548                               | \$ 10,762                | \$ 29,035                               | \$ 26,930                |
| Less net income attributable to participating securities | 214                                     | 155                      | 405                                     | 397                      |
| Net income attributable to common shareholders           | \$ 15,334                               | \$ 10,607                | \$ 28,630                               | \$ 26,533                |
| Weighted average number of common shares<br>outstanding: |   |                          |   |                          |
| Basic  | 22,362,787                              | 22,197,609               | 22,314,198                              | 22,158,690               |
| Diluted  | 22,373,351                              | 22,218,052               | 22,330,095                              | 22,178,688               |
| Earnings per common share:                               |   |                          |   |                          |
| Basic  | \$ 0.69                                 | \$ 0.48                  | \$ 1.28                                 | \$ 1.20                  |
| Diluted  | \$ 0.68                                 | \$ 0.47                  | \$ 1.27                                 | \$ 1.19                  |
| Cash dividends declared and paid per share               | \$ 0.22                                 | \$ 0.22                  | \$ 0.67                                 | \$ 0.65                  |

|                      |           |           |           |           |
|----------------------|-----------|-----------|-----------|-----------|
| Comprehensive income | \$ 14,553 | \$ 10,778 | \$ 28,307 | \$ 26,974 |
|----------------------|-----------|-----------|-----------|-----------|

See the accompanying notes to consolidated financial statements.



Table of Contents

Douglas Dynamics, Inc.

## Consolidated Statements of Cash Flows

(in thousands)

|   | Nine Months Ended        |                          |
|---|--------------------------|--------------------------|
|   | September<br>30,<br>2015 | September<br>30,<br>2014 |
|   | (unaudited)              |                          |
| Operating activities  |                          |                          |
| Net income  | \$ 29,035                | \$ 26,930                |
| Adjustments to reconcile net income to net cash used in operating activities: |                          |                          |
| Depreciation and amortization   | 9,193                    | 6,885                    |
| Inventory step up of acquired business included in cost of sales              | 1,956                    | -                        |
| Amortization of deferred financing costs and debt discount                    | 502                      | 569                      |
| Loss recognized on assets held for sale                                       | -                        | 67                       |
| Stock-based compensation  | 2,740                    | 2,143                    |
| Provision for losses on accounts receivable                                   | 170                      | 171                      |
| Deferred income taxes   | 3,219                    | 4,124                    |
| Earnout liability   | 556                      | 810                      |
| Changes in operating assets and liabilities, net of acquisitions:             |                          |                          |
| Accounts receivable   | (57,790)                 | (54,397)                 |
| Inventories   | (8,954)                  | (8,441)                  |
| Prepaid and other assets  | (962)                    | 1,866                    |
| Accounts payable  | 3,714                    | (2,742)                  |
| Accrued expenses and other current liabilities                                | 5,607                    | 6,188                    |
| Benefit obligations and other long-term liabilities                           | (908)                    | (2,306)                  |
| Net cash used in operating activities   | (11,922)                 | (18,133)                 |
| Investing activities  |                          |                          |
| Capital expenditures  | (7,110)                  | (3,310)                  |
| Proceeds from sale of assets held for sale                                    | -                        | 1,018                    |

Edgar Filing: DOUGLAS DYNAMICS, INC - Form 10-Q

|   |          |          |
|---|----------|----------|
| Acquisition of business   | (11,818) | —        |
| Net cash used in investing activities                                 | (18,928) | (2,292)  |
| Financing activities  |          |          |
| Shares withheld on restricted stock vesting paid for employees' taxes | (27)     | (97)     |
| Proceeds from exercise of stock options                               | 111      | -        |
| Dividends paid  | (15,131) | (14,690) |
| Net revolver borrowings   | 27,000   | 20,500   |
| Repayment of long-term debt   | (1,425)  | (863)    |
| Net cash provided by financing activities                             | 10,528   | 4,850    |
| Change in cash and cash equivalents                                   | (20,322) | (15,575) |
| Cash and cash equivalents at beginning of period                      | 24,195   | 19,864   |
| Cash and cash equivalents at end of period                            | \$ 3,873 | \$ 4,289 |

See the accompanying notes to consolidated financial statements.

Table of Contents

Douglas Dynamics, Inc.

Notes to Unaudited Consolidated Financial Statements

(in thousands except share and per share data)

1. Basis of presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for fiscal year-end financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. For further information, refer to the financial statements and related footnotes included in our 2014 Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission on March 12, 2015.

We operate as a single business segment.

Certain reclassifications have been made to the prior period financial statements to conform to the 2015 presentation. Loss recognized on assets held for sale has been combined with selling, general, and administrative expense on the Consolidated Statements of Operations and Comprehensive Income. Deferred compensation has been combined with other long-term liabilities on the Consolidated Balance Sheet. Deferred compensation has been combined with benefit obligations and other long-term liabilities on the Consolidated Statements of Cash Flows.

Interim Consolidated Financial Information

The accompanying consolidated balance sheet as of September 30, 2015 and the consolidated statements of operations and comprehensive income for the three and nine months ended September 30, 2015 and 2014 and cash flows for the nine months ended September 30, 2015 and 2014 have been prepared by the Company and have not been audited.

The Company is a counterparty to interest-rate swap agreement to hedge against the potential impact on earnings from increases in market interest rates. The Company entered into three interest rate swap agreements during the first quarter of 2015 with notional amounts of \$45,000, \$90,000 and \$135,000 effective for the periods December 31,

2015 through March 29, 2018, March 29, 2018 through March 31, 2020 and March 31, 2020 through June 30, 2021, respectively. Under the interest rate swap agreement, effective as of December 31, 2015 the Company will either receive or make payments on a monthly basis based on the differential between 6.105% and London Interbank Offered Rate (“LIBOR”) plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 29, 2018 the Company will either receive or make payments on a monthly basis based on the differential between 6.916% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement effective as of March 31, 2020 the Company will either receive or make payments on a monthly basis based on the differential between 7.168% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). The negative fair value of the interest rate swap, net of tax, of (\$1,170) at September 30, 2015 is included in “Accumulated other comprehensive loss” on the balance sheet. This fair value was determined using Level 2 inputs as defined in Accounting Standards Codification Topic (“ASC”) 820. Additionally, other comprehensive income includes the net income of the Company plus the Company’s adjustments for its defined benefit retirement plans based on the measurement date as of the Company’s year-end. For further disclosure, refer to Note 14 to the Unaudited Consolidated Financial Statements.

The Company’s business is seasonal and consequently its results of operations and financial condition vary from quarter-to-quarter. Because of this seasonality, the Company’s results of operations for any quarter may not be indicative of results of operations that may be achieved for a subsequent quarter or the full year, and may not be similar to results of operations experienced in prior years. The Company attempts to manage the seasonal impact of snowfall on its revenues in part through its pre-season sales program. This pre-season sales program encourages the Company’s distributors to re-stock their inventory during the second and third quarters in anticipation of the peak fourth quarter retail sales period by offering favorable pre-season pricing and payment

Table of Contents

deferral until the fourth quarter. Thus, the Company tends to generate its greatest volume of sales during the second and third quarters. By contrast, its revenue and operating results tend to be lowest during the first quarter, as management believes the Company's end-users prefer to wait until the beginning of a snow season to purchase new equipment and as the Company's distributors sell off inventory and wait for the pre-season sales incentive period to re-stock inventory. Fourth quarter sales vary from year-to-year as they are primarily driven by the level, timing and location of snowfall during the quarter. This is because most of the Company's fourth quarter sales and shipments consist of re-orders by distributors seeking to restock inventory to meet immediate customer needs caused by snowfall during the winter months.

## 2.Fair Value

Fair value is the price at which an asset could be exchanged in a current transaction between knowledgeable, willing parties. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new obligor, not the amount that would be paid to settle the liability with the creditor. Fair value measurements are categorized into one of three levels based on the lowest level of significant input used: Level 1 (unadjusted quoted prices in active markets); Level 2 (observable market inputs available at the measurement date, other than quoted prices included in Level 1); and Level 3 (unobservable inputs that cannot be corroborated by observable market data).

The following table presents financial assets and liabilities measured at fair value on a recurring basis and discloses the fair value of long-term debt:

|                            | Fair Value<br>at<br>September<br>30,<br>2015 | Fair Value<br>at<br>December<br>31,<br>2014 |
|----------------------------|--|---|
| Assets:                    |  |   |
| Other long-term assets (a) | \$ 2,437                                     | \$ 1,725                                    |
| Total Assets               | \$ 2,437                                     | \$ 1,725                                    |
| Liabilities:               |  |   |
| Interest rate swaps (b)    | \$ 1,888                                     | \$ -  |

|                         |            |            |
|-------------------------|------------|------------|
| Long term debt (c)      | 186,412    | 187,160    |
| Earnout - TrynEx (d)    | 2,032      | 1,987      |
| Earnout - Henderson (e) | 798        | 600        |
| Total Liabilities       | \$ 191,130 | \$ 189,747 |

---

(a) Included in other assets is the cash surrender value of insurance policies on various individuals that are associated with the Company. The carrying amounts of these insurance policies approximates their fair value.

(b) Valuation models are calibrated to initial trade price. Subsequent valuations are based on observable inputs to the valuation model (e.g. interest rates and credit spreads). Model inputs are changed only when corroborated by market data. A credit risk adjustment is made on each swap using observable market credit spreads. Thus, inputs used to determine fair value of the interest rate swap are Level 2 inputs. Interest rate swaps of \$212 and \$1,676 at September 30, 2015 are included in accrued expenses and other current liabilities and other long-term liabilities, respectively.

