EACO CORP
Form 10-Q
April 14, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended February 28, 2014

OR

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

For the transition period from _______ to _______

Commission File No. **000-14311**

EACO CORPORATION

(Exact name of registrant as specified in its charter)

Florida	**59-2597349**
(State of Incorporation)	(I.R.S. Employer Identification No.)

1500 NORTH LAKEVIEW AVENUE

ANAHEIM, CALIFORNIA 92807

(Address of Principal Executive Offices)

(714) 876-2490

(Registrant's Telephone No.)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o   Accelerated filer o   Non-accelerated filer o   Smaller reporting company x

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

As of April 11, 2014, 4,861,590 shares of the registrant's common stock were outstanding.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

EACO Corporation and Subsidiaries

Condensed Consolidated Statements of Income

(in thousands, except for share and per share information)

(Unaudited)

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Revenues	$30,922	$28,520	$61,957	$57,780
Cost of revenues	22,412	20,474	44,541	41,633
Gross margin	8,510	8,046	17,416	16,147
Operating expenses:				
Selling, general and administrative expenses	8,027	7,350	15,806	14,610
Income from operations	483	696	1,610	1,537
Other (expense) income:				
Loss on trading securities	(148)	(97)	(57)	(119)
Gain on sale of property	-	540	535	540
Interest expense, net	(112)	(166)	(211)	(333)
Total other (expense) income	(260)	277	267	88
Net income before income taxes	223	973	1,877	1,625
Provision for income taxes	114	332	704	601
Net income	109	641	1,173	1,024
Cumulative preferred stock dividend	(19)	(19)	(38)	(38)
Net income attributable to common shareholders	$90	$622	$1,135	$986
Basic and diluted earnings per share	$0.02	$0.13	$0.23	$0.20
Basic and diluted weighted average common shares outstanding	4,861,590	4,861,590	4,861,590	4,861,590

See accompanying notes to unaudited condensed consolidated financial statements.

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EACO Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income

(in thousands)

(Unaudited)

	Three Months Ended February 28,		Six Months Ended February 28,	
	2014	2013	2014	2013
Net income	$ 109	$ 641	$ 1,173	$ 1,024
Other comprehensive income, net of tax:				
Foreign translation gain	69	56	139	156
Total comprehensive income	$ 178	$ 697	$ 1,312	$ 1,180

See accompanying notes to unaudited condensed consolidated financial statements.

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EACO Corporation and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share information)

	February 28, 2014 (unaudited)	August 31, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,669	$ 1,507
Restricted cash, current	1,576	—
Trade accounts receivable, net	15,524	14,438
Inventory, net	14,122	14,272
Marketable securities, trading	417	1,395
Real estate properties held for sale	7,494	7,988
Prepaid expenses and other current assets	655	619
Total current assets	42,457	40,219
Non-current Assets:		
Restricted cash, non-current	548	548
Equipment and leasehold improvements, net	1,394	1,396
Deferred tax asset	1,755	1,712
Other assets	430	605
Total assets	$ 46,584	$ 44,480
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current Liabilities:		
Trade accounts payable	$ 9,193	$ 9,315
Accrued expenses and other current liabilities	2,682	2,880
Securities sold short, at fair value	1,576	—
Liabilities of discontinued operations – short-term	153	146
Liabilities of assets held for sale	4,917	5,397
Total current liabilities	18,521	17,738
Non-current Liabilities:		
Liabilities of discontinued operations – long-term	2,301	2,410
Deposit liability	63	87
Long-term debt	6,714	6,534
Total liabilities	27,599	26,769
Shareholders’ Equity:		
Convertible preferred stock, $0.01 par value per share; 10,000,000 shares authorized; 36,000 shares outstanding (liquidation value $900)	1	1
Common stock, $0.01 par value per share; 8,000,000 shares authorized; 4,861,590 shares outstanding	49	49

Additional paid-in capital	12,378	12,378
Accumulated other comprehensive income	959	820
Retained earnings	5,598	4,463
Total shareholders’ equity	18,985	17,711
Total liabilities and shareholders’ equity	$ 46,584	$ 44,480

See accompanying notes to unaudited condensed consolidated financial statements.

