

SHOPSMITH INC
Form 10-Q
August 15, 2005

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended July 2, 2005

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 0-9318

SHOPSMITH, INC.

(Exact name of registrant as specified in its charter)

Ohio

31-0811466

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

6530 Poe Avenue, Dayton, Ohio

45414

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (937) 898-6070

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is an accelerated filer (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.

Common shares, without par value: 2,605,233 shares as of July 26, 2005.

**SHOPSMITH, INC. AND SUBSIDIARIES
INDEX**

Page No.

Part I. Financial Information:

Item 1. Financial Statements

Consolidated Balance Sheets July 2, 2005 and April 2, 2005

3-4

Table of Contents

2

<u>Consolidated Statements of Operations and Deficit Three Months Ended July 2, 2005 and July 3, 2004</u>	5
<u>Consolidated Statements of Cash Flows Three Months Ended July 2, 2005 and July 3, 2004</u>	6
<u>Notes to Consolidated Financial Statements</u>	7-9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	10-12
<u>Item 4. Controls and Procedures</u>	13
<u>Part II. Other Information</u>	
<u>Item 3. Default Upon Senior Securities</u>	14
<u>Item 6. Exhibits</u>	14
<u>Signatures</u>	15
Exhibits	16-19
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	

Table of Contents**Part I FINANCIAL INFORMATION**

Item 1. Financial Statements

SHOPSMITH, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	July 2, 2005 (Unaudited)	April 2, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,099	\$ 1,099
Accounts receivable:		
Trade, less allowance for doubtful accounts: \$585,887 on July 2, 2005 and \$608,060 on April 2, 2005	541,948	1,206,143
Inventories:		
Finished products	930,236	811,215
Raw materials and work in process	1,158,909	1,223,402
Total inventories	2,089,145	2,034,617
Prepaid expenses	297,754	112,754
Total current assets	2,929,946	3,354,613
Properties:		
Land, building and improvements	3,157,054	3,157,054
Machinery, equipment and tooling	6,894,871	6,885,915
Total cost	10,051,925	10,042,969
Less, accumulated depreciation and amortization	7,566,796	7,526,435
Net properties	2,485,129	2,516,534
Long-term portion of accounts receivable trade, less allowance for doubtful accounts: \$14,234 on July 2, 2005 and \$265,688 on April 2, 2005	59,409	1,068,050
Other assets	2,253	2,253
Total assets	\$ 5,476,737	\$ 6,941,450

Continued
Page 3

Table of ContentsSHOPSMITH, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	July 2, 2005 (Unaudited)	April 2, 2005
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,358,819	\$ 2,052,134
Revolving line of credit	250,592	577,727
Current portion of long-term debt	1,902,558	1,926,915
Customer advances	77,252	79,547
Accrued liabilities:		
Compensation, employee benefits and payroll taxes	213,798	318,075
Sales taxes payable	49,883	59,685
Accrued recourse liability	241,481	266,768
Accrued expenses	256,085	232,758
Other	54,118	73,349
Total current liabilities	4,404,586	5,586,958
Long-term debt, less current portion		
Total liabilities	4,404,586	5,586,958
Shareholders equity:		
Preferred shares- without par value; authorized 500,000; none issued		
Common shares- without par value; authorized 5,000,000; issued and outstanding 2,605,233	2,806,482	2,806,482
Deficit	(1,734,331)	(1,451,990)
Total shareholders equity	1,072,151	1,354,492
Total liabilities and shareholders equity	\$ 5,476,737	\$ 6,941,450

See notes to consolidated financial statements.

Page 4

Table of Contents

SHOPSMITH, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

	Three Months Ended	
	July 2, 2005 (Unaudited)	July 3, 2004 (Unaudited)
Net sales	\$ 2,603,012	\$ 2,787,436
Cost of products sold	1,267,582	1,395,440
Gross margin	1,335,430	1,391,996
Selling expenses	1,172,696	1,384,268
Administrative expenses	407,256	455,978
Total operating expenses	1,579,952	1,840,246
Loss before other income and expense	(244,522)	(448,250)
Interest income	153	44,538
Interest expense	(38,378)	(53,698)
Other income, net	406	895
Loss before income taxes	(282,341)	(456,515)
Income tax expense		
Net loss	(282,341)	(456,515)
Deficit:		
Beginning	(1,451,990)	(681,171)
Ending	\$(1,734,331)	\$(1,137,686)
Net loss per common share (Note 3)		
Basic	\$ (0.11)	\$ (0.18)
Diluted	\$ (0.11)	\$ (0.18)

See notes to consolidated financial statements.

