IMPERIAL INDUSTRIES INC
Form 10-Q
May 12, 2006

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTIONS 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended March 31, 2006

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 1-7190

IMPERIAL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**65-0854631**
(State or Other Jurisdiction of Incorporation)	(I.R.S. Employer Identification No.)

1259 Northwest 21st Street, Pompano Beach, Florida 33069-1428

(Address of principal executive offices) (Zip Code)

(954) 917-7665

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 ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, and accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ý

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

Indicate the number of shares of Imperial Industries, Inc. Common Stock ($.01 par value) outstanding as of May 1, 2006: 2,472,645

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1.

Financial Statements

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	March 31, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,054,000	$ 974,000
Restricted cash	763,000	1,082,000
Trade accounts receivable (less allowance for doubtful accounts of $970,000 and $917,000 at March 31, 2006 and December 31, 2005, respectively)	9,659,000	8,344,000
Inventories	8,071,000	6,563,000
Deferred income taxes	593,000	596,000
Assets held for sale	211,000	211,000
Other current assets	714,000	1,061,000
Total current assets	21,065,000	18,831,000
Property, plant and equipment, net	6,865,000	6,356,000
Deferred income taxes	405,000	405,000
Other assets	343,000	360,000
Total assets	$ 28,678,000	$ 25,952,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$ 4,336,000	$4,696,000
Current portion of long-term debt	886,000	740,000
Accounts payable	4,573,000	3,059,000
Payable to former preferred stockholders	86,000	196,000
Accrued expenses and other liabilities	1,606,000	1,864,000
Income taxes payable	830,000	657,000
Total current liabilities	12,317,000	11,212,000
Long-term debt, less current maturities	3,973,000	3,461,000
Deferred gain	1,035,000	1,035,000
Deferred compensation	135,000	120,000

Deferred income taxes		2,000		2,000
Total liabilities		17,462,000		15,830,000
Commitments and contingencies				
Stockholders' equity:				
Preferred stock, $0.01 par value; 5,000,000 shares authorized; none issued				
Common stock, $0.01 par value; 40,000,000 shares authorized; 2,470,770 and 2,465,772 issued and outstanding at March 31, 2006 and December 31, 2005, respectively		25,000		25,000
Additional paid-in capital		14,467,000		14,454,000
Accumulated deficit		(3,276,000)		(4,357,000)
Total stockholders' equity		11,216,000		10,122,000
Total liabilities and stockholders' equity	$	28,678,000	$	25,952,000

See accompanying notes to consolidated financial statements.

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended March 31, 2006		Three Months Ended March 31, 2005	
Net sales	$	20,033,000	$	16,592,000
Cost of sales		14,088,000		11,414,000
Gross profit		5,945,000		5,178,000
Selling, general and administrative expenses		4,135,000		3,793,000
Operating income		1,810,000		1,385,000
Other income (expense):				
Interest expense		(170,000)		(139,000)
Miscellaneous income		78,000		80,000
		(92,000)		(59,000)
Income before income taxes		1,718,000		1,326,000
Income tax expense		(637,000)		(495,000)
Net income	$	1,081,000	$	831,000
Income per common share basic	$	0.44	$	0.34
Income per common share diluted	$	0.42	$	0.33
Weighted average shares outstanding basic		2,468,241		2,413,924
Weighted average shares outstanding diluted		2,552,685		2,501,842

See accompanying notes to consolidated financial statements.