EACO Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

	Six Months Ended February 28,	
	2014	2013
Operating activities:		
Net income	$ 1,173	$ 1,024
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	297	316
Bad debt expense	58	5
Change in inventory reserve	22	(62)
Gain on sale of real estate property	(535)	(540)
Net loss on trading securities	57	119
(Increase) decrease:		
Trade accounts receivable	(1,144)	5
Inventory	128	(1,218)
Prepaid expenses and other assets	139	24
Deferred tax asset	(43)	450
Increase (decrease):		
Trade accounts payable	(128)	(165)
Accrued expenses and other current liabilities	(198)	344
Deposit liability	(24)	(27)
Liabilities of discontinued operations	(102)	(74)
Net cash (used in) provided by operating activities	(300)	201
Investing activities:		
Purchase of property and equipment	(405)	(123)
Sale (purchase) of marketable securities, trading	921	(579)
Proceeds from securities sold short	1,576	724
Change in restricted cash	(1,576)	(724)
Proceeds from sale of property	1,139	650
Net cash provided by (used in) investing activities	1,655	(52)
Financing activities:		
Net borrowings on revolving credit facility	186	734
Preferred stock dividend	(38)	(38)
Bank overdraft	6	(111)
Payments on long-term debt	(124)	(1,512)
Payments on long-term debt - real estate held for sale	(362)	(92)
Net cash used in financing activities	(332)	(1,019)
Effect of foreign currency exchange rate changes on cash and cash equivalents	139	156
Net increase (decrease) in cash and cash equivalents	1,162	(714)
Cash and cash equivalents - beginning of period	1,507	2,568
Cash and cash equivalents - end of period	$ 2,669	$ 1,854

Supplemental disclosures of cash flow information:		
Cash paid for interest	$212	$339
Cash paid for taxes	$674	$196
Non-cash investing activities:		
Transfer of real estate properties held for leasing, net to assets held for sale	$7,206	$-
Non-cash financing activities:		
Transfer of long-term debt to liabilities of assets held for sale	$4,917	$-

See accompanying notes to unaudited condensed consolidated financial statements.

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EACO CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

February 28, 2014

Note 1. Organization and Basis of Presentation

The condensed consolidated financial statements comprise, the accounts of EACO Corporation ("EACO") and its wholly-owned subsidiary, Bisco Industries, Inc. ("Bisco"), and Bisco's wholly-owned Canadian subsidiary, Bisco Industries Limited (which are collectively referred to herein as the "Company", "we", "us" and "our"), EACO was incorporated in the State of Florida in September 1985 and previously operated restaurants in Florida. The only remaining activities of EACO relate to: a) real estate located in Sylmar, California and the related debt which are presented as assets and liabilities held for sale in the accompanying condensed consolidated financial statements and b) workers' compensation claim liability relating to the restaurant operations, which is presented as liabilities of discontinued operations in the accompanying condensed consolidated financial statements.

Bisco is a distributor of electronic components and fasteners with 45 sales offices and six distribution centers located throughout the United States and Canada. Bisco supplies parts used in the manufacture of products in a broad range of industries, including the aerospace, circuit board, communication, computer, fabrication, instrumentation, industrial equipment and marine industries.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. These estimates include allowance for doubtful accounts receivable, slow moving and obsolete inventory reserves, recoverability of the carrying value and estimated useful lives of long-lived assets, workers' compensation liability and the valuation allowance against deferred tax assets. Actual results could differ from those estimates.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in conformity with GAAP for interim financial information and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") for interim reporting. In the opinion of management, all adjustments considered necessary in order to make the financial statements not misleading have been included.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations for presentation of interim financial information. Therefore, the condensed consolidated interim financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended August 31, 2013. The condensed consolidated balance sheet as of August 31, 2013 and related disclosures were derived from the audited consolidated financial statements as of August 31, 2013. Operating results for the three and six month periods ended February 28, 2014 are not necessarily indicative of the results that may be expected for future quarterly periods or the entire fiscal year.

