GENCOR INDUSTRIES INC
Form 10-Q
August 03, 2017
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2017
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: 001-11703

GENCOR INDUSTRIES, INC.

Delaware	**59-0933147**
(State or other jurisdiction of	**(I.R.S. Employer**

incorporation or organization)	**Identification No.)**
5201 North Orange Blossom Trail, Orlando, Florida	**32810**
(Address of principal executive offices)	**(Zip Code)**

(407) 290-6000

(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 and 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.

Large accelerated filer	Accelerated Filer
Non-accelerated Filer (Do not check if a smaller reporting company)	Smaller Reporting Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at July 28, 2017
Common stock, $.10 par value	12,137,829 shares
Class B stock, $.10 par value	2,263,857 shares

Table of Contents

GENCOR INDUSTRIES, INC.

Introductory Note: Caution Concerning Forward-Looking Statements

This Form 10-Q Report and the Company s other communications and statements may contain forward-looking statements, including statements about the Company s beliefs, plans, objectives, goals, expectations, estimates, projections and intentions. These statements are subject to significant risks and uncertainties and are subject to change based on various factors, many of which are beyond the Company s control. The words may, could, should, would, believe, anticipate, estimate, expect, intend, plan, target, goal, and similar expressions are intended to i forward-looking statements. All forward-looking statements, by their nature, are subject to risks and uncertainties. The Company s actual future results may differ materially from those set forth in its forward-looking statements. For information concerning these factors and related matters, see Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, in this Report, and the following sections of the Company s Annual Report on Form 10-K for the year ended September 30, 2016: (a) Risk Factors in Part I, and (b) Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II. However, other factors besides those referenced could adversely affect the Company s results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by the Company herein speak as of the date of this Report. The Company does not undertake to update any forward-looking statements, except as required by law.

Unless the context otherwise indicates, all references in this Report to the Company, Gencor, we, us, or our, or s words are to Gencor Industries, Inc. and its subsidiaries.

Table of Contents

Part I. Financial Information

GENCOR INDUSTRIES, INC.

Condensed Consolidated Balance Sheets

	June 30, 2017 (Unaudited)	September 30, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 25,219,000	$ 18,219,000
Marketable securities at fair value (cost $87,273,000 at June 30, 2017 and $86,203,000 at September 30, 2016)	87,132,000	85,938,000
Accounts receivable, less allowance for doubtful accounts of $186,000 at June 30, 2017 and $195,000 at September 30, 2016	1,383,000	1,110,000
Costs and estimated earnings in excess of billings	4,897,000	4,921,000
Inventories, net	15,321,000	11,634,000
Prepaid expenses and other current assets	1,707,000	1,598,000
Total Current Assets	135,659,000	123,420,000
Property and equipment, net	5,231,000	5,239,000
Other assets	53,000	53,000
Total Assets	$ 140,943,000	$ 128,712,000
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 2,246,000	$ 1,443,000
Customer deposits	7,224,000	4,484,000
Accrued expenses and other current liabilities	3,359,000	2,264,000
Total Current Liabilities	12,829,000	8,191,000
Deferred and other income taxes	322,000	316,000
Total Liabilities	13,151,000	8,507,000
Commitments and contingencies		
Shareholders equity:		
Preferred stock, par value $.10 per share; authorized 300,000 shares; none issued		
Common stock, par value $.10 per share; 15,000,000 shares authorized; 12,137,829 and 12,111,079 shares issued and outstanding at June 30, 2017 and September 30, 2016, respectively	1,214,000	1,211,000
	226,000	226,000

Class B Stock, par value $.10 per share; 6,000,000 shares authorized; 2,263,857 shares issued and outstanding		
Capital in excess of par value	11,074,000	10,887,000
Retained earnings	115,278,000	107,881,000
Total Shareholders Equity	127,792,000	120,205,000
Total Liabilities and Shareholders Equity	$ 140,943,000	$ 128,712,000

See accompanying Notes to Condensed Consolidated Financial Statements

3

Table of Contents

GENCOR INDUSTRIES, INC.