(c) The fair value of the Company's long-term debt, including current maturities, is estimated using discounted cash flows based on the Company's current incremental borrowing rates for similar types of borrowing arrangements, which is a Level 2 input for all periods presented. Meanwhile, long-term debt is recorded at carrying amount, net of discount, as disclosed on the face of the balance sheet.

Table of Contents

(d) Included in accrued expenses and other current liabilities in the amount of \$2,032 at September 30, 2015 is an obligation for a portion of the potential earn out incurred in conjunction with the acquisition of substantially all of the assets of TrynEx, Inc. (“TrynEx”). The carrying amount of the earn out approximates its fair value. Fair value is based upon Level 3 inputs of a monte carlo simulation analysis using key inputs of forecasted future sales and financial performance as well as a growth rate reduced by the market required rate of return. See reconciliation of liability included below:

|                           | Three<br>Months<br>Ended<br>September<br>30,<br>2015 | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 | Three<br>Months<br>Ended<br>September<br>30,<br>2014 | Nine<br>Months<br>Ended<br>September<br>30,<br>2014 |
|---------------------------|--|---|--|---|
| Beginning Balance         | \$ 2,032   | \$ 1,987  | \$ 3,587   | \$ 3,587  |
| Additions                 | —  | —   | —  | —   |
| Adjustments to fair value | —  | 313   | 400  | 400   |
| Payment to former owners  | —  | (268)   | —  | —   |
| Ending balance            | \$ 2,032   | \$ 2,032  | \$ 3,987   | \$ 3,987  |

(e) Included in accrued expenses and other current liabilities and other long term liabilities in the amounts of \$356 and \$442, respectively, at September 30, 2015 is the fair value of an obligation for a portion of the potential earn out acquired in conjunction with the acquisition of Henderson Enterprise Group, Inc. (“Henderson”). Fair value is based upon Level 3 discounted cash flow analysis using key inputs of forecasted future sales as well as a growth rate reduced by the market required rate of return. See reconciliation of liability included below:

| Three<br>Months<br>Ended<br>September<br>30,<br>2015 | Nine<br>Months<br>Ended<br>September<br>30,<br>2015 |
|--|---|
|--|---|

|                           |        |        |
|---------------------------|--------|--------|
| Beginning Balance         | \$ 714 | \$ 600 |
| Additions                 | —      | —      |
| Adjustments to fair value | 95     | 287    |
| Payment to former owners  | (11)   | (89)   |
| Ending balance            | \$ 798 | \$ 798 |

### 3. Inventories

Inventories consist of the following:

|                                    | September<br>30,<br>2015 | December<br>31,<br>2014 |
|------------------------------------|--------------------------|-------------------------|
| Finished goods and work-in-process | \$ 42,086                | \$ 38,906               |
| Raw material and supplies          | 13,159                   | 9,342                   |
|                                    | \$ 55,245                | \$ 48,248               |





Table of Contents

## 4. Property, plant and equipment

Property, plant and equipment are summarized as follows:

|                                     | September<br>30,<br>2015 | December<br>31,<br>2014 |
|-------------------------------------|--------------------------|-------------------------|
| Land                                | \$ 1,500                 | \$ 1,500                |
| Land improvements                   | 2,999                    | 2,292                   |
| Leasehold Improvements              | 643                      | 499                     |
| Buildings                           | 22,862                   | 21,918                  |
| Machinery and equipment             | 33,931                   | 31,780                  |
| Furniture and fixtures              | 10,577                   | 10,070                  |
| Mobile equipment and other          | 2,253                    | 1,999                   |
| Construction-in-process             | 3,949                    | 1,930                   |
| Total property, plant and equipment | 78,714                   | 71,988                  |
| Less accumulated depreciation       | (37,641)                 | (34,442)                |
| Net property, plant and equipment   | \$ 41,073                | \$ 37,546               |

## 5. Long-Term Debt

Long-term debt is summarized below:

|  | September<br>30,<br>2015 | December<br>31,<br>2014 |
|--|--------------------------|-------------------------|
| Term Loan, net of debt discount of \$1,696 and \$1,900 at September 30, 2015 and December 31, 2014, respectively | \$ 186,879               | \$ 188,100              |
| Less current maturities  | 1,629                    | 1,629                   |
|  | \$ 185,250               | \$ 186,471              |

The Company's senior credit facilities consist of a \$190,000 term loan facility and a \$100,000 revolving credit facility with a group of banks, of which \$10,000 will be available in the form of letters of credit and \$5,000 will be available for the issuance of short-term swing line loans. The agreement for the term loan (the "Term Loan Credit Agreement") provides for a senior secured term loan facility in the aggregate principal amount of \$190,000 and generally bears interest (at the Company's election) at either (i) 3.25% per annum plus the greatest of (a) the Prime Rate (as defined in the Term Loan Credit Agreement) in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) 1.00% plus the greater of (1) the LIBOR for a one month interest period multiplied by the Statutory Reserve Rate (as defined in the Term Loan Credit Agreement) and (2) 1.00% or (ii) 4.25% per annum plus the greater of (a) the LIBOR for the applicable interest period multiplied by the Statutory Reserve Rate and (b) 1.00%. The Term Loan Credit Agreement also allows the Company to request the establishment of one or more additional term loan commitments in an aggregate amount not in excess of \$80,000 subject to specified terms and conditions, which amount may be further increased so long as the First Lien Debt Ratio (as defined in the Term Loan Credit Agreement) is not greater than 3.25 to 1.00.

The revolving credit facility (the "Revolving Credit Agreement") provides that the Company has the option to select whether borrowings will bear interest at either (i) a margin ranging from 1.50% to 2.00% per annum, depending on the utilization of the facility, plus the LIBOR for the applicable interest period multiplied by the Statutory Reserve Rate (as defined by the Revolving Credit Agreement) or (ii) a margin ranging from 0.50% to

Table of Contents

1.00% per annum, depending on the utilization of the facility, plus the greatest of (a) the Prime Rate (as defined in the Revolving Credit Agreement) in effect on such day, (b) the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers plus 0.50% and (c) the LIBOR for a one month interest period multiplied by the Statutory Reserve Rate plus 1%. The maturity date for the Revolving Credit Agreement is December 31, 2019, and the Company's term loan amortizes in nominal amounts quarterly with the balance payable on December 31, 2021.

The term loan was issued at a \$1,900 discount which is being amortized over the term of the term loan.

At September 30, 2015, the Company had outstanding borrowings on the Revolving Credit Agreement of \$27,000 and remaining borrowing availability of \$72,440. There were no outstanding borrowings on the Revolving Line of Credit at December 31, 2014.

The Company's senior credit facilities include certain negative and operating covenants, including restrictions on its ability to pay dividends, and other customary covenants, representations and warranties and events of default. The senior credit facilities entered into and recorded by the Company's subsidiaries significantly restrict its subsidiaries from paying dividends and otherwise transferring assets to Douglas Dynamics, Inc. The terms of the Revolving Credit Agreement specifically restrict subsidiaries from paying dividends if a minimum availability under the Revolving Credit Agreement is not maintained, and both senior credit facilities restrict subsidiaries from paying dividends above certain levels or at all if an event of default has occurred. These restrictions would affect the Company indirectly since the Company relies principally on distributions from its subsidiaries to have funds available for the payment of dividends. In addition, the Revolving Credit Agreement includes a requirement that, subject to certain exceptions, capital expenditures may not exceed \$12,500 in any calendar year (plus the unused portion of permitted capital expenditures from the preceding year subject to a \$12,500 cap and a separate one-time \$15,000 capital expenditures to be used for the consolidation of facilities and costs associated with the acquiring and/or development and construction of one new manufacturing facility) and, if certain minimum availability under the Revolving Credit Agreement is not maintained, that the Company comply with a monthly minimum fixed charge coverage ratio test of 1.0:1.0. Compliance with the fixed charge coverage ratio test is subject to certain cure rights under the Revolving Credit Agreement. At September 30, 2015, the Company was in compliance with the respective covenants. The credit facilities are collateralized by substantially all assets of the Company.

In accordance with the senior credit facilities, the Company is required to make additional principal prepayments over the above scheduled payments under certain conditions. This includes, in the case of the term loan facility, 100% of the net cash proceeds of certain asset sales, certain insurance or condemnation events, certain debt issuances, and, within 150 days of the end of the fiscal year, 50% of excess cash flow, as defined, including a deduction for certain distributions (which percentage is reduced to 0% upon the achievement of certain leverage ratio thresholds), for any fiscal year. Excess cash flow is defined in the senior credit facilities as consolidated adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) plus a working capital adjustment less the sum of repayments of debt and capital expenditures subject to certain adjustments, interest and taxes paid in cash, management fees and certain restricted payments (including dividends or distributions). Working capital adjustment is defined in the senior credit facilities as the change in working capital, defined as current assets excluding cash and cash equivalents less

current liabilities excluding current portion of long term debt. As of September 30, 2015, the Company was not required to make an excess cash flow payment.

The Company entered into interest rate swap agreements on February 20, 2015 to reduce its exposure to interest rate volatility. The three interest rate swap agreements have notional amounts of \$45,000, \$90,000 and \$135,000 effective for the periods December 31, 2015 through March 29, 2018, March 29, 2018 through March 31, 2020 and March 31, 2020 through June 30, 2021, respectively. The interest rate swaps' negative fair value at September 30, 2015 was \$1,888, of which \$212 and \$1,676 are included in accrued expenses and other current liabilities and other long-term liabilities on the Consolidated Balance Sheet, respectively. The Company has counterparty credit risk resulting from the interest rate swap, which it monitors on an on-going basis. This risk lies with one global financial institution. Under the interest rate swap agreement, effective as of December 31, 2015, the Company will either receive or make payments on a monthly basis based on the differential between 6.105% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap

Table of Contents

agreement, effective as of March 29, 2018, the Company will either receive or make payments on a monthly basis based on the differential between 6.916% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 31, 2020, the Company will either receive or make payments on a monthly basis based on the differential between 7.168% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%).