Reclassification

Certain prior year amounts have been reclassified to conform to the current year's presentation, primarily relating to the reclassification of assets and liabilities of assets held for sale.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of EACO, Bisco and Bisco Industries Limited. All significant intercompany transactions and balances have been eliminated in consolidation.

Note 2. Significant Accounting Policies

Restricted Cash

The State of Florida Division of Workers' Compensation requires self-insured companies to pledge collateral in an amount sufficient to cover the projected outstanding liability. In compliance with this requirement, for EACO's previous restaurant operations, the Company pledged two irrevocable letters of credit totaling $2,713,000 as of February 28, 2014 and August 31, 2013. These letters were secured by certificates of deposits totaling $548,000 at February 28, 2014 and August 31, 2013 and EACO's two real estate properties in Sylmar, California (the "Sylmar Properties").

The Company also has restricted cash of $1,576,000 at February 28, 2014 on deposit with a securities brokerage firm, which relates to the potential liability for short sales of trading securities. There was no such restricted cash at August 31, 2013.

Trade Accounts Receivable

Trade accounts receivable are carried at original invoice amount, less an estimate for doubtful accounts. The allowance for doubtful accounts was $110,000 and $183,000 at February 28, 2014 and August 31, 2013, respectively.

Inventories

Inventories consist of finished goods, primarily electronic fasteners and components, stated at the lower of cost or estimated market value. Cost is determined using the average cost method. Inventories are reported net of a reserve for slow moving or obsolete items of $946,000 and $924,000 at February 28, 2014 and August 31, 2013, respectively. The reserve is based upon management's review of inventories on-hand over their expected future utilization and length of time held by the Company.

Securities Sold Short

Securities sold short represent transactions in which the Company sells a security it does not own and is obligated to deliver such security at a future date. The short sale is recorded as a liability, and unrealized appreciation or depreciation is recorded for the difference between the proceeds received and the fair value of the open short position. The Company records a realized gain or loss when the short position is closed. By entering into short sales, the Company bears the market risk of an unfavorable increase in the price of the security sold short in excess of the proceeds received. Short sales are separately presented as a liability in the Company's consolidated balance sheet.

The Company is required to establish a margin account with the brokers lending the securities sold short. While the short sale is outstanding, the short sale proceeds may be restricted to the extent of the fair value of the short position. See discussion of Restricted Cash.

Revenue Recognition

The Company generally recognizes revenue at the time of product shipment as the shipping terms are FOB shipping point. Revenue is considered to be realized or realizable and earned when there is persuasive evidence of a sales arrangement in the form of an executed contract or purchase order, the product has been shipped, the sales price is fixed or determinable, and collectability is reasonably assured.

Earnings Per Common Share

Basic earnings per common share for the three and six months ended February 28, 2014 and 2013 were computed based on the weighted average number of common shares outstanding during each respective period. Diluted earnings per common share for those periods have been computed based on the weighted average number of common shares outstanding, giving effect to all dilutive potential common shares that were outstanding during the respective periods.(See Note 4).

Foreign Currency Translation and Transactions

Assets and liabilities recorded in functional currencies other than the U.S. dollar (i.e., Canadian dollars for the Company's Canadian subsidiary) are translated into U.S. dollars at the quarter-end rate of exchange. Revenue and expenses are translated at the weighted-average exchange rates for the three and six months ended February 28, 2014 and 2013. The average exchange rate for the three months ended February 28, 2014 and 2013 was $0.92 and $1.00 Canadian dollars for one U.S. dollar, respectively. The average exchange rate for the six months ended February 28, 2014 and 2013 was 0.94 and $1.01 Canadian dollars for one U.S. dollar, respectively. The resulting translation adjustments are charged or credited directly to accumulated other comprehensive income.