Condensed Consolidated Statements of Income

(Unaudited)

	For the Quarters Ended June 30,		For the Nine Months Ended June 30,	
	2017	**2016**	**2017**	**2016**
Net revenue	$ 23,743,000	$ 19,863,000	$ 62,052,000	$ 55,199,000
Costs and expenses:				
Production costs	17,053,000	14,712,000	44,555,000	41,325,000
Product engineering and development	637,000	379,000	1,523,000	1,140,000
Selling, general and administrative	2,259,000	1,979,000	6,576,000	5,954,000
	19,949,000	17,070,000	52,654,000	48,419,000
Operating income	3,794,000	2,793,000	9,398,000	6,780,000
Other income (expense), net:				
Interest and dividend income, net of fees	181,000	99,000	384,000	688,000
Net realized and unrealized gains (losses) on marketable securities	(253,000)	464,000	810,000	567,000
Other				2,000
	(72,000)	563,000	1,194,000	1,257,000
Income before income tax expense	3,722,000	3,356,000	10,592,000	8,037,000
Income tax expense	1,134,000	1,242,000	3,195,000	2,718,000
Net income	$ 2,588,000	$ 2,114,000	$ 7,397,000	$ 5,319,000
Basic Income per Common Share:				
Net income per share *	$ 0.18	$ 0.15	$ 0.51	$ 0.37
Diluted Income per Common Share:				
Net income per share *	$ 0.18	$ 0.15	$ 0.50	$ 0.37

See accompanying Notes to Condensed Consolidated Financial Statements

*Prior year adjusted for three-for-two stock split

4

Table of Contents

GENCOR INDUSTRIES, INC.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the Nine Months Ended June 30, 2017	2016
Cash flows from operations:		
Net income	$ 7,397,000	$ 5,319,000
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Purchases of marketable securities	(413,993,000)	(335,848,000)
Proceeds from sale and maturity of marketable securities	413,491,000	334,844,000
Change in fair value of marketable securities	(692,000)	(251,000)
Deferred income taxes	6,000	796,000
Depreciation and amortization	862,000	1,050,000
Provision for doubtful accounts	65,000	55,000
Stock-based compensation	54,000	25,000
Changes in assets and liabilities:		
Accounts receivable	(338,000)	(680,000)
Costs and estimated earnings in excess of billings	24,000	(7,341,000)
Inventories	(3,687,000)	1,213,000
Prepaid expenses and other current assets	(109,000)	306,000
Accounts payable	803,000	(336,000)
Customer deposits	2,740,000	(810,000)
Accrued expenses and other current liabilities	1,095,000	1,388,000
Total adjustments	321,000	(5,589,000)
Cash flows provided by (used in) provided by operating activities	7,718,000	(270,000)
Cash flows used in investing activities:		
Capital expenditures	(854,000)	(158,000)
Cash flows used in investing activities	(854,000)	(158,000)
Cash flows from financing activities:		
Proceeds from stock option exercises	136,000	164,000
Cash flows provided by financing activities	136,000	164,000
Net increase (decrease) in cash	7,000,000	(264,000)
Cash at:		
Beginning of period	18,219,000	11,152,000

End of period	$ 25,219,000	$ 10,888,000

See accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents

GENCOR INDUSTRIES, INC.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note 1 Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all material adjustments (consisting of normal, recurring adjustments) considered necessary for a fair presentation have been included in the interim financial information. Operating results for the quarter and nine months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending September 30, 2017.

The accompanying condensed consolidated balance sheet at September 30, 2016 has been derived from the audited financial statements at that date but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and notes thereto included in the Gencor Industries, Inc. Annual Report on Form 10-K for the year ended September 30, 2016.

Recent Accounting Pronouncements

In July 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-09, Improvements to Employee Share-Based Payment Accounting, which is a part of FASB s Simplification initiative. The areas for simplification in ASU 2016-09 involve several aspects of the accounting for share-based payment awards issued by entities to their employees, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The Company adopted the provisions of ASU 2016-09 during the quarter ended March 31, 2017 with no material impact on the Company s financial position, results of operations or cash flows.

Note 2 Marketable Securities

Marketable debt and equity securities are categorized as trading securities and are thus marked to market and stated at fair value. Fair value is determined using the quoted closing or latest bid prices for Level 1 investments and market standard valuation methodologies for Level 2 investments. Realized gains and losses on investment transactions are determined by specific identification and are recognized as incurred in the condensed consolidated statements of income. Changes in net unrealized gains and losses are reported in the condensed consolidated statements of income in the current period and represent the change in the fair value of investment holdings during the period.