## 6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other liabilities are summarized as follows:

|                           | September<br>30,<br>2015 | December<br>31,<br>2014 |
|---------------------------|--------------------------|-------------------------|
| Payroll and related costs | \$ 8,418                 | \$ 3,860                |
| Employee benefits         | 4,016                    | 7,716                   |
| Accrued warranty          | 6,628                    | 6,279                   |
| Amounts due to sellers    | -                        | 11,824                  |
| Other                     | 5,711                    | 3,991                   |
|                           | \$ 24,773                | \$ 33,670               |

## 7. Warranty Liability

The Company accrues for estimated warranty costs as sales are recognized and periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. The Company's warranties generally provide, with respect to its snow and ice control equipment, that all material and workmanship will be free from defect for a period of two years after the date of purchase by the end-user, and with respect to its parts and accessories purchased separately, that such parts and accessories will be free from defect for a period of one year after the date of purchase by the end-user. Certain snowplows only provide for a one year warranty. The Company determines the amount of the estimated warranty costs (and its corresponding warranty reserve) based on the Company's prior five years of warranty history utilizing a formula driven by historical warranty expense and applying management's judgment. The Company adjusts its historical warranty costs to take into account unique factors such as the introduction of new products into the marketplace that do not provide a historical warranty record to assess. The warranty reserve is included in accrued expenses and other current liabilities in the accompanying consolidated balance sheets.

The following is a rollforward of the Company's warranty liability:

|  | Three Months Ended |                    | Nine Months Ended  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2015 | September 30, 2014 | September 30, 2015 | September 30, 2014 |
| Balance at the beginning of the period | \$ 5,641           | \$ 3,634           | \$ 6,279           | \$ 3,808           |
| Warranty provision                     | 1,475              | 1,313              | 3,256              | 3,132              |
| Claims paid/settlements                | (488)              | (211)              | (2,907)            | (2,204)            |
| Balance at the end of the period       | \$ 6,628           | \$ 4,736           | \$ 6,628           | \$ 4,736           |

Table of Contents

## 8. Employee Retirement Plans

The components of net periodic pension cost consist of the following:

|   | Three months<br>ended    |                          | Nine Months Ended        |                          |
|---|--------------------------|--------------------------|--------------------------|--------------------------|
|   | September<br>30,<br>2015 | September<br>30,<br>2014 | September<br>30,<br>2015 | September<br>30,<br>2014 |
| Component of net periodic pension cost: |                          |                          |                          |                          |
| Service cost                            | \$ 64                    | \$ 54                    | \$ 192                   | \$ 162                   |
| Interest cost                           | 372                      | 374                      | 1,116                    | 1,122                    |
| Expected return on plan assets          | (407)                    | (408)                    | (1,221)                  | (1,224)                  |
| Amortization of net loss                | 255                      | 51                       | 765                      | 153                      |
| Net periodic pension cost               | \$ 284                   | \$ 71                    | \$ 852                   | \$ 213                   |

The Company estimates its total required minimum contributions to its pension plans in 2015 will be \$775. Through September 30, 2015, the Company has made \$572 of cash contributions to the pension plans versus \$1,108 through the same period in 2014.

Components of net periodic other postretirement benefit cost (gain) consist of the following:

|  | Three Months<br>Ended | Nine Months<br>Ended |
|--|-----------------------|----------------------|
|--|-----------------------|----------------------|



|   | September<br>30,<br>2015 | September<br>30,<br>2014 | September<br>30,<br>2015 | September<br>30,<br>2014 |
|---|--------------------------|--------------------------|--------------------------|--------------------------|
| Component of periodic other postretirement benefit cost (gain): |                          |                          |                          |                          |
| Service cost  | \$ 57                    | \$ 40                    | \$ 171                   | \$ 119                   |
| Interest cost   | 64                       | 53                       | 192                      | 160                      |
| Amortization of net gain  | (17)                     | (100)                    | (51)                     | (299)                    |
| Net periodic other postretirement benefit cost (gain)           | \$ 104                   | \$ (7)                   | \$ 312                   | \$ (20)                  |

## 9.Earnings per Share

Basic earnings per share of common stock is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share of common stock is computed by dividing net income by the weighted average number of common shares and common stock equivalents related to the assumed exercise of stock options, using the two-class method. Stock options for which the exercise price exceeds the average fair value have an anti-dilutive effect on earnings per share and are excluded from the calculation.

As restricted shares and restricted stock units both participate in dividends, in accordance with ASC 260, the Company has calculated earnings per share pursuant to the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and participating securities according to dividends declared and participation rights in undistributed earnings. Under this method, all earnings (distributed and undistributed) are allocated to common shares and participating securities based on their respective rights to receive dividends.

Table of Contents

|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September          | September  | September         | September  |
|   | 30,                | 30,        | 30,               | 30,        |
|   | 2015               | 2014       | 2015              | 2014       |
| Basic earnings per common share                           |                    |            |                   |            |
| Net income  | \$ 15,548          | \$ 10,762  | \$ 29,035         | \$ 26,930  |
| Less income allocated to participating securities         | 214                | 155        | 405               | 397        |
| Net income allocated to common shareholders               | \$ 15,334          | \$ 10,607  | \$ 28,630         | \$ 26,533  |
| Weighted average common shares outstanding                | 22,362,787         | 22,197,609 | 22,314,198        | 22,158,690 |
|   | \$ 0.69            | \$ 0.48    | \$ 1.28           | \$ 1.20    |
| Earnings per common share assuming dilution               |                    |            |                   |            |
| Net income  | \$ 15,548          | \$ 10,762  | \$ 29,035         | \$ 26,930  |
| Less income allocated to participating securities         | 214                | 155        | 405               | 397        |
| Net income allocated to common shareholders               | \$ 15,334          | \$ 10,607  | \$ 28,630         | \$ 26,533  |
| Weighted average common shares outstanding                | 22,362,787         | 22,197,609 | 22,314,198        | 22,158,690 |
| Incremental shares applicable to stock based compensation | 10,564             | 20,443     | 15,897            | 19,998     |
| Weighted average common shares assuming dilution          | 22,373,351         | 22,218,052 | 22,330,095        | 22,178,688 |
|   | \$ 0.68            | \$ 0.47    | \$ 1.27           | \$ 1.19    |

#### Amended and Restated 2004 Stock Incentive Plan

As of September 30, 2015, no additional shares of common stock were reserved for issuance upon the exercise of outstanding options under the Company's Amended and Restated 2004 Stock Incentive Plan (the "A&R 2004 Plan"). No further awards are permitted to be issued under the A&R 2004 Plan.

There were 26,350 stock options exercised with respect to the Company's stock under the A&R 2004 Plan during both the three months and nine months ended September 30, 2015. The option holder paid the Company the required aggregate exercise price of \$111 for options exercised at the time of exercise. Stock options were previously expensed over the vesting period and therefore no additional expense was recorded at the time of exercise. There were no stock options exercised with respect to the Company's stock under the A&R 2004 Plan for the three and nine months ended September 30, 2014.

#### 2010 Stock Incentive Plan

In May 2010, the Company's Board of Directors and stockholders adopted the 2010 Stock Incentive Plan (the "2010 Plan"). The Company's Board of Directors approved an amendment and restatement of the 2010 Plan on March 5, 2014, contingent on stockholder approval of the performance goals under the 2010 Plan, and the amendment and restatement became effective upon stockholder approval of the performance goals at the 2014 annual meeting of stockholders held on April 30, 2014. The 2010 Plan provides for the issuance of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock awards and restricted stock units ("RSUs"), any of which may be performance-based, and for incentive bonuses, which may be paid in cash or stock or a combination of both, to eligible employees, officers, non-employee directors and other service providers to the Company and its subsidiaries. A maximum of 2,130,000 shares of common stock may be issued pursuant to all awards under the 2010 Plan.

Table of Contents

## Restricted Stock Awards

A summary of restricted stock activity for the nine months ended September 30, 2015 is as follows:

|  | Shares | Weighted<br>Average<br>Grant<br>Date<br>Fair value | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|--|--------|--|---|
| Unvested at December 31, 2014                        | 85,021 | \$ 13.02   | 0.51 years  |
| Granted  | -      | -  | -   |
| Vested   | 70,320 | \$ 12.65   |   |
| Cancelled and forfeited                              | —      | —  |   |
| Unvested at September 30, 2015                       | 14,701 | \$ 14.78   | 0.25 years  |
| Expected to vest in the future at September 30, 2015 | 14,172 | \$ 14.78   | 0.25 years  |

The fair value of the Company's restricted stock awards is the closing stock price on the date of grant. The Company recognized \$52 and \$325 of compensation expense related to restricted stock awards granted for the three and nine months ended September 30, 2015, respectively. The Company recognized \$215 and \$660 of compensation expense related to restricted stock awards granted for the three and nine months ended September 30, 2014, respectively. The unrecognized compensation expense calculated under the fair value method for shares expected to vest as of September 30, 2015 was approximately \$52 and is expected to be recognized over a weighted average period of 0.25 years.

## Performance Share Unit Awards

The Company granted performance share units as performance based awards under the 2010 Plan in the first quarter of 2015 that are subject to performance conditions. Upon meeting the prescribed performance conditions, in the first quarter of the year subsequent to grant, employees will be issued RSUs a portion of which will be subject to vesting over the two years following the end of the performance period. In accordance with ASC 718, such awards are being expensed over the vesting period from the date of grant through the requisite service period, based upon the most probable outcome. The fair value per share of the awards is the closing stock price on the date of grant, which was \$22.63. The Company recognized \$396 and \$925 of compensation expense related to the awards in the three and nine months ended September 30, 2015, respectively. The Company recognized \$171 and \$390 of compensation expense related to the awards in the three and nine months ended September 30, 2014, respectively. The unrecognized compensation expense calculated under the fair value method for shares that were, as of September 30, 2015, expected to be earned through the requisite service period was approximately \$767 and is expected to be recognized through 2018.