Concentrations

Net sales to customers outside the United States were approximately 7% for the six months ended February 28, 2014 and 2013, and related accounts receivable were approximately 10% at February 28, 2014 and August 31, 2013.

No single customer accounted for more than 10% of revenues for the three or six months ended February 28, 2014 or 2013.

Note 3. Debt

The Company has a $10,000,000 line of credit agreement with Community Bank. Borrowings under this agreement bear interest at either the 30, 60, or 90 day London Inter-Bank Offered Rate ("LIBOR") (0.24% and 0.26% for the 90 day LIBOR at February 28, 2014 and August 31, 2013, respectively) plus 1.75% and/or the bank's reference rate (3.25% at February 28, 2014 and August 31, 2013). Borrowings are secured by substantially all assets of Bisco and are guaranteed by the Company's Chief Executive Officer, Chairman of the Board and majority shareholder, Glen F. Ceiley. The agreement expires on March 1, 2015.

The amounts outstanding under this line of credit as of February 28, 2014 and August 31, 2013 were $6,665,000 and $6,479,000, respectively. Availability under the line of credit was $3,335,000 and $3,521,000 at February 28, 2014 and August 31, 2013, respectively.

The line of credit agreement contains nonfinancial and financial covenants, including the maintenance of certain financial ratios. As of February 28, 2014 and August 31, 2013, the Company was in compliance with all covenants.

In October 2013, the Company modified its mortgage on the Sylmar Properties with Community Bank. As amended, principal and interest payments totaling $26,627 are due monthly and interest is fixed at 3.75% per annum. As of February 28, 2014 and August 31, 2013, the outstanding balance due on this loan with Community Bank, collateralized by the Sylmar Properties, was approximately $4,917,000 and $5,035,000, respectively. Such loan was classified as liabilities of assets held for sale on the accompanying consolidated balance sheets as of February 28, 2014 and August 31, 2013 (See Note 6).

Note 4. Earnings per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted computations for earnings per common share:

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(In thousands, except share and per share information)	For the Three Months Ended February 28, 2014	2013	For the Six Months Ended February 28, 2014	2013
EPS:				
Net income	$109	$641	$1,173	$1,024
Less: accrued preferred stock dividends	(19)	(19)	(38)	(38)
Net income available for common shareholders	$90	$622	$1,135	$986
Earnings per common share – basic and diluted	$0.02	$0.13	$0.23	$0.20

For the three and six months ended February 28, 2014 and 2013, 40,000 potential common shares (issuable upon conversion of 36,000 shares of the Company’s Series A Cumulative Convertible Preferred Stock) have been excluded from the computation of diluted earnings per share because their effect would have been anti-dilutive.

Note 5. Related Party Transactions

The Company leases three buildings under operating lease agreements from its majority stockholder. During the three months ended February 28, 2014 and 2013, the Company incurred approximately $156,000 of expense related to these leases.

Note 6. Real Estate Properties

In March 2014, the Company entered into an agreement to sell the Sylmar Properties for approximately $9.2 million in cash. As such, the associated land, buildings and improvements and related liabilities were reclassified as assets held for sale and liabilities held for sale, respectively, on the accompanying consolidated balance sheets as of February 28, 2014 and August 31, 2013. The Company expects to amend the security interests relating to its irrevocable letters of credit relating to the self-insurance of its previous restaurant operations.

In October 2013, the Company sold the restaurant property in Orange Park, Florida (the “Orange Park Property”) for $1,138,500 in cash. The transaction closed in October 2013. The sale of this property resulted in a net gain of approximately $535,000.