Page 5

Table of Contents

SHOPSMITH, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	July 2, 2005 (Unaudited)	July 3, 2004 (Unaudited)
Cash flows from operating activities:		
Net loss	\$ (282,341)	\$(456,515)
Adjustments to reconcile net loss to cash (used in) operating activities		
Depreciation and amortization	40,361	38,433
Provision for doubtful accounts	26,102	47,887
Proceeds from sale of consumer revolving credit receivables	1,138,721	
Changes in operating assets and liabilities:		
Accounts receivable	508,013	344,757
Inventories	(54,528)	(16,818)
Prepaid expenses and other	(185,000)	(102,696)
Accounts payable and customer advances	(695,610)	49,461
Other current liabilities	(135,270)	(122,747)
Cash (used in) operating activities	360,448	(218,238)
Cash flows from investing activities:		
Property additions	(8,956)	(22,692)
Cash (used in) investing activities	(8,956)	(22,692)
Cash flows from financing activities:		
Net borrowings (repayments) on revolving line of credit	(327,135)	614,754
Payments on long-term debt	(24,357)	(373,824)
Cash provided from financing activities	(351,492)	240,930
Net decrease in cash		
Cash and cash equivalents:		
At beginning of period	1,099	800
At end of period	\$ 1,099	\$ 800

See notes to consolidated financial statements.

Page 6

Table of Contents

SHOPSMITH, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. In the opinion of management, all adjustments (consisting of only normal and recurring adjustments) have been made as of July 2, 2005 and July 3, 2004 to present the financial statements fairly. However, the results of operations for the three months then ended are not necessarily indicative of results for the full fiscal year. The financial statements and notes are presented as permitted by Form 10-Q, and do not contain certain information included in the annual financial statements. The financial statements accompanying this report should be read in conjunction with the financial statements and notes thereto included in the Annual Report to Shareholders for the year ended April 2, 2005.
2. There was no tax benefit during the three-month periods ended July 2, 2005 and July 3, 2004, as the tax benefits were offset by changes in a valuation allowance.
3. Basic loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted loss per share reflects per share amounts that would have resulted if dilutive stock options had been converted into common stock. The following reconciles amounts reported in the financial statements:

	Three Months Ended	
	July 2, 2005	July 3, 2004
Net loss	\$ (282,341)	\$ (456,515)
Weighted average shares	2,605,233	2,605,233
Additional dilutive shares		
Total dilutive shares	2,605,233	2,605,233
Basic loss per share	\$ (0.11)	\$ (0.18)
Diluted loss per share	\$ (0.11)	\$ (0.18)

There were no additional dilutive shares included in the computation for the three-month periods ended July 2, 2005 and July 3, 2004 because the effect of stock options were anti-dilutive.

4. On June 3, 2005, the Company executed a Loan Agreement (the "Revolving Credit Agreement") with National City Bank. Under the loan documents, the Company may borrow the lesser of (i) \$600,000 or (ii) the sum of 80% of accounts receivable due from Lowe's Companies. Interest on the Revolving Credit Agreement is charged at one and one-half percent over the bank's prime rate. The maturity date on the agreement is August 15, 2005. All loans under the Revolving Credit Agreement are at the discretion of National City Bank. At July 2, 2005, \$250,592 was outstanding under the Revolving Credit Agreement.

The Revolving Credit Agreement contains the following financial covenants:

- 2.1 Tangible Net Worth. The Company's Tangible Net Worth shall not at any time be less than the required amount of One Million One Hundred Thirty-five Thousand and 00/100 dollars (\$1,135,000.00), tested quarterly.