#### Restricted Stock Unit Awards

RSUs are granted to both non-employee directors and management. RSUs carry dividend equivalent rights but do not carry voting rights. Each RSU represents the right to receive one share of the Company's common stock and is subject to time based vesting restrictions. Participants are not required to pay any consideration to the Company at either the time of grant of a RSU or upon vesting.

RSUs issued to management include a retirement provision under which members of management who either (1) are age 65 or older or (2) have at least ten years of service and are at least age 55 will continue to vest in unvested RSUs upon retirement. As the retirement provision does not qualify as a substantive service condition, the Company incurred \$303 and \$278 in additional expense in the first quarter of 2015 and 2014, respectively, for

Table of Contents

employees who meet the thresholds of the retirement provision. In 2013, the Company's nominating and governance committee approved a retirement provision for the RSUs issued to non-employee directors that accelerates the vesting of such RSUs upon retirement. Such awards are fully expensed immediately upon grant in accordance with ASC 718, as the retirement provision eliminates substantive service conditions associated with the awards.

A summary of RSU activity for the nine months ended September 30, 2015 is as follows:

|  | Shares    | Weighted<br>Average<br>Grant<br>Date<br>Fair value | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|--|-----------|--|---|
| Unvested at December 31, 2014                        | 81,623    | \$ 15.05   | 1.09 years  |
| Granted  | 116,141   | \$ 18.72   | 0.48 years  |
| Vested   | (131,504) | \$ 16.43   |   |
| Cancelled and forfeited                              | (1,882)   | \$ 15.82   |   |
| Unvested at September 30, 2015                       | 64,378    | \$ 17.29   | 0.97 years  |
| Expected to vest in the future at September 30, 2015 | 62,060    | \$ 17.29   | 0.97 years  |

The Company recognized \$311 and \$1,490 of compensation expense related to the RSU awards in the three and nine months ended September 30, 2015, respectively. The Company recognized \$160 and \$1,093 of compensation expense related to the RSU awards in the three and nine months ended September 30, 2014, respectively. The unrecognized compensation expense, net of expected forfeitures, calculated under the fair value method for shares that were, as of September 30, 2015, expected to be earned through the requisite service period was approximately \$544 and is expected to be recognized through 2018.

Vested director RSUs are "settled" by the delivery to the participant or a designated brokerage firm of one share of common stock per vested RSU as soon as reasonably practicable following a termination of service of the participant that constitutes a separation from service, and in all events no later than the end of the calendar year in which such termination of service occurs or, if later, two and one-half months after such termination of service. Vested

management RSUs are “settled” by the delivery to the participant or a designated brokerage firm of one share of common stock per vested RSU as soon as reasonably practicable following vesting.

#### 11. Commitments and Contingencies

In the ordinary course of business, the Company is engaged in various litigation including product liability and intellectual property disputes. However, the Company does not believe that any pending litigation will have a material adverse effect on its consolidated financial position. In addition, the Company is not currently a party to any environmental-related claims or legal matters.

#### 12. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The largest item affecting deferred taxes is the difference between book and tax amortization of goodwill and other intangibles amortization. The Company’s effective tax rate was 34.3% and 35.0% for the three months ended September 30, 2015 and 2014, respectively. The Company’s effective tax rate was 35.8% and 34.8% for the nine months ended September 30, 2015 and 2014, respectively. The effective tax rate for the three months ended September 30, 2015 is lower than the corresponding period in 2014 due to discrete period adjustments. The effective tax rate for the nine

Table of Contents

months ended September 30, 2015 is higher than the corresponding period in 2014 due to the Company generating additional state tax liabilities following the acquisition of Henderson.

## 13. Acquisition

On December 31, 2014, the Company acquired by merger all of the outstanding common stock of Henderson for the purpose of expanding its current market presence in the snow and ice segment. Total consideration was \$98,511 including a working capital adjustment of \$4,688. The Company paid the former shareholders of Henderson \$4,688 of the working capital adjustment in the nine months ended September 30, 2015 and as of December 31, 2014 had an outstanding amount payable to a former Henderson shareholder. The outstanding amount payable to the former Henderson shareholder was \$3,340 at December 31, 2014 was included in accrued expenses and other current liabilities until it was paid to the former shareholder in the three and nine months ended September 30, 2015. As required by the merger agreement, the Company also paid the sellers \$3,790 in cash that was acquired at December 31, 2014 in the nine months ended September 30, 2015. The acquisition was financed by amending the Company's senior credit facilities, which are described above in Note 5 and through the use of on hand cash. The Company did not incur any transaction expenses related to this acquisition in the three or nine months ended September 30, 2014.

The following table summarizes the preliminary allocation of the purchase price paid and the subsequent working capital adjustment to the fair value of the net assets acquired as of the acquisition date:

|  |           |
|--|-----------|
| Cash and cash equivalents                      | \$ 3,950  |
| Accounts receivable                            | 14,951    |
| Inventories                                    | 16,308    |
| Refundable income taxes paid                   | 1,307     |
| Deferred income taxes - current                | 625       |
| Other current assets                           | 876       |
| Property and equipment                         | 10,848    |
| Goodwill                                       | 47,529    |
| Intangible assets                              | 17,390    |
| Other assets - long term                       | 74        |
| Accounts payable and other current liabilities | (12,265)  |
| Deferred income taxes - long term              | (2,834)   |
| Other liabilities - long term                  | (248)     |
| Total  | \$ 98,511 |

The fair values of the assets acquired and liabilities assumed included in the table above are preliminary and subject to change as the Company assesses certain reserves.





Table of Contents

The following unaudited pro forma information presents the consolidated results of operations of the Company and Henderson for the three and nine months ended September 30, 2014, as if the acquisition had occurred on January 1, 2014, with pro forma adjustments to give effect to amortization of intangible assets, depreciation of fixed assets, an increase in interest expense from acquisition financing, and certain other adjustments:

|   | Three Months Ended<br>September 30,<br>2014 | Nine<br>Months<br>Ended<br>September<br>30,<br>2014 |
|---|---|---|
| Net sales   | \$ 98,772                                   | \$ 259,777  |
| Net income  | \$ 12,814                                   | \$ 28,112   |
| Earnings per common share assuming dilution attributable to common shareholders | \$ 0.55                                     | \$ 1.24   |

This information is presented for information purposes only and is not necessarily indicative of what the Company's results of operations would have been had the acquisition been in effect for the periods presented or future results.

## 14.Changes in Accumulated Other Comprehensive Loss by Component

Changes to accumulated other comprehensive loss by component for the nine months ended September 30, 2015 are as follows:

| Unrealized<br>Net Loss<br>on Interest<br>Rate<br>Swap | Retiree<br>Health<br>Benefit<br>Obligation | Pension<br>Obligation | Total |
|---|--|-----------------------|-------|
|---|--|-----------------------|-------|

Edgar Filing: DOUGLAS DYNAMICS, INC - Form 10-Q

|   |            |        |            |            |
|---|------------|--------|------------|------------|
| Balance at December 31, 2014  | \$ -       | \$ 807 | \$ (6,835) | \$ (6,028) |
| Other comprehensive loss before reclassifications                   | (1,170)    | —      | —          | (1,170)    |
| Amounts reclassified from accumulated other comprehensive loss: (1) | -          | (32)   | 474        | 442        |
| Balance at September 30, 2015                                       | \$ (1,170) | \$ 775 | \$ (6,361) | \$ (6,756) |
| (1) Amounts reclassified from accumulated other comprehensive loss: |            |        |            |            |
| Amortization of Other Postretirement Benefit items:                 |            |        |            |            |
| Actuarial gains (a)   | (51)       |        |            |            |
| Tax expense   | 19         |        |            |            |
| Reclassification net of tax   | \$ (32)    |        |            |            |
| Amortization of pension items:                                      |            |        |            |            |
| Actuarial losses (a)  | 765        |        |            |            |
| Tax benefit   | (291)      |        |            |            |
| Reclassification net of tax   | \$ 474     |        |            |            |

(a) – These components are included in the computation of benefit plan costs in Note 8.

Table of Contents

Changes to accumulated other comprehensive loss by component for the nine months ended September 30, 2014 are as follows:

|  | Unrealized<br>Net Loss<br>on Interest<br>Rate<br>Swap | Retiree<br>Health<br>Benefit<br>Obligation | Pension<br>Obligation | Total    |
|--|---|--|-----------------------|----------|
| Balance at December 31, 2013   | \$ (184)  | \$ 2,234                                   | \$ (2,912)            | \$ (862) |
| Other comprehensive loss before reclassifications                          | (2)   | -  | -                     | (2)      |
| Amounts reclassified from accumulated other comprehensive loss:<br>(1)     | 136   | (185)                                      | 95                    | 46       |
| Balance at September 30, 2014  | \$ (50)   | \$ 2,049                                   | \$ (2,817)            | \$ (818) |
| (1) Amounts reclassified from accumulated other comprehensive<br>loss:     |   |  |                       |          |
| Amortization of Other Postretirement Benefit items:                        |   |  |                       |          |
| Actuarial gains (a)  | (299)   |  |                       |          |
| Tax expense  | 114   |  |                       |          |
| Reclassification net of tax  | \$ (185)  |  |                       |          |
| Amortization of pension items:   |   |  |                       |          |
| Actuarial losses (a)   | 153   |  |                       |          |
| Tax benefit  | (58)  |  |                       |          |
| Reclassification net of tax  | \$ 95   |  |                       |          |
| Realized losses on interest rate swaps reclassified to interest<br>expense | 220   |  |                       |          |
| Tax benefit  | (84)  |  |                       |          |
| Reclassification net of tax  | \$ 136  |  |                       |          |

- (a) These components are included in the computation of benefit plan costs in Note 8.