Fair Value Measurements

The fair value of financial instruments is presented based upon a hierarchy of levels that prioritizes the inputs of valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). A financial instrument s level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

The fair value of marketable equity securities, mutual funds, exchange-traded funds, government securities, and cash and money funds are substantially based on quoted market prices (Level 1). Corporate and municipal bonds are valued using market standard valuation methodologies, including: discounted cash flow methodologies, matrix pricing or other similar techniques. The inputs to these market standard valuation methodologies include, but are not limited to: interest rates, credit standing of the issuer or counterparty, industry sector of the issuer, coupon rate, call provisions, maturity, estimated duration and assumptions regarding liquidity and estimated future cash flows. In addition to bond characteristics, the valuation methodologies incorporate market data, such as actual trades completed, bids and actual dealer quotes, where such information is available. Accordingly, the estimated fair values are based on available market information and judgments about financial instruments (Level 2). Fair values of the Level 2 investments, if any, are provided by the Company s professional investment management firm.

Table of Contents

The following table sets forth, by level, within the fair value hierarchy, the Company s marketable securities measured at fair value as of June 30, 2017:

	Fair Value Measurements			
	Level 1	**Level 2**	**Level 3**	**Total**
Equities	$ 11,037,000	$	$	$ 11,037,000
Mutual Funds	6,013,000			6,013,000
Exchange-Traded Funds	1,440,000			1,440,000
Government Securities	66,090,000			66,090,000
Cash and Money Funds	2,552,000			2,552,000
Total	$ 87,132,000	$	$	$ 87,132,000

Changes in net unrealized gains and (losses) included in the consolidated statements of income for the quarter and nine months ended June 30, 2017, on trading securities still held as of June 30, 2017, were $(341,000) and $123,000, respectively. There were no transfers of investments between Level 1 and Level 2 during the nine months ended June 30, 2017.

The following table sets forth by level, within the fair value hierarchy, the Company s marketable securities measured at fair value as of September 30, 2016:

	Fair Value Measurements			
	Level 1	**Level 2**	**Level 3**	**Total**
Equities	$ 2,408,000	$	$	$ 2,408,000
Mutual Funds	5,212,000			5,212,000
Exchange-Traded Funds	510,000			510,000
Government Securities	69,583,000			69,583,000
Cash and Money Funds	8,225,000			8,225,000
Total	$ 85,938,000	$	$	$ 85,938,000

Changes in net unrealized gains included in the consolidated statements of income for the quarter and nine months ended June 30, 2016, on trading securities still held as of June 30, 2016, were $698,000 and $2,288,000, respectively. There were no transfers of investments between Level 1 and Level 2 during the nine months ended June 30, 2016.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term nature of these items.

Note 3 Inventories

Inventories are valued at the lower of cost or market, with cost being determined principally by using the last-in, first-out (LIFO) method and market defined as replacement cost for raw materials and net realizable value for work in process and finished goods. Appropriate consideration is given to obsolescence, excessive levels, deterioration, possible alternative uses and other factors in determining net realizable value. The cost of work in process and finished goods includes materials, direct labor, variable costs and overhead. The Company evaluates the need to record inventory allowances on all inventories, including raw material, work in process, finished goods, spare parts and used equipment. Used equipment acquired by the Company on trade-in from customers is carried at estimated net realizable value. Unless specific circumstances warrant different treatment regarding inventory obsolescence, the cost basis of inventories three to four years old is reduced by 50%, while the cost basis of inventories four to five years old is reduced by 75%, and the cost basis of inventories greater than five years old is reduced to zero. Inventory is typically reviewed for obsolescence on an annual basis computed as of September 30, the Company s fiscal year end. If significant known changes in trends, technology or other specific circumstances that warrant consideration occur during the year, then the impact on obsolescence is considered at that time. No such provisions were made during the quarter and nine months ended June 30, 2017.