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

Cautionary Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Such statements can be identified by the use of terminology such as “anticipate,” “believe,” “could,” “estimate,” “expect “forecast,” “intend,” “may,” “plan,” “possible,” “project,” “should,” “will” and similar words or expressions. These forward-lo statements include but are not limited to statements regarding our anticipated revenue, expenses, profits and capital needs. These statements are based on our current expectations, estimates and projections and are subject to a number of risks and uncertainties that could cause our actual results to differ materially from those projected or estimated, including but not limited to adverse economic conditions, competitive pressures, unexpected costs and losses from operations or investments, increases in general and administrative costs, our ability to maintain an effective system of internal controls over financial reporting, potential losses from trading in securities, our ability to retain key personnel and relationships with suppliers, the willingness of Community Bank or other lenders to extend financing commitments and the availability of capital resources, and the other risks set forth in “Risk Factors” in Part II, Item 1A of this report or identified from time to time in our other filings with the SEC and in public announcements. You should not place undue reliance on these forward-looking statements that speak only as of the date hereof. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, including to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. The inclusion of forward looking statements in this Quarterly Report should not be regarded as a representation by management or any other person that the objectives or plans of the Company will be achieved.

Overview

The condensed consolidated financial statements comprise the accounts of EACO Corporation ("EACO") and its wholly-owned subsidiary, Bisco Industries, Inc. ("Bisco") and Bisco's wholly-owned Canadian subsidiary, Bisco Industries Limited (which are collectively referred to herein as the "Company", "we", "us" and "our")

EACO was incorporated in the State of Florida in September 1985 and previously operated restaurants in Florida. The only remaining activities of EACO relate to: a) real estate located in Sylmar, California and b) workers' compensation claim liability relating to the restaurant operations, which is presented as liabilities of discontinued operations in the condensed consolidated financial statements.

Bisco is a distributor of electronic components and fasteners with 45 sales offices and six distribution centers located throughout the United States and Canada. Bisco supplies parts used in the manufacture of products in a broad range of industries, including the aerospace, circuit board, communication, computer, fabrication, instrumentation, industrial equipment and marine industries.

Revenues derived from the Bisco subsidiary have represented approximately 99% of our total revenues and is expected to continue to represent substantially all of the Company's total revenues for the foreseeable future.

Critical Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. These estimates include allowance for doubtful accounts receivable, slow moving and obsolete inventory reserves, recoverability of the carrying value and estimated useful lives of long-lived assets, workers' compensation liability and the valuation allowance against deferred tax assets. Actual results could differ from those estimates. For additional description of the Company's critical accounting policies, see Note 2 above and Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Annual Report on Form 10-K for the year ended August 31, 2013 as filed with the SEC on November 29, 2013.

Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of the impairment review, assets are measured by comparing the carrying amount to future net cash flows. If assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their estimated fair values.

Revenue Recognition

The Company generally recognizes revenue at the time of product shipment as the shipping terms are FOB shipping point. Revenue is considered to be realized or realizable and earned when there is persuasive evidence of a sales arrangement in the form of an executed contract or purchase order, the product has been shipped, the sales price is fixed or determinable, and collectability is reasonably assured.

Liabilities of Discontinued Operations

The Company maintains a reserve for self-insured losses for workers' compensation claims up from its previous restaurant operations. The liability for workers' compensation represents an estimate of the present value of the ultimate cost of uninsured losses which are unpaid as of the balance sheet dates. This liability is presented as liabilities of discontinued operations in the accompanying condensed consolidated balance sheets. The estimate is continually reviewed and adjustments to the Company's estimated liability, if any, are reflected in discontinued operations. On a periodic basis, the Company obtains an actuarial report which estimates its overall exposure based on historical claims and an evaluation of future claims. An actuarial evaluation was last obtained by the Company as of August 31, 2013. No changes to the estimated liability were recorded during the six months ended February 28, 2014.

Deferred Tax Assets

The Company's policy for recording a valuation allowance against deferred tax assets is considered critical. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Company is able to realize their benefit or when future deductibility is uncertain. The Company records net deferred tax assets to the extent management believes these assets will more likely than not be realized. In making such determination, the Company considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future t