## 15. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (“ASU”) No. 2014-09 “Revenue from Contracts with Customers.” ASU 2014-09 provides a single principles-based, five-step model to be applied to all contracts with customers. The five steps are to identify the contract(s) with the customer, to identify the performance obligations in the contract, to determine the transaction price, to allocate the transaction price to the performance obligations in the contract and to recognize revenue when each performance obligation is satisfied. Revenue will be recognized when promised goods or services are transferred to the customer in an amount that reflects the consideration expected in exchange for those goods or services. ASU 2014-09 will be effective for the Company beginning on January 1, 2018 and the standard allows for either full retrospective adoption or modified retrospective adoption. The Company is continuing to evaluate the impact that the adoption of this guidance will have on our financial condition, results of operations and the presentation of our financial statements.

In April 2015, the FASB issued ASU No. 2015-03, “Interest – Imputation of Interest’ (“ASU No. 2015-03”). ASU No. 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. Debt issuance costs are currently required to be capitalized and presented in the balance sheet as deferred charges or assets. The recognition and

Table of Contents

measurement for debt issuance costs are not affected by ASU No. 2015-03. The new guidance is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. The Company has recognized these types of costs related to its senior credit facilities which will be reclassified from other assets to long-term debt liabilities when the Company adopts ASU No. 2015-03.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes which are included in Item 1 of this Quarterly Report on Form 10-Q, as well as the information contained in our Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission.

In this Quarterly Report on Form 10-Q, unless the context indicates otherwise: "Douglas Dynamics," the "Company," "we," "our," or "us" refer to Douglas Dynamics, Inc.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements include information relating to future events, product demand, the payment of dividends, future financial performance, strategies, expectations, competitive environment, regulation and availability of financial resources. These statements are often identified by use of words such as "anticipate," "believe," "intend," "estimate," "expect," "continue," "should," "could," "may," "project," "predict," "will" and similar expressions and include references to assumptions and relate to our future prospects, developments and business strategies. Such statements involve known and unknown risks, uncertainties and other factors that could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to: (i) weather conditions, particularly lack of or reduced levels of snowfall and the timing of such snowfall; (ii) a significant decline in economic conditions; (iii) our inability to maintain good relationships with our distributors; (iv) lack of available or favorable financing options for our end-users or distributors; (v) increases in the price of steel or other materials necessary for the production of our products that cannot be passed on to our distributors; (vi) increases in the price of fuel; (vii) the inability of our suppliers to meet our volume or quality requirements; (viii) inaccuracies in our estimates of future demand for our products; (ix) our inability to protect or continue to build our intellectual property portfolio; (x) the effects of laws and regulations and their interpretations on our business and financial condition; (xi) our inability to develop new products or improve upon existing products in response to end-user needs; (xii) losses due to lawsuits arising out of personal injuries associated with our products; (xiii) factors that could impact the future declaration and payment of dividends; (xiv) our inability to compete effectively against competition; (xv) our inability to achieve the projected financial

performance with the assets of TrynEx, which we acquired in 2013, or the business of Henderson, which we acquired in 2014; and (xvi) unexpected costs or liabilities related to such acquisitions, as well as those discussed in the sections entitled “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q, if any, or in our most recent Annual Report on Form 10-K. Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. In addition, the forward-looking statements in this Quarterly Report on Form 10-Q speak only as of the date hereof and we undertake no obligation, except as required by law, to update or release any revisions to any forward-looking statement, even if new information becomes available in the future.

## Results of Operations

### Overview

The following table sets forth, for the three and nine months ended September 30, 2015 and 2014, the consolidated statements of operations of the Company and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In the table below and throughout this “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” consolidated statements of operations data for the three and nine months ended September 30, 2015 and 2014 have been derived from our unaudited consolidated financial statements. The information contained in the table below should be read in conjunction with

Table of Contents

our unaudited consolidated financial statements and the related notes included elsewhere in this Quarterly Report on Form 10-Q.

|  | Three Months Ended |                    | Nine Months Ended  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 30, 2015 | September 30, 2014 | September 30, 2015 | September 30, 2014 |
|  | (unaudited)        |                    | (unaudited)        |                    |
|  | (in thousands)     |                    | (in thousands)     |                    |
| Net sales                                    | \$ 120,565         | \$ 78,836          | \$ 281,598         | \$ 203,457         |
| Cost of sales                                | 79,700             | 49,746             | 187,286            | 125,827            |
| Gross profit                                 | 40,865             | 29,090             | 94,312             | 77,630             |
| Selling, general, and administrative expense | 12,506             | 9,006              | 35,227             | 25,824             |
| Intangibles amortization                     | 1,803              | 1,439              | 5,610              | 4,348              |
| Income from operations                       | 26,556             | 18,645             | 53,475             | 47,458             |
| Interest expense, net                        | (2,824)            | (2,037)            | (8,057)            | (6,007)            |
| Other expense, net                           | (60)               | (53)               | (189)              | (136)              |
| Income before taxes                          | 23,672             | 16,555             | 45,229             | 41,315             |
| Income tax expense                           | 8,124              | 5,793              | 16,194             | 14,385             |
| Net income                                   | \$ 15,548          | \$ 10,762          | \$ 29,035          | \$ 26,930          |

The following table sets forth for the three and nine months ended September 30, 2015 and 2014, the percentage of certain items in our consolidated statement of operations, relative to net sales:

|               | Three Months Ended |                    | Nine Months Ended  |                    |   |   |
|---------------|--------------------|--------------------|--------------------|--------------------|---|---|
|               | September 30, 2015 | September 30, 2014 | September 30, 2015 | September 30, 2014 |   |   |
|               | (unaudited)        |                    | (unaudited)        |                    |   |   |
| Net sales     | 100.0              | % 100.0            | % 100.0            | % 100.0            | % | % |
| Cost of sales | 66.1               | % 63.1             | % 66.5             | % 61.8             | % | % |
| Gross profit  | 33.9               | % 36.9             | % 33.5             | % 38.2             | % | % |



Edgar Filing: DOUGLAS DYNAMICS, INC - Form 10-Q

|  |       |         |         |         |   |
|--|-------|---------|---------|---------|---|
| Selling, general, and administrative expense | 10.4  | % 11.4  | % 12.5  | % 12.7  | % |
| Intangibles amortization                     | 1.5   | % 1.8   | % 2.0   | % 2.1   | % |
| Income from operations                       | 22.0  | % 23.7  | % 19.0  | % 23.4  | % |
| Interest expense, net                        | (2.3) | % (2.6) | % (2.9) | % (3.0) | % |
| Other expense, net                           | (0.0) | % -     | % (0.1) | % (0.1) | % |
| Income before taxes                          | 19.7  | % 21.1  | % 16.0  | % 20.3  | % |
| Income tax expense                           | 6.8   | % 7.4   | % 5.7   | % 7.1   | % |
| Net income                                   | 12.9  | % 13.7  | % 10.3  | % 13.2  | % |

Table of Contents

The following table shows our sales of snow and ice control equipment and related parts and accessories as a percentage of net sales for the three and nine months ended September 30, 2015 and 2014.

|                       | Three Months<br>Ended<br>September<br>30,<br>2015 |     | September<br>30,<br>2014 |     | Nine Months<br>Ended<br>September<br>30,<br>2015 |  | September<br>30,<br>2014 |  |
|-----------------------|---|-----|--------------------------|-----|--|--|--------------------------|--|
| Equipment             | 90%   | 87% | 86%                      | 82% |  |  |                          |  |
| Parts and accessories | 10%   | 13% | 14%                      | 18% |  |  |                          |  |

## Net Sales

Net sales were \$120.6 million for the three months ended September 30, 2015 compared to \$78.8 million in the three months ended September 30, 2014, an increase of \$41.8 million, or 53.0%. Net sales were \$281.6 million for the nine months ended September 30, 2015 compared to \$203.5 million in the nine months ended September 30, 2014, an increase of \$78.1 million or 38.4%. The increase in net sales for the three and nine months ended September 30, 2015 was primarily attributable to \$26.9 million and \$67.4 million in sales at Henderson, respectively, which was acquired on December 31, 2014. Due primarily to sales of snow and ice control equipment at Henderson, overall sales of snow and ice control equipment increased for both the three and nine months ended September 30, 2015 by 58.3% and 45.7%, respectively, compared to the corresponding periods in 2014. Due primarily to the sales of parts and accessories at Henderson, overall parts and accessories sales increased by 16.7% and 5.1% for the three and nine months ended September 30, 2015, respectively, compared to the corresponding periods in 2014. Sales of non-Henderson products also increased for both the three and nine month periods ending September 30, 2015 as compared to the three and nine month periods ending September 30, 2014. The increase in sales of non-Henderson products was due to a record number of new product releases which commenced shipping in the third quarter of 2015.