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IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Cash flows from operating activities:		
Net income	$ 1,081,000	$ 831,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	216,000	138,000
Amortization	10,000	12,000
Provision for doubtful accounts	186,000	143,000
Provision for deferred income taxes	3,000	24,000
Loss (gain) on disposal of fixed assets	1,000	
Deferred compensation	15,000	15,000
Changes in operating assets and liabilities		
Trade accounts receivable	(1,501,000)	(611,000)
Inventories	(1,508,000)	(198,000)
Other current assets	347,000	(45,000)
Other assets	7,000	(43,000)
Accounts payable	1,514,000	431,000
Accrued expenses and other liabilities	(258,000)	297,000
Income taxes payable	173,000	257,000
Net cash provided by operating activities	286,000	1,251,000
Cash flows from investing activities:		
Purchases of property, plant and equipment	(727,000)	(445,000)
Proceeds received from sale of property and equipment	1,000	2,000
Net cash used in investing activities	(726,000)	(443,000)
Cash flows from financing activities		
Proceeds from notes payable line of credit	20,070,000	16,121,000
Repayments of notes payable line of credit	(20,430,000)	(16,981,000)
Payment to former preferred stockholders	(110,000)	
Proceeds from issuance of long-term debt	860,000	25,000
Proceeds from exercise of stock options	13,000	50,000
Payment for cancellation of fractional shares of common stock		(20,000)
Repayment of long-term debt	(202,000)	(179,000)

Decrease (Increase) in restricted cash		319,000		(58,000)
Net cash provided by (used in) financing activities		520,000		(1,042,000)
Net increase (decrease) in cash and cash equivalents		80,000		(234,000)
Cash and cash equivalents, beginning of period		974,000		1,146,000
Cash and cash equivalents, end of period	$	1,054,000	$	912,000

See accompanying notes to consolidated financial statements.

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three Months Ended March 31,			
		2006		**2005**
Supplemental disclosure of cash flow information:				
Cash paid during the three months for interest	$	169,000	$	141,000
Cash paid during the three months for income taxes	$	460,000	$	90,000
Non-cash transactions:				
Asset acquisitions financed	$		$	25,000

See accompanying notes to consolidated financial statements.

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

(1)

Interim Consolidated Financial Statements

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting solely of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for future fiscal quarters in 2006 or for the year ended December 31, 2006. The significant accounting principles used in the preparation of these unaudited interim consolidated financial statements are the same as those used in the preparation of the annual audited consolidated financial statements. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

(2)

Description of Business

Imperial Industries, Inc., (Imperial) and its wholly-owned subsidiaries, Just-Rite Supply, Inc. (Just-Rite), Premix-Marbletite Manufacturing Co. (Premix), and DFH, Inc. (DFH), formerly known as Acrocrete, Inc. (Acrocrete), collectively the (Company), are primarily involved in the manufacture and sale of exterior and interior finishing wall coatings and mortar products for the construction industry, as well as the purchase and resale of building materials from other manufacturers. Sales of the Company s and other products are made to customers primarily in Florida and the Southeastern United States through independent distributors and company-owned distribution facilities.

The consolidated financial statements contain the accounts of Imperial and its wholly-owned subsidiaries, Just-Rite, Premix and DFH. All material intercompany transactions and balances have been eliminated.

(3)

Sale of Certain Assets and Closure of Manufacturing Facility

On July 25, 2005, DFH entered into an agreement with Degussa Wall Systems, Inc. (Degussa) and Degussa Construction Chemical Operations, Inc. (DCCO and collectively with Degussa, the Purchasers) to sell certain assets associated with its manufacturing facility in Kennesaw, Georgia and also agreed to cease the manufacture of products that had been formerly used in exterior insulation finish wall systems (EIFS) applications prior to December 31, 2005 (the Degussa Sales Agreement).

Pursuant to the Degussa Sales Agreement, the Purchasers acquired certain of the assets of DFH and its affiliate, Premix. The assets consisted of certain equipment, customer lists, trademarks, proprietary rights, including product formulas, code approvals and books and records associated with DFH s manufacturing operations in Kennesaw, Georgia (the Assets). In addition, the Purchasers purchased certain of DFH s accounts receivable outstanding as of September 30, 2005 at face value, subject to DFH s obligation to repurchase the unpaid balances of such accounts receivable ninety (90) days thereafter. As of December 31, 2005, all accounts receivable were collected by Degussa.