Table of Contents

Net inventories at June 30, 2017 and September 30, 2016 consist of the following:

	June 30, 2017	September 30, 2016
Raw materials	$ 8,672,000	$ 7,072,000
Work in process	2,715,000	976,000
Finished goods	3,918,000	3,545,000
Used equipment	16,000	41,000
	$ 15,321,000	$ 11,634,000

Note 4 Costs and Estimated Earnings in Excess of Billings

Costs and estimated earnings in excess of billings on uncompleted contracts as of June 30, 2017 and September 30, 2016 consist of the following:

	June 30, 2017	September 30, 2016
Costs incurred on uncompleted contracts	$ 7,473,000	$ 8,898,000
Estimated earnings	2,734,000	3,124,000
	10,207,000	12,022,000
Billings to date	5,310,000	7,101,000
Costs and estimated earnings in excess of billings	$ 4,897,000	$ 4,921,000

Note 5 Earnings per Share Data

The following table sets forth the computation of basic and diluted earnings per share for the quarters and nine months ended June 30, 2017 and 2016:

	Quarter Ended June 30,		Nine Months Ended June 30,	
	2017	2016	2017	2016
Net Income	$ 2,588,000	$ 2,114,000	$ 7,397,000	$ 5,319,000
Common Shares:				
Weighted average common shares outstanding	14,400,000	14,333,000	14,390,000	14,321,000
Effect of dilutive stock options	299,000	217,000	290,000	170,000
Diluted shares outstanding	14,699,000	14,550,000	14,680,000	14,491,000

Basic:

Net earnings per share	$ 0.18	$ 0.15	$ 0.51	$ 0.37
Diluted:				
Net earnings per share	$ 0.18	$ 0.15	$ 0.50	$ 0.37

On July 11, 2016, the Company s Board of Directors approved a three-for-two split of the Company s common and Class B stock to be effected in the form of a 50% stock dividend. As a result, shareholders received one additional share of common or Class B stock for every two shares they held of the respective class of stock as of the record date. These shares were distributed on August 1, 2016, to shareholders of record as of the end of business on July 22, 2016. All share and per share data (except par value) have been adjusted to reflect the effect of the stock split for all periods presented. The number of shares of common and Class B stock issuable upon exercise of outstanding stock options were proportionately increased in accordance with terms of the respective plans. The number of authorized shares, as reflected on the condensed consolidated balance sheets, was not affected by the stock split and, accordingly, has not been adjusted.

Table of Contents

Basic earnings per share are based on the weighted-average number of shares outstanding. Diluted earnings per share are based on the sum of the weighted average number of shares outstanding plus common stock equivalents. Weighted-average shares issuable upon the exercise of stock options included in the diluted earnings per share calculation for the quarter and nine months ended June 30, 2017 were 459,000 and 469,000, respectively, which equates to 299,000 and 290,000 dilutive common stock equivalents, respectively. Weighted-average shares issuable upon the exercise of stock options included in the diluted earnings per share calculation for the quarter and nine months ended June 30, 2016 were 496,000 and 488,000, respectively, which equates to 217,000 and 170,000 dilutive common stock equivalents, respectively. There were no anti-dilutive shares for the quarters and nine months ended June 30, 2017 and June 30, 2016.

Note 6 Customers with 10% (or greater) of Net Revenues

During the quarter ended June 30, 2017, 15.1% of net revenues were from entities owned by one global company versus 30.6% for the quarter ended June 30, 2016. For the nine months ended June 30, 2017, 11.6% of net revenues were from entities owned by one global company versus 14.6% for the nine months ended June 30, 2016.

Two other customers accounted for 12.8% and 14.8% of net revenues, respectively, for the quarter ended June 30, 2017, and 4.9% and 5.7% of net revenues, respectively, for the nine months ended June 30, 2017. Net revenues for these two customers were less than 1% during the prior year comparative periods.

Table of Contents

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

Overview

Gencor Industries, Inc. (the Company) is a leading manufacturer of heavy machinery used in the production of highway construction materials and environmental control equipment. The Company s core products include asphalt plants, combustion systems, and fluid heat transfer systems. The Company s products are manufactured in two facilities in the United States.

Because the Company s products are sold primarily to the highway construction industry, the business is seasonal in nature. Traditionally, the Company s customers do not purchase new equipment for shipment during the summer and fall months to avoid disrupting their peak season for highway construction and repair work. The majority of orders for the Company s products are thus received between October and February, with a significant volume of shipments occurring prior to June. The principal factors driving demand for the Company s products are the overall economic conditions, the level of government funding for domestic highway construction and repair, Canadian infrastructure spending, the need for spare parts, fluctuations in the price of crude oil (liquid asphalt, as well as fuel costs), and a trend towards larger plants resulting from industry consolidation.