## Cost of Sales

Cost of sales was \$79.7 million for the three months ended September 30, 2015 compared to \$49.7 million for the three months ended September 30, 2014, an increase of \$30.0 million, or 60.4%. Cost of sales was \$187.3 million for the nine months ended September 30, 2015 compared to \$125.8 million for the nine months ended September 30, 2014, an increase of \$61.5 million, or 48.9%. The increase in cost of sales for the three and nine months ended

September 30, 2015 compared to the corresponding periods in 2014 was driven by \$20.9 million and \$53.7 million in cost attributable to the \$26.9 million and \$67.4 million in sales at Henderson and costs associated with the non-Henderson new products as discussed above under “—Net Sales” for the three and nine months ended September 30, 2015, respectively. The Company experienced higher cost of sales as a percent of sales of 66.1% for the three-month period ended September 30, 2015 compared to 63.1% for the three month period ended September 30, 2014. The Company experienced higher cost of sales as a percent of sales of 66.5% for the nine month period ended September 30, 2015 compared to 61.8% for the nine month period ended September 30, 2014. The increases in cost of sales as a percentage of sales was primarily due to higher cost of sales as a percentage of sales for Henderson products. In addition, the cost of sales as a percentage of sales for the nine months ended September 30, 2015 includes a \$2.0 million fair value purchase accounting write up of inventory that was sold during the period. As a percentage of cost of sales, fixed and variable costs were approximately 15% and 85%, respectively, for the three months ended September 30, 2015 versus approximately 13% and 87%, respectively, for the three months ended September 30, 2014 and approximately 16% and 84%, respectively, for the nine months ended September 30, 2015 versus approximately 14% and 86%, respectively, for the nine months ended September 30, 2014.

#### Gross Profit

Gross profit was \$40.9 million for the three months ended September 30, 2015 compared to \$29.1 million for the three months ended September 30, 2014, an increase of \$11.8 million, or 40.5%. Gross profit was \$94.3 million for the nine months ended September 30, 2015 compared to \$77.6 million for the nine months ended September 30, 2014, an increase of \$16.7 million, or 21.5%. Gross profit increased for the three and nine month

## Table of Contents

periods due to increased sales of both Henderson and non-Henderson products as discussed above under “-Net Sales”. As a percentage of net sales, gross profit decreased from 36.9% for the three months ended September 30, 2014 to 33.9% for the corresponding period in 2015. As a percentage of net sales, gross profit decreased from 38.2% for the nine months ended September 30, 2014 to 33.5% for the corresponding period in 2015. The reasons for the decrease in gross profit as a percentage of net sales are the same as those relating to the increase in cost of sales as a percentage of sales discussed above under “—Cost of Sales.”

### Selling, General and Administrative Expense

Selling, general and administrative expenses, including intangibles amortization, were \$14.3 million for the three months ended September 30, 2015, compared to \$10.4 million for the three months ended September 30, 2014, an increase of \$3.9 million, or 37.5%. The increase compared to 2014 was mostly due to expenses related to ongoing operations at Henderson of \$2.9 million. Intangible amortization expense increased \$0.4 million due to additional intangible assets created as a result of the Henderson acquisition. The remainder of the increase is due to increased performance compensation due to improved results in the three months ended September 30, 2015 as compared to the three months ended September 30, 2014. Selling, general and administrative expenses, including intangibles amortization, were \$40.8 million for the nine months ended September 30, 2015, compared to \$30.2 million for the nine months ended September 30, 2014, an increase of \$10.6 million, or 35.1%. Of the increase, \$7.9 million was attributable to expenses related to ongoing operations at Henderson. Intangible amortization expense increased \$1.3 million due to additional intangible assets created as a result of the Henderson acquisition. The remainder of the increase was due to advertising and promotional expenses resulting from the record number of new product launches in the nine months ended September 30, 2015 and a \$0.3 million increase in employee benefits expenses driven by increased healthcare costs.

### Interest Expense

Interest expense was \$2.8 million for the three months ended September 30, 2015 which was higher than the \$2.0 million incurred in the same period in the prior year. Interest expense was \$8.1 million for the nine months ended September 30, 2015 which was higher than the \$6.0 million incurred in the same period in the prior year. Interest expense increased due to the additional borrowings resulting from the modifications made to the Company’s existing term loan facility in connection with the financing of the Henderson acquisition.

### Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The largest item affecting deferred taxes is the difference between book and tax amortization of goodwill and other intangibles amortization.

The Company's effective tax rate was 34.3% and 35.0% for the three months ended September 30, 2015 and 2014, respectively. The Company's effective tax rate was 35.8% and 34.8% for the nine months ended September 30, 2015 and 2014, respectively. The effective tax rate for the three months ended September 30, 2015 is lower than the corresponding period in 2014 due to discrete period adjustments. The effective tax rate for the nine months ended September 30, 2015 is higher than the corresponding period in 2014 due to the Company generating additional state tax liabilities following the acquisition of Henderson.

#### Net Income

Net income for the three months ended September 30, 2015 was \$15.5 million compared to net income of \$10.8 million for the corresponding period in 2014, an increase in net income of \$4.7 million. Net income for the nine months ended September 30, 2015 was \$29.0 million compared to net income of \$26.9 million for the corresponding period in 2014, an increase in net income of \$2.1 million. The increase in net income for the three and nine months ended September 30, 2015 was driven by the factors described above under “— Net Sales,” “—Cost of Sales,” and “— Selling General and Administrative Expense”. As a percentage of net sales, net income was 12.9% for the three months ended September 30, 2015 compared to 13.7% for the three months ended September 30, 2014. As a percentage of net sales, net income was 10.3% for the nine months ended September 30, 2015 compared to 13.2% for the nine months ended September 30, 2014.

Table of Contents

Adjusted EBITDA

Adjusted EBITDA for the three months ended September 30, 2015 was \$31.1 million compared to \$22.2 million in the corresponding period in 2014, an increase of \$8.9 million. Adjusted EBITDA for the nine months ended September 30, 2015 was \$68.7 million compared to \$58.3 million in the corresponding period in 2014, an increase of \$10.4 million. For the three and nine month periods ended September 30, 2015 the increase in Adjusted EBITDA is attributable to the increase in unit sales of snow and ice control equipment and parts and accessories sales of both Henderson and non-Henderson products in 2015.

Free Cash Flow

Free cash flow for the three months ended September 30, 2015 was (\$26.2) million compared to (\$31.1) million in the corresponding period in 2014, a decrease in cash used of \$4.9 million. The increase in free cash flow is primarily a result of lower cash used in operating activities of \$8.0 million, as discussed below under “Liquidity and Capital Resources.” Meanwhile, acquisitions of property and equipment increased from \$0.7 million for the three months ended September 30, 2014 to \$3.8 million for the three months ended September 30, 2015. Free cash flow for the nine months ended September 30, 2015 was (\$19.0) million compared to (\$21.4) million in the corresponding period in 2014, a decrease in cash used of \$2.4 million. The increase in free cash flow is primarily a result of lower cash used in operating activities of \$6.2 million, as discussed below under “Liquidity and Capital Resources.” Meanwhile, acquisitions of property and equipment increased from \$3.3 million for the nine months ended September 30, 2014 to \$7.1 million for the nine months ended September, 30, 2015.

Non-GAAP Financial Measures

This Quarterly Report on Form 10-Q contains financial information calculated other than in accordance with U.S. generally accepted accounting principles (“GAAP”).

These non-GAAP measures include:

- Free cash flow; and
- Adjusted EBITDA.

These non-GAAP disclosures should not be construed as an alternative to the reported results determined in accordance with GAAP.

Free cash flow is a non-GAAP financial measure which we define as net cash provided by (used in) operating activities less capital expenditures. Free cash flow should be evaluated in addition to, and not considered a substitute for, other financial measures such as net income and cash flow provided by operations. We believe that free cash flow represents our ability to generate additional cash flow from our business operations.

The following table reconciles net cash provided by operating activities, a GAAP measure, to free cash flow, a non-GAAP measure.

|                                       | Three Months Ended |             | Nine Months Ended |             |
|---------------------------------------|--------------------|-------------|-------------------|-------------|
|                                       | September          | September   | September         | September   |
|                                       | 30,                | 30,         | 30,               | 30,         |
|                                       | 2015               | 2014        | 2015              | 2014        |
|                                       | (In Thousands)     |             | (In Thousands)    |             |
| Net cash used in operating activities | \$ (22,353)        | \$ (30,390) | \$ (11,922)       | \$ (18,133) |
| Acquisition of property and equipment | (3,826)            | (705)       | (7,110)           | (3,310)     |
| Free cash flow                        | \$ (26,179)        | \$ (31,095) | \$ (19,032)       | \$ (21,443) |

Adjusted EBITDA represents net income before interest, taxes, depreciation and amortization, as further adjusted for certain charges consisting of unrelated legal and consulting fees, stock based compensation and certain purchase accounting expenses. We use, and we believe our investors benefit from the presentation of Adjusted

Table of Contents

EBITDA in evaluating our operating performance because it provides us and our investors with additional tools to compare our operating performance on a consistent basis by removing the impact of certain items that management believes do not directly reflect our core operations. In addition, we believe that Adjusted EBITDA is useful to investors and other external users of our consolidated financial statements in evaluating our operating performance as compared to that of other companies, because it allows them to measure a company's operating performance without regard to items such as interest expense, taxes, depreciation and amortization, which can vary substantially from company to company depending upon accounting methods and book value of assets and liabilities, capital structure and the method by which assets were acquired. Our management also uses Adjusted EBITDA for planning purposes, including the preparation of our annual operating budget and financial projections. Management also uses Adjusted EBITDA to evaluate our ability to make certain payments, including dividends, in compliance with our senior credit facilities, which is determined based on a calculation of "Consolidated Adjusted EBITDA" that is substantially similar to Adjusted EBITDA.

Adjusted EBITDA has limitations as an analytical tool. As a result, you should not consider it in isolation, or as a substitute for net income, operating income, cash flow from operating activities or any other measure of financial performance or liquidity presented in accordance with GAAP. Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures or future requirements for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our indebtedness;
  - Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- Other companies, including other companies in our industry, may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure; and
- Adjusted EBITDA does not reflect tax obligations whether current or deferred.