The aggregate sales price for the Assets consisted of $1,100,000 in cash, plus the net book value of the accounts receivable and equipment to be transferred prior to December 31, 2005. The Company incurred $65,000 in aggregate transaction expenses. Of the aggregate sales price of $1,320,000, $250,000 was received on July 25, 2005, $983,000 was received on September 30, 2005 and the remaining $87,000 was received in the fourth quarter of 2005.

As part of the transaction, Just-Rite entered into a three-year distribution agreement with Degussa (the Distribution Agreement) to sell products previously manufactured and sold by DFH and now manufactured by Degussa. Just-Rite has agreed to purchase at least $16,000,000 of products manufactured by Degussa under the Acrocrete brand name over the term of the Distribution Agreement. In the event the Company fails to purchase a minimum of $12,000,000, it will be required to refund to Degussa $1,100,000 of the purchase price under the Degussa Sales Agreement plus $1,200,000. Once the Company has purchased a minimum of $12,000,000,

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

$1,100,000 of the purchase price becomes non-refundable and the $1,200,000 is reduced ratably down to zero until $16,000,000 of purchases are achieved. Upon achieving $12,000,000 of purchases, the Company has the option to extend the Distribution Agreement for an additional two years to meet the total purchase commitment. As a result, the Company has deferred the gain of $1,035,000 on the Degussa Sales Agreement until it has reached the minimum purchase requirement. Subsequently, the Company will recognize the gain ratably to the extent the remaining purchase commitment is attained.

In connection with the Degussa Sales Agreement, DFH ceased manufacturing operations at its Kennesaw, Georgia facility in the fourth quarter of 2005 and completed closure activities in the first quarter of 2006.

The closure charge against cost of sales in the third quarter of 2005 reflected an accrual of the severance payments due to employees at September 30, 2005 of $52,000, in accordance with the terms of a work force reduction plan adopted in July 2005. At December 31, 2005 and March 31, 2006 there is an accrued liability for $25,000 for estimated repair work to the facility in Kennesaw, Georgia. The accrual was recorded in selling, general and administrative expenses in the fourth quarter of 2005.

Costs incurred related to closing the facility are as follows:

	Costs Incurred for the Year Ended December 31, 2005	Costs Incurred for the Quarter Ended March 31, 2006	Total Costs Incurred
Severance expenses	$ 75,000	$ 9,000	$ 84,000
Dismantling of production equipment & other plant expenses	52,000	30,000	82,000
Accelerated depreciation & surplus equipment	74,000		74,000
Inventory write-down	25,000		25,000
	$ 226,000	$ 39,000	$ 265,000

(4)

Trade Accounts Receivable

At March 31, 2006, accounts aggregating $996,000, or approximately 9% of total gross accounts receivable, were deemed to be ineligible for borrowing purposes under the Company s borrowing agreement with its commercial lender, compared to $927,000 or approximately 10%, of total gross accounts receivables outstanding at December 31, 2005. Management believes the allowance for doubtful accounts at March 31, 2006 of $970,000 is sufficient to absorb any losses which may arise from uncollectible accounts receivable.

Accounting for doubtful accounts is uncertain because management must use judgment to assess the collectibility of these accounts. Although the Company believes the allowance for doubtful accounts is sufficient, if the financial condition of certain customers were to unexpectedly deteriorate, resulting in an impairment of their ability to make payments, additional allowances may subsequently be required that could adversely impact the Company s consolidated statements of operations.

(5)

Inventories

Inventories are stated at the lower of cost or market (net realizable value), on a first-in, first-out basis. Finished goods include the cost of raw materials, freight in, direct labor and plant overhead.

The Company has an arrangement with a buying group providing for inventory purchase rebates (vendor rebates) based principally upon achievement of certain volume purchasing levels during the year. The Company accrues the estimated receipt of vendor rebates as a reduction of the cost of inventory purchases based on progress towards earning the vendor rebates taking into consideration cumulative purchases throughout the year.