The manufacture of an asphalt plant typically has a lead time from order to shipment of 90 to 160 days. The lead time can be impacted by the timing and scope of the order, as well as the customer s delivery requirements. Therefore, the size of the Company s backlog should not be viewed as an indicator of its revenues for the upcoming quarter or annual period. The Company s backlog was $37.9 million at June 30, 2017.

On December 4, 2015, President Obama signed into law a five-year, $305 billion transportation bill, Fixing America s Surface Transportation Act (the FAST Act). The FAST Act reauthorized the collection of the 18.4 cents per gallon gas tax that is typically used to pay for transportation projects. It also included $70 billion from other areas of the federal budget to close a $16 billion annual funding deficit. The bill includes spending of more than $205 billion on roads and highways over five years. The 2016 funding levels are approximately 5% above the 2015 projected funding, with annual increases between 2.0% and 2.5% from 2016 through 2020.

In addition to government funding and overall economic conditions, fluctuations in the price of oil, which is a major component of asphalt mix, may affect the Company s financial performance. An increase in the price of oil increases the cost of liquid asphalt and could, therefore, decrease demand for hot mix asphalt paving materials and certain of the Company s products. Increases in oil prices also drive up the cost of gasoline and diesel, which results in increased freight costs. Where possible, the Company will pass increased freight costs on to its customers. However, the Company may not be able to recapture all of the increased costs and thus could have a negative impact on the Company s financial performance.

Steel is a major component used in manufacturing the Company s equipment. The Company is subject to fluctuations in market prices for raw materials such as steel. If the Company is unable to purchase materials it requires or is unable to pass on price increases to its customers or otherwise reduce its cost of goods sold, its business results of operations and financial condition may be adversely affected.

The Company believes its strategy of continuing to invest in product engineering and development and its focus on delivering the highest quality products and superior service will strengthen the Company s market position. The Company continues to review its internal processes to identify inefficiencies and cost-reduction opportunities. The Company will continue to scrutinize its relationships with external suppliers to ensure it is achieving the highest quality materials and services at the most competitive cost.

Results of Operations

Quarter Ended June 30, 2017 versus June 30, 2016

Net revenue for the quarter ended June 30, 2017 was $23,742,000, as compared to $19,863,000 for the quarter ended June 30, 2016, an increase of $3,879,000 or 19.5%. Sales of asphalt plants and related components continued to be strong as a result of the FAST Act and the continued optimism of our customers.

Table of Contents

As a percent of net revenue, gross profit margins increased to 28.2% in the quarter ended June 30, 2017 from 25.9% in the quarter ended June 30, 2016. The improved gross margin was primarily from higher net revenue and better cost absorption.

Product engineering and development expenses were $637,000 in the quarter ended June 30, 2017, compared to $379,000 for the quarter ended June 30, 2016, due to increased headcount. Selling, general and administrative (SG&A) expenses increased $280,000 to $2,259,000 in the quarter ended June 30, 2017, compared to $1,979,000 in the quarter ended June 30, 2016. Sales commissions increased due to the higher revenues and trade show expenses increased to capitalize on the optimism within the domestic highway construction industry. As a percentage of net revenues, SG&A expenses declined to 9.5%, compared to 10.0% in the prior year quarter.

The Company had operating income of $3,794,000 for the quarter ended June 30, 2017 versus operating income of $2,793,000 for the quarter ended June 30, 2016. Operating margins improved to 16.0%, compared to 14.1% in the prior year quarter. The increase in operating income was due to higher net revenue, and cost and expense controls.

For the quarter ended June 30, 2017, interest and dividend income, net of fees, from the investment portfolio was $181,000, as compared to $99,000 in the quarter ended June 30, 2016. Net realized and unrealized losses on marketable securities were $(253,000) for the quarter ended June 30, 2017 versus net realized and unrealized gains of $464,000 for the quarter ended June 30, 2016.