Table of Contents

The following table presents a reconciliation of net income, the most comparable GAAP financial measure, to Adjusted EBITDA as well as the resulting calculation of Adjusted EBITDA for the three and nine months ended September 30, 2015 and 2014:

|                                  | Three Months Ended |           | Nine Months Ended |           |
|----------------------------------|--------------------|-----------|-------------------|-----------|
|                                  | September          | September | September         | September |
|                                  | 30,                | 30,       | 30,               | 30,       |
|                                  | 2015               | 2014      | 2015              | 2014      |
|                                  | (in thousands)     |           | (in thousands)    |           |
| Net income                       | \$ 15,548          | \$ 10,762 | \$ 29,035         | \$ 26,930 |
| Interest expense - net           | 2,824              | 2,037     | 8,057             | 6,007     |
| Income tax expense               | 8,124              | 5,793     | 16,194            | 14,385    |
| Depreciation expense             | 1,267              | 872       | 3,583             | 2,537     |
| Amortization                     | 1,803              | 1,439     | 5,610             | 4,348     |
| EBITDA                           | 29,566             | 20,903    | 62,479            | 54,207    |
| Stock based compensation expense | 759                | 546       | 2,740             | 2,143     |
| Purchase accounting (1)          | 162                | 537       | 2,512             | 810       |
| Other charges (2)                | 580                | 232       | 1,001             | 1,131     |
| Adjusted EBITDA                  | \$ 31,067          | \$ 22,218 | \$ 68,732         | \$ 58,291 |

- 
- (1) Reflects \$96 and \$66 in earn out compensation expense related to Henderson and TrynEx, respectively, in the three months ended September 30, 2015. Reflects \$288 and \$1,956 in earn out compensation expense related to Henderson and inventory step up related to Henderson included in cost of sales in the nine months ended September 30, 2015, respectively. Reflects \$268 in earnout compensation expense related to TrynEx in the nine months ended September 30, 2015. Reflects \$537 and \$810 in earnout compensation expense related to TrynEx in the three and nine months ended September 30, 2014, respectively.
- (2) Reflects expenses of \$580 and \$232 for one time, unrelated legal and consulting fees for the three months ended September 30, 2015 and September 30, 2014, respectively. Reflects expenses of \$1,001 and \$1,131 for one time, unrelated legal and consulting fees for the nine months ended September 30, 2015 and September 30, 2014, respectively.

## Discussion of Critical Accounting Policies

For a discussion of our critical accounting policies, please see the disclosure included in our Form 10-K (Commission File No. 001-34728) filed with the Securities and Exchange Commission, under the heading "Management's Discussion

and Analysis of Financial Condition and Results of Operation — Critical Accounting Policies.”

#### New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (“ASU”) No. 2014-09 “Revenue from Contracts with Customers.” ASU 2014-09 provides a single principles-based, five-step model to be applied to all contracts with customers. The five steps are to identify the contract(s) with the customer, to identify the performance obligations in the contract, to determine the transaction price, to allocate the transaction price to the performance obligations in the contract and to recognize revenue when each performance obligation is satisfied. Revenue will be recognized when promised goods or services are transferred to the customer in an amount that reflects the consideration expected in exchange for those goods or services. ASU 2014-09 will be effective for the Company beginning on January 1, 2018 and the standard allows for either full retrospective adoption or modified retrospective adoption. The Company is continuing to evaluate the impact that the adoption of this guidance will have on our financial condition, results of operations and the presentation of our financial statements.

Table of Contents

In April 2015, the FASB issued ASU No. 2015-03, “Interest – Imputation of Interest’ (“ASU No. 2015-03”). ASU No. 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. Debt issuance costs are currently required to be capitalized and presented in the balance sheet as deferred charges or assets. The recognition and measurement for debt issuance costs are not affected by ASU No. 2015-03. The new guidance is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. The Company has recognized these types of costs related to its senior credit facilities which will be reclassified from other assets to long-term debt liabilities when the Company adopts ASU No. 2015-03.

Liquidity and Capital Resources

Our principal sources of cash have been and we expect will continue to be cash from operations and borrowings under our senior credit facilities.

Our primary uses of cash are to provide working capital, meet debt service requirements, finance capital expenditures, pay dividends under our dividend policy and support our growth, including through potential acquisitions, and for other general corporate purposes. For a description of the seasonality of our working capital rates see “—Seasonality and Year To Year Variability.”

Our Board of Directors has adopted a dividend policy that reflects an intention to distribute to our stockholders a regular quarterly cash dividend. The declaration and payment of these dividends to holders of our common stock is at the discretion of our Board of Directors and depends upon many factors, including our financial condition and earnings, legal requirements, taxes and other factors our Board of Directors may deem to be relevant. The terms of our indebtedness may also restrict us from paying cash dividends on our common stock under certain circumstances. As a result of this dividend policy, we may not have significant cash available to meet any large unanticipated liquidity requirements. As a result, we may not retain a sufficient amount of cash to fund our operations or to finance unanticipated capital expenditures or growth opportunities, including acquisitions. Our Board of Directors may, however, amend, revoke or suspend our dividend policy at any time and for any reason.

As of September 30, 2015, we had \$76.3 million of total liquidity, comprised of \$3.9 million in cash and cash equivalents and borrowing availability of \$72.4 million under our revolving credit facility, compared with total liquidity as of December 31, 2014 of approximately \$99.3 million, comprised of approximately \$24.2 million in cash and cash equivalents and borrowing availability of approximately \$75.1 million under our revolving credit facility. The decrease in our total liquidity from December 31, 2014 is primarily due to working capital needs being greater at September 30, 2015 as compared to December 31, 2014 due to the seasonality of our business. Borrowing availability under our revolving credit facility is governed by a borrowing base, the calculation of which includes cash on hand. Accordingly, use of cash on hand may also result in a reduction in the amount available for borrowing under our

revolving credit facility. Furthermore, our revolving credit facility requires us to maintain at least \$10.5 million of borrowing availability and 15% of the aggregate revolving commitments at the time of determination. We expect that cash on hand and cash we generate from operations, as well as available credit under our senior credit facilities, will provide adequate funds for the purposes described above for at least the next 12 months.

The following table shows our cash and cash equivalents and inventories in thousands at September 30, 2015, December 31, 2014 and September 30, 2014.

|                           | As of     |           |           |
|---------------------------|-----------|-----------|-----------|
|                           | September | December  | September |
|                           | 30,       | 31,       | 30,       |
|                           | 2015      | 2014      | 2014      |
| Cash and cash equivalents | \$ 3,873  | \$ 24,195 | \$ 4,289  |
| Inventories               | 55,245    | 48,248    | 36,418    |

Table of Contents

We had cash and cash equivalents of \$3.9 million at September 30, 2015 compared to cash and cash equivalents of \$24.2 million and \$4.3 million at December 31, 2014 and September 30, 2014, respectively. The table below sets forth a summary of the significant sources and uses of cash for the periods presented in thousands.

| Cash Flows (in thousands)                 | Nine Months Ended  |                    | Change     | % Change |   |
|---|--------------------|--------------------|------------|----------|---|
|   | September 30, 2015 | September 30, 2014 |            |          |   |
| Net cash used in operating activities     | \$ (11,922)        | \$ (18,133)        | \$ 6,211   | (34.3)   | % |
| Net cash used in investing activities     | (18,928)           | (2,292)            | (16,636)   | 725.8    | % |
| Net cash provided by financing activities | 10,528             | 4,850              | 5,678      | 117.1    | % |
| Decrease in cash                          | \$ (20,322)        | \$ (15,575)        | \$ (4,747) | 30.5     | % |

Net cash used in operating activities decreased \$6.2 million from the nine months ended September 30, 2014 to the nine months ended September 30, 2015. The decrease in cash used in operating activities was due to a \$5.7 million increase in net income adjusted for reconciling items and favorable changes in working capital of \$0.5 million.

Net cash used in investing activities increased \$16.6 million for the nine months ended September 30, 2015, compared to the corresponding period in 2014. This increase was primarily due to the \$11.8 million cash payments that occurred in the nine months ended September 30, 2015 related to the acquisition of Henderson. Additionally contributing to the increase in cash used was an increase in acquisitions of property and equipment from \$3.3 million for the nine months ended September 30, 2014 to \$7.1 million for the nine months ended September 30, 2015.

Net cash provided by financing activities increased \$5.7 million for the nine months ended September 30, 2015 as compared to the corresponding period in 2014. The increase in cash provided by financing activities was primarily a result of an increase in net revolver borrowings of \$6.5 million.

## Contractual Obligations

There have been no material changes to our contractual obligations in the nine months ended September 30, 2015.

#### Off-Balance Sheet Arrangements

We are not party to any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

#### Seasonality and Year-to-Year Variability

Our business is seasonal and also varies from year-to-year. Consequently, our results of operations and financial condition vary from quarter-to-quarter and from year-to-year as well. In addition, because of this seasonality and variability, our results of operations for any quarter may not be indicative of results of operations that may be achieved for a subsequent quarter or the full year, and may not be similar to results of operations experienced in prior years. That being the case, while snowfall levels vary within a given year and from year-to-year, snowfall, and the corresponding replacement cycle of snow and ice control equipment, is relatively consistent over multi-year periods.