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Substantially all vendor rebate receivables are collected within three months immediately following fiscal year-end. Management believes the Company will continue to receive rebates from the buying group in 2006 and thereafter. However, receipt of historical levels of rebates will be primarily dependent on maintaining existing purchasing levels. There can be no assurance that the buying group will continue to provide comparable vendor rebates in the future on products purchased by the Company. The Company recorded vendor rebates in cost of sales of approximately $145,000 and $82,000 in the first quarter of 2006 and 2005, respectively. At March 31, 2006 and December 31, 2005, the Company recorded rebates in a contra inventory account of approximately $18,000. Also at March 31, 2006 and December 31, 2005, the Company recorded amounts due from vendors in other assets of $151,000 and $346,000, respectively.

Inventories consisted of the following at:

	March 31, 2006	December 31, 2005
Raw Materials	$ 371,000	$ 400,000
Finished Goods	7,342,000	5,785,000
Packaging materials	358,000	378,000
	$ 8,071,000	$ 6,563,000

(6)

Property, Plant and Equipment

Property, plant and equipment is stated at cost, less accumulated depreciation. Equipment under capital leases is stated at the present value of minimum lease payments at inception. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

Property, Plant and Equipment consisted of the following at:

	March 31, 2006	December 31, 2005	Estimated useful life (years)
Land	$ 559,000	$ 559,000	
Buildings and improvements	1,750,000	1,718,000	10 - 40
Machinery and equipment	4,260,000	3,913,000	3 - 20

Vehicles		2,906,000		2,589,000	2 - 8
Furniture and fixtures		252,000		243,000	3 - 12
		9,727,000		9,022,000	
Less accumulated depreciation		(2,862,000)		(2,666,000)	
	$	6,865,000	$	6,356,000	

(7)

Notes Payable

At March 31, 2006 and December 31, 2005, notes payable represent amounts outstanding under a line of credit from a commercial lender to the Company s subsidiaries. The line of credit is collateralized by the subsidiaries accounts receivable and inventory, and bears interest at a variable rate of 6.739% (Libor + 2.0%) as of March 31, 2006. Additionally, Imperial is a guarantor of the subsidiaries notes payable. In February 2005, the line of credit was increased from $8,000,000 to $9,000,000. The maturity date is June 1, 2007 and is subject to annual renewal thereafter. Although the credit facility matures June 1, 2007, Imperial has classified the borrowings thereunder as a current liability in accordance with Emerging Issues Task Force (EITF) 95-22 Balance Sheet Classifications of Borrowings Outstanding under Revolving Credit Agreements That Include Both a Subjective Acceleration Clause and a Lock-Box Arrangement.

At March 31, 2006, the line of credit limit available for borrowing based on eligible receivables and inventory aggregated approximately $9,000,000, of which $4,336,000 was outstanding. The average amounts

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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outstanding during the three months ending March 31, 2006 and year ending December 31, 2005 were $4,070,000 and $5,104,000, respectively. The maximum amounts outstanding at any month-end during the three months ending March 31, 2006 and year ending December 31, 2005 were $4,336,000 and $5,850,000, respectively. The effective interest rate on the line of credit was 7.02% and 7.4%, at March 31, 2006 and December 31, 2005, respectively.

In February 2006, the line of credit was amended allowing the Company to select its interest rate from either the Libor rate or the prime rate, plus the applicable margin. The margin is dependent on the ratio of consolidated funded debt to consolidated EBITDA calculated quarterly for the preceding 12 fiscal months.

(8)

Product Warranty

The Company provides its customers with limited warranties on certain manufactured products. Limited warranties generally range from 5 to 10 years. Warranty reserves are established based on known or probable claims, together with historical experience factors. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. The warranty reserve at March 31, 2006 and 2005 of $52,000 and $117,000, respectively, is recorded in the balance sheet in accrued expense and other liabilities.

Product warranty accrual activity during the periods ending March 31, is as follows:

		2006		2005
Beginning balance	$	50,000	$	87,000
Warranty provision		24,000		54,000
Warranty payments		(22,000)		(24,000)
Ending balance	$	52,000	$	117,000

(9)

Long-Term Debt and Current Installments of Long-Term Debt

Included in long-term debt at March 31, 2006, are six mortgage loans, collateralized by the Company s real property, in the aggregate amount of $1,608,000, less current installments aggregating $104,000.