The effective income tax rate for the quarter ended June 30, 2017 was 30.5%, compared to 37.0% for the quarter ended June 30, 2016.

Net income for the quarter ended June 30, 2017 was $2,588,000, or $0.18 per diluted share, versus $2,114,000, or $0.15 per diluted share, for the quarter ended June 30, 2016. The increase in net income was due to improved net revenues and higher gross margins.

Nine Months Ended June 30, 2017 versus June 30, 2016

Net revenue for the nine months ended June 30, 2017 and 2016 were $62,052,000 and $55,199,000, respectively, an increase of $6,853,000, or 12.4%. The increased net revenue reflects continued improvement in plant and component orders.

As a percent of net revenue, gross profit margins increased to 28.2% in the nine months ended June 30, 2017 from 25.1% in the nine months ended June 30, 2016. The improved gross profit margin resulted from increased net revenues and cost absorption.

Product engineering and development expenses increased $383,000 in the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016, due to increased headcount. SG&A expenses increased $622,000 in the nine months ended June 30, 2017, compared to the nine months ended June 30, 2016. The higher expenses in 2017 were due to increased sales force, increased sales commissions due to the higher revenues, and increased trade show expenses to capitalize on the optimism within the highway construction industry. As a percentage of net revenues, SG&A expenses were 10.6% in 2017, as compared to 10.8% in the prior year nine months.

The Company had operating income of $9,398,000 for the nine months ended June 30, 2017 versus operating income of $6,780,000 for the nine months ended June 30, 2016. The improved operating results were due to increased net revenues and cost absorption. Operating margins improved to 15.1%, compared to 12.3% in the prior year nine months.

Table of Contents

For the nine months ended June 30, 2017, interest and dividend income, net of fees, from the investment portfolio was $384,000, as compared to $688,000 for the prior period. The net realized and unrealized gains on marketable securities were $810,000 for the nine months ended June 30, 2017 versus $567,000 for the nine months ended June 30, 2016.

The effective income tax rate for the nine months ended June 30, 2017 was 30.2% versus 33.8% for the nine months ended June 30, 2016. The effective income tax rate for the nine months ended June 30, 2016 was positively impacted by a $256,000 increase in the prior year federal tax benefit estimate.

Net income for the nine months ended June 30, 2017 was $7,397,000, or $0.50 per diluted share, versus $5,319,000, or $0.37 per diluted share, for the nine months ended June 30, 2016. The increase in net income was due to the improved net revenues and higher gross margins.

Liquidity and Capital Resources

The Company generates capital resources through operations and returns on its investments.

The Company had no long-term or short-term interest-bearing debt outstanding at June 30, 2017 or September 30, 2016. As of June 30, 2017, the Company has funded $135,000 in cash deposits at insurance companies to cover related collateral needs.

As of June 30, 2017, the Company had $25,219,000 in cash and cash equivalents, and $87,132,000 in marketable securities, including $11,037,000 in equities, $6,013,000 in mutual funds, $1,440,000 in exchange-traded funds, $66,090,000 in government securities, and $2,552,000 in cash and money funds. These securities may be liquidated at any time into cash and cash equivalents.

The Company s backlog was $37.9 million at June 30, 2017, compared to $21.4 million at June 30, 2016. The Company s working capital (defined as current assets less current liabilities) was $122.8 million at June 30, 2017 and $115.2 million at September 30, 2016. Cash provided by operations during the nine months ended June 30, 2017 was $7,718,000. The significant purchases, sales and maturities of marketable securities shown on the condensed consolidated statements of cash flows reflect the recurring purchase and sale of United States treasury bills. Inventories increased $3,687,000, reflecting an increase in raw materials and jobs-in-progress at June 30, 2017, compared to September 30, 2016. Accounts payable increased $803,000, reflecting increased parts and raw material purchases. Customer deposits increased $2,740,000 with the increase in the number of open percentage-of-completion jobs, compared to September 30, 2016. Accrued expenses and other current liabilities increased $1,095,000, reflecting the increase in income taxes payable.

Cash flows used in investing activities for the nine months ended June 30, 2017 of $854,000 were related to capital expenditures. Cash flows from financing activities of $136,000 during the nine months ended June 30, 2017 reflect the proceeds received from stock option exercises.