Sales of our products are significantly impacted by the level, timing and location of snowfall, with sales in any given year and region most heavily influenced by snowfall levels in the prior snow season (which we consider to begin in October and end in March) in that region. This is due to the fact that end-user demand for our products is

Table of Contents

driven primarily by the condition of their snow and ice control equipment, and in the case of professional snowplowers, by their financial ability to purchase new or replacement snow and ice control equipment, both of which are significantly affected by snowfall levels. Heavy snowfall during a given winter causes usage of our products to increase, resulting in greater wear and tear to our products and a shortening of their life cycles, thereby creating a need for replacement snow and ice control equipment and related parts and accessories. In addition, when there is a heavy snowfall in a given winter, the increased income our professional snowplowers generate from their professional snowplow activities provides them with increased purchasing power to purchase replacement snow and ice control equipment prior to the following winter. To a lesser extent, sales of our products are influenced by the timing of snowfall in a given winter. Because an early snowfall can be viewed as a sign of a heavy upcoming snow season, our end-users may respond to an early snowfall by purchasing replacement snow and ice control equipment during the current season rather than delaying purchases until after the season is over when most purchases are typically made by end-users.

We attempt to manage the seasonal impact of snowfall on our revenues in part through our pre-season sales program, which involves actively soliciting and encouraging pre-season distributor orders in the second and third quarters by offering our distributors a combination of pricing, payment and freight incentives during this period. These pre-season sales incentives encourage our distributors to re-stock their inventory during the second and third quarters in anticipation of the peak fourth quarter retail sales period by offering pre-season pricing and payment deferral until the fourth quarter. As a result, we tend to generate our greatest volume of sales (an average of over two-thirds over the last ten years) during the second and third quarters, providing us with manufacturing visibility for the remainder of the year. By contrast, our revenue and operating results tend to be lowest during the first quarter, as management believes our end-users prefer to wait until the beginning of a snow season to purchase new equipment and as our distributors sell off inventory and wait for our pre-season sales incentive period to re-stock inventory. Fourth quarter sales vary from year-to-year as they are primarily driven by the level, timing and location of snowfall during the quarter. This is because most of our fourth quarter sales and shipments consist of re-orders by distributors seeking to restock inventory to meet immediate customer needs caused by snowfall during the winter months.

Because of the seasonality of our sales, we experience seasonality in our working capital needs as well. In the first quarter, we typically require capital as we are generally required to build our inventory in anticipation of our second and third quarter pre-season sales. During the second and third quarters, our working capital requirements rise as our accounts receivable increase as a result of the sale and shipment of products ordered through our pre-season sales program and we continue to build inventory. Working capital requirements peak towards the end of the third quarter and then begin to decline through the fourth quarter through a reduction in accounts receivable when we receive the majority of the payments for pre-season shipped products.

We also attempt to manage the impact of seasonality and year-to-year variability on our business costs through the effective management of our assets. Our asset management and profit focus strategies include:

- the employment of a highly variable cost structure facilitated by a core group of workers that we supplement with a temporary workforce as sales volumes dictate, which allows us to adjust costs on an as-needed basis in response to changing demand;

- our enterprise-wide lean concept, which allows us to adjust production levels up or down to meet demand;
- the pre-season order program described above, which incentivizes distributors to place orders prior to the retail selling season; and
- a vertically integrated business model.

These asset management and profit focus strategies, among other management tools, allow us to adjust fixed overhead and sales, general and administrative expenditures to account for the year-to-year variability of our sales volumes.

Additionally, although modest, our annual capital expenditure requirements can be temporarily reduced by up to approximately 40% in response to actual or anticipated decreases in sales volumes. If we are unsuccessful in our asset management initiatives, the seasonality and year-to-year variability effects on our business may be compounded and in turn our results of operations and financial condition may suffer.



Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not use financial instruments for speculative trading purposes, and do not hold any derivative financial instruments that could expose us to significant market risk. Our primary market risk exposures are changes in interest rates and steel price fluctuations.

Interest Rate Risk

We are exposed to market risk primarily from changes in interest rates. Our borrowings, including our term loan and any revolving borrowings under our senior credit facilities, are at variable rates of interest and expose us to interest rate risk. A portion of our interest rate risk associated with our term loan is mitigated through an interest rate swap as discussed in Note 5 to the Consolidated Financial Statements, above. In addition, the interest rate on any revolving borrowings is subject to an increase in the interest rate based on our average daily availability under our revolving credit facility.

As of September 30, 2015, we had outstanding borrowings under our term loan of \$186.9 million. A hypothetical interest rate change of 1%, 1.5% and 2% on our term loan would have changed interest incurred for the three months ended September 30, 2015 by \$0.1 million, \$0.4 million and \$0.6 million, respectively. We entered into three interest rate swap agreements with notional amounts of \$45.0 million, \$90.0 million and \$135.0 million effective for the periods December 31, 2015 through March 29, 2018, March 29, 2018 through March 31, 2020 and March 31, 2020 through June 30, 2021, respectively. We have counterparty credit risk resulting from the interest rate swap, which we monitor on an on-going basis. This risk lies with one global financial institution. Under the interest rate swap agreement, effective as of December 31, 2015, we will either receive or make payments on a monthly basis based on the differential between 6.105% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 29, 2018, we will either receive or make payments on a monthly basis based on the differential between 6.916% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). Under the interest rate swap agreement, effective as of March 31, 2020, we will either receive or make payments on a monthly basis based on the differential between 7.168% and LIBOR plus 4.25% (with a LIBOR floor of 1.0%). As of September 30, 2015, we had outstanding borrowings under our revolving credit facility of \$27.0 million. A hypothetical interest rate change of 1%, 1.5% and 2% on our revolving credit facility would have changed interest incurred for the three months ended September 30, 2015 by \$0.0 million, \$0.0 million and \$0.0 million, respectively.

Commodity Price Risk

In the normal course of business, we are exposed to market risk related to our purchase of steel, the primary commodity upon which our manufacturing depends. Our steel purchases as a percentage of revenue were 17.2% and 18.4% for the three and nine months ended September 30, 2015, respectively, compared to 12.2% and 14.4% for

the three and nine months ended September 30, 2014, respectively. While steel is typically available from numerous suppliers, the price of steel is a commodity subject to fluctuations that apply across broad spectrums of the steel market. We do not use any derivative or hedging instruments to manage steel price risk. If the price of steel increases, our variable costs could also increase. While historically we have successfully mitigated these increased costs through the implementation of either permanent price increases and/or temporary invoice surcharges, in the future we may not be able to successfully mitigate these costs, which could cause our gross margins to decline. If our costs for steel were to increase by \$1.00 in a period where we are not able to pass any of this increase onto our distributors, our gross margins would decline by \$1.00 in the period in which such inventory was sold.

#### Item 4. Controls And Procedures

##### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this Quarterly Report our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that the

Table of Contents

information required to be disclosed by us in such reports is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, we are engaged in various litigation primarily including product liability and intellectual property disputes. However, management does not believe that any current litigation is material to our operations or financial position. In addition, we are not currently party to any environmental-related claims or legal matters.

Item 1A. Risk Factors

There have been no significant changes in our risk factors from those described in our Annual Report on Form 10-K for the year ended December 31, 2014.

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

Unregistered Sales of Equity Securities

On August 6, 2015, one of the Company's executive officers exercised stock options granted pursuant to the Douglas Dynamics, Inc. Amended and Restated 2004 Stock Incentive Plan to purchase an aggregate of 26,350 shares of common stock for an aggregate exercise price of \$110,959.85. The exercise price of the stock options was \$4.211 per share. Of the 26,350 stock options exercised, all stock option exercise price was paid in cash.

The Company believes that the sales of the above securities to the executive officer were exempt from registration under the Securities Act of 1933, as amended (the "Securities Act"), in reliance on Rule 701 under the Securities Act as transactions pursuant to a written compensatory benefit plan established by the Company for the benefit of its employees. The stock options that were exercised were granted prior to the effectiveness of the Company's initial public offering. None of the foregoing transactions involved any underwriters, underwriting discounts or commissions or any public offering.

Other than the sales previously noted in this section, we sold no securities that were not registered under the Securities Act during the three months ended September 30, 2015.

#### Dividend Payment Restrictions

The Company's senior credit facilities include certain restrictions on its ability to pay dividends. The senior credit facilities also restrict the Company's subsidiaries from paying dividends and otherwise transferring assets to Douglas Dynamics, Inc. For additional detail regarding these restrictions, see Note 5 to the notes to the consolidated financial statements.

#### Item 3.Defaults Upon Senior Securities

None.

#### Item 4.Mine Safety Disclosures

None.

#### Item 5.Other Information

None.

31

---

Table of Contents

Item 6.Exhibits

The following documents are filed as Exhibits to this Quarterly Report on Form 10-Q:

| Exhibit<br>Numbers | Description  |
|--------------------|--|
| 31.1*              | Certification of the Company's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2*              | Certification of the Company's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1*              | Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101*               | Financial statements from the quarterly report on Form 10-Q of Douglas Dynamics, Inc. for the quarter ended September 30, 2015, filed on November 3, 2015, formatted in XBRL: (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows; and (iv) the Notes to the Consolidated Financial Statements |

---

\*Filed herewith.

Table of Contents

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.

DOUGLAS DYNAMICS, INC.

By: /s/ ROBERT MCCORMICK  
Robert McCormick  
Executive Vice President and Chief Financial Officer  
(Principal Financial Officer and Authorized Signatory)

Dated: November 3, 2015

Table of Contents

Exhibit Index to Form 10-Q for the Period Ended September 30, 2015

| Exhibit<br>Numbers | Description  |
|--------------------|--|
| 31.1*              | Certification of the Company's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2*              | Certification of the Company's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1*              | Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101*               | Financial statements from the quarterly report on Form 10-Q of Douglas Dynamics, Inc. for the quarter ended September 30, 2015, filed on November 3, 2015, formatted in XBRL: (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations and Comprehensive Income; (iii) the Consolidated Statements of Cash Flows; and (iv) the Notes to the Consolidated Financial Statements |

---

\*Filed herewith.