Other long-term debt in the aggregate amount of $3,251,000, less current installments of $782,000, relates principally to equipment financing. The notes bear interest at various annual rates ranging from approximately 3.0% to 13.4%.

(10)

Income Taxes

At March 31, 2006, the net deferred tax asset of approximately $998,000 consisted primarily of the basis differences attributable to accounts receivable, fixed assets, litigation reserve, goodwill and a deferred gain resulting from the sale of assets upon closing the manufacturing facility.

In the three months ended March 31, 2006, the Company recognized income tax expense of $637,000, compared to tax expense of $495,000, for the same period in 2005 primarily due to higher net income before taxes.

(11)

Common Stock

At March 31, 2006 and December 31, 2005, the Company had authorized 40,000,000 shares of common stock, $.01 par value per share, of which 2,470,770 and 2,465,772 shares were issued and outstanding, respectively (Common Stock). The holders of Common Stock are entitled to one vote per share on all matters, voting together with the holders of preferred stock, if any. In the event of liquidation, holders of Common Stock are entitled to share ratably in all the remaining assets of the Company, if any, after satisfaction of the liabilities of the Company and the preferential rights of the holders of outstanding preferred stock, if any.

In the first three months of 2006, the Company issued 5,880 shares of common stock in connection with the exercise of stock options. In connection with the exercise of stock options, 882 shares of common stock held by optionees were utilized as partial payment of the exercise price of options and were canceled.

IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

As a result of a one-for-four reverse stock split effective March 23, 2005, fractional shares aggregating 1,511 shares were cancelled in consideration of a total cash payment of approximately $3,000 to stockholders during the first quarter of 2005.

(12)

Stock-Based Compensation

The Company has two stock option plans, the Directors Stock Option Plan (the Directors Plan) and the 1999 Employee Stock Option Plan (the Employee Plan and collectively with the Directors Plan, the 1999 Plans). The 1999 Plans provide for options to be granted with exercise prices at generally no less than the fair market value of the Company s common stock at the grant date. Options granted under the 1999 Plans have a term of up to 10 years and are exercisable six months from the grant date subject to vesting requirements that may be imposed on individual grants. The 1999 Plans are administered by the Board s Compensation and Stock Option Committee (the Committee), which is comprised of four outside directors. The Committee determines who is eligible to participate and the number of shares for which options are to be granted. A total of 225,000 and 100,000 shares are reserved for issuance pursuant to options under the Employee and Directors Plans, respectively. As of March 31, 2006, options for 17,875 shares were available for future grants under the 1999 Employee Plan and no shares were available under the Directors Plan. All options have been adjusted for the one-for-four reverse stock split effective March 22, 2005, where necessary.

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R), Share-Based Payments, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. SFAS 123R supersedes the Company s previous accounting methodology using the intrinsic value method under Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees. Under the intrinsic value method, no share-based compensation expense related to stock option awards granted to employees had been recognized in the Company s Consolidated Statements of Operations, as all stock option awards granted under the 1999 Plans had an exercise price equal to or greater than the market value of the Common Stock on the date of the grant.

The Company adopted SFAS 123R using the modified prospective transition method. In accordance with this method, the Company s Consolidated Financial Statements for prior periods will not be restated to reflect the impact of SFAS 123R, if any. The impact from adoption of FAS 123R on the Company s Consolidated Financial Statements is contingent on the terms of the individual awards granted.

As of December 31, 2005, all stock options were 100% vested and, as a result, will not be subject to compensation recognition required by FAS 123R beginning in January 2006. Pursuant to the 1999 Plans, all options are not exercisable for a period of six months following the date of grant to ensure compliance with the Securities and Exchange Commission regulations.

A summary of the activity and status of the 1999 Plans was as follows:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Life	Aggregate Intrinsic Value
Outstanding Options at January 1, 2006	149,000	$ 6.24		
Options Granted				
Options Exercised	(5,000)	$ 4.37		
Options Cancelled				