Table of Contents

Seasonality

The Company primarily manufactures and sells asphalt plants and related components and is subject to a seasonal slow-down during the third and fourth quarters of the calendar year. This slow-down often results in lower reported sales and operating results during the first and fourth quarters of each fiscal year ended September 30.

Forward-Looking Information

This Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which represent the Company s expectations and beliefs, including, but not limited to, statements concerning gross margins, sales of the Company s products and future financing plans. These statements by their nature involve substantial risks and uncertainties, certain of which are beyond the Company s control. Actual results may differ materially depending on a variety of important factors, including the financial condition of the Company s customers, changes in the economic and competitive environments, and demand for the Company s products.

For information concerning these factors and related matters, see the following sections of the Company s Annual Report on Form 10-K for the year ended September 30, 2016: (a) Risk Factors in Part I and (b) Management s Discussion and Analysis of Financial Condition and Results of Operations in Part II. However, other factors besides those referenced could adversely affect the Company s results, and you should not consider any such list of factors to be a complete set of all potential risks or uncertainties. Any forward-looking statements made by the Company herein speak as of the date of this Report. The Company does not undertake to update any forward-looking statements, except as required by law.

Critical Accounting Policies, Estimates and Assumptions

The Company believes the following discussion addresses its most critical accounting policies, which are those that are most important to the portrayal of the financial condition and results of operations and require management s most difficult, subjective, or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Accounting policies, in addition to the critical accounting policies referenced below, are presented in Note 1 to the Company s Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended September 30, 2016, Accounting Policies.

Estimates and Assumptions

In preparing the condensed consolidated financial statements, the Company uses certain estimates and assumptions that may affect reported amounts and disclosures. Estimates and assumptions are used, among other places, when accounting for certain revenue (e.g., contract accounting), expense, and asset and liability valuations. The Company believes that the estimates and assumptions made in preparing the condensed consolidated financial statements are reasonable, but are inherently uncertain. Assumptions may be incomplete or inaccurate and unanticipated events may occur. The Company is subject to risks and uncertainties that may cause actual results to differ from estimated results.

Revenues & Expenses

Revenues from contracts for the design, manufacture and sale of asphalt plants are recognized under the percentage-of-completion method. The percentage-of-completion method of accounting for these contracts recognizes revenue, net of any promotional discounts, and costs in proportion to actual labor costs incurred, as compared with total estimated labor costs expected to be incurred during the entire contract. Pre-contract costs are expensed as incurred. Changes to total estimated contract costs or losses, if any, are recognized in the period in which they are determined. Revenue recognized in excess of amounts billed is classified as current assets under costs and estimated earnings in excess of billings. The Company anticipates that all incurred costs associated with these contracts at June 30, 2017 will be billed and collected within one year.

Revenues from all other contracts for the design and manufacture of custom equipment, for service and for parts sales, net of any discounts and return allowances, are recorded when the following four revenue recognition criteria are met: product is delivered or service is performed, persuasive evidence of an arrangement exists, the selling price is fixed or determinable, and collectability is reasonably assured.

Return allowances, which reduce product revenue, are estimated using historical experience. The Company s customers may qualify for certain cash rebates generally based on the level of sales attained during a twelve-month period. Provisions for these rebates, as well as estimated returns and allowances and other adjustments are provided for in the same period the related sales are recorded.

Product warranty costs are estimated using historical experience and known issues and are charged to production costs as revenue is recognized.

All product engineering and development costs, and SG&A expenses are charged to operations as incurred. Provision is made for any anticipated contract losses in the period that the loss becomes evident.

The allowance for doubtful accounts is determined by performing a specific review of all account balances greater than 90 days past due and other higher risk amounts to determine collectability and also adjusting for any known customer payment issues with account balances in the less-than-90-day past due aging buckets. Account balances are charged off against the allowance for doubtful accounts when they are determined to be uncollectable. Any recoveries of account balances previously considered in the allowance for doubtful accounts reduce future additions to the allowance for doubtful accounts.

Inventories

Inventories are valued at the lower of cost or market, with cost being determined principally by using the last-in, first-out (LIFO) method and market defined as replacement cost for raw materials and net realizable value for work in process and finished goods. Appropriate consideration is given to obsolescence, excessive levels, deterioration, possible alternative uses and other factors in determining net realizable value. The cost of work in process and finished goods includes materials, direct labor, variable costs and overhead. The Company evaluates the need to record inventory adjustments on all inventories, including raw material, work in process, finished goods, spare parts and used equipment. Used equipment acquired by the Company on trade-in from customers is carried at estimated net realizable value. Unless specific circumstances warrant different treatment regarding inventory obsolescence, the cost basis of inventories three to four years old is reduced by 50%, while the cost basis of inventories four to five years old is reduced by 75%, and the cost basis of inventories greater than five years old is reduced to zero. Inventory is typically reviewed for obsolescence on an annual basis computed as of September 30, the Company s fiscal year end. If significant known changes in trends, technology or other specific circumstances that warrant consideration occur during the year, then the impact on obsolescence is considered at that time.

Investments

Marketable debt and equity securities are categorized as trading securities and are thus marked to market and stated at fair value. Fair value is determined using the quoted closing or latest bid prices for Level 1 investments and market standard valuation methodologies for Level 2 investments. Realized gains and losses on investment transactions are determined by specific identification and are recognized as incurred in the condensed consolidated statements of income. Net unrealized gains and losses are reported in the condensed consolidated statements of income in the current period and represent the change in the fair value of investment holdings during the period.

Table of Contents

Long-Lived Asset Impairment

Property and equipment and intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. An impairment loss would be recognized when the carrying amount of an asset exceeds the estimated undiscounted cash flows expected to result from the use of the asset and its eventual disposition. The amount of the impairment loss to be recorded is calculated by the excess over its fair value of the asset s carrying value. Fair value is generally determined using a discounted cash flow analysis.

Off-Balance Sheet Arrangements

None

Table of Contents

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company operates manufacturing facilities and sales offices located in the United States. The Company is subject to business risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations, and market risk related to changes in interest rates and foreign currency exchange rates. The Company may use derivative financial instruments consisting primarily of interest rate hedge agreements to manage exposure to interest rate changes. The Company s objective in managing its exposure to changes in interest rates on any future variable rate debt is to limit the impact on earnings and cash flow and reduce overall borrowing costs.

At June 30, 2017 and September 30, 2016, the Company had no interest-bearing debt outstanding. The Company s marketable securities are invested primarily in equities, mutual funds, exchange-traded funds, government securities, and cash and money funds. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with investment securities, it is possible that changes in these risk factors could have an adverse, material impact on the Company s results of operations or equity.

The Company s sensitivity analysis for interest rate risk excludes accounts receivable, accounts payable, and accrued liabilities, because of the short-term maturity of such instruments. The analysis does not consider the effect on other variables, such as changes in sales volumes or management s actions with respect to levels of capital expenditures, future acquisitions or planned divestures, all of which could be significantly influenced by changes in interest rates.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company s Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Report. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that, as of the end of the period covered by this Report, the Company s disclosure controls and procedures are effective.

Because of inherent limitations, the Company s disclosure controls and procedures, no matter how well-designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of such disclosure controls and procedures are met, and no evaluation can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

Changes in Internal Control over Financial Reporting

The Company s management, including the Chief Executive Officer and Chief Financial Officer, has reviewed the Company s internal control over financial reporting. There were no changes in the Company s internal control over financial reporting during the quarter and nine months ended June 30, 2017 that materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Part II. Other Information

ITEM 1. LEGAL PROCEEDINGS

From time to time the Company is engaged in legal proceedings in the ordinary course of business. We do not believe any current legal proceedings are material to our business.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from those set forth in Part I, Item 1A, Risk Factors contained in our Annual Report on Form 10K for the period ended September 30, 2016, as filed with the SEC on December 2, 2016.

Item 6. Exhibits

(a) Exhibits

31.1	Certification of Chief Executive Officer Pursuant to Rule 13a 14(a) of the Securities Exchange Act of 1934, as amended
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a 14(a) of the Securities Exchange Act of 1934, as amended
32	Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U. S. C. Section 1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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.

GENCOR INDUSTRIES, INC.

/s/ John E. Elliott
John E. Elliott
Chief Executive Officer

August 3, 2017

/s/ Eric E. Mellen
Eric E. Mellen
Chief Financial Officer
(Principal Financial and Accounting Officer)

August 3, 2017