2.2 Net Income. The Company's Net Income shall not at any time be less than negative Two Hundred Thirty-five Thousand and 00/100 (-\$235,000.00), tested quarterly

As of July 2, 2005, the Company was not in compliance with the above two financial covenants, having a tangible net worth of \$1,072,151 and a year-to-date net loss of \$282,341. The Company has notified the lender of such noncompliance, but no waiver has been obtained. Failure to obtain a waiver could materially affect the Company's financial position, liquidity, and operations.

In connection with the Revolving Credit Agreement, Mr. John R. Folkerth, Chairman and Chief Executive Officer of the Company, delivered to Provident Bank (National City Bank is successor to Provident Bank) a Continuing Unconditional Guaranty pursuant to which Mr. Folkerth guaranteed repayment of \$200,000 of the indebtedness then or thereafter owing

Table of Contents

by the Company to the Bank. In consideration of that Guaranty, the Company has agreed to pay to Mr. Folkerth an annual fee of \$3,000 (being 1.5% of the guaranteed amount).

On June 29, 2004, the Company refinanced a mortgage note on its building with a mortgage note from Provident Bank in the amount of \$2,000,000 with interest at one-quarter percent over the bank's prime rate. The note requires monthly payments of interest and from \$8,000 to \$10,000 of the principal. In August 2009, the remaining balance on the note of approximately \$1,477,000 will become due. At July 2, 2005, there was \$1,902,558 outstanding under the building mortgage agreement.

Under the terms of the mortgage loan, default by the Company under the Revolving Credit Agreement can trigger default under the mortgage loan. In the event of default, Provident Bank may declare the mortgage loan immediately due and payable. The outstanding balance of the mortgage note has been classified as a current liability in the accompanying consolidated balance sheets due to the Company's noncompliance with the financial covenants of its Revolving Credit Agreement. The Company has requested a forbearance agreement from National City Bank (successor to Provident Bank) concerning the mortgage loan, but no such agreement is yet in place.

The mortgage loan and the revolving credit loans are collateralized by a mortgage on, or security interest in, substantially all assets of the Company.

The Company is dependent upon the Revolving Credit Agreement to fund operations during periods of negative cash flow. Termination of the Revolving Credit Agreement, without the establishment of a substitute credit facility, would create significant liquidity issues for the Company.

5. A major retailer (Lowe's) represented 35% and 44% of net sales for the quarters ended July 2, 2005 and July 3, 2004, respectively. This retailer also represented 44% and 31% of trade accounts receivable at July 2, 2005 and April 2, 2005, respectively.
6. The Company has adopted the disclosure only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, and, accordingly, accounts for its stock option plans using the intrinsic value method of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees.

The following table illustrates the effect on net loss and net loss per share if compensation expense was measured using the fair value recognition provisions of SFAS No. 123.

	Three Months Ended	
	July 2, 2005	July 3, 2004
Net loss as reported	\$(282,341)	\$(456,515)
Net loss pro forma	\$(282,341)	\$(456,515)
Diluted loss per share as reported	\$ (0.11)	\$ (0.18)
Diluted loss per share pro forma	\$ (0.11)	\$ (0.18)

7. Uncertainties. The accompanying consolidated financial statements have been prepared assuming that the Company will continue to operate as a going concern. As discussed below, the Company has incurred recurring losses and is in default of its debt obligations, which taken as a whole, raise substantial doubt about its ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments

that might result from the outcome of this uncertainty. At July 2, 2005, the Company had a deficiency of working capital of \$1,474,640, a net loss of \$282,341 for the quarter ended July 2, 2005, and was not in compliance with various debt covenants (see Note 4). The future of the Company as an operating entity will depend on management's plans and ability to (a) maintain or replace existing financing arrangements, (b) obtain financing to meet its cash requirements and (c) operate profitably in the future.

To improve profitability, the Company needs to reduce costs and increase per event sales. One effort to reduce costs in fiscal 2006 is a reduction in the number of Mark V sales demonstration events. Demonstration sales are focused on the most promising locations for the events. The Company is also continuing its prospect generation advertising efforts to increase the number of prospects invited to each sales event.

In April 2005, the Company has implemented a employee salary reduction plan. As part of this plan, fiscal 2006 pre-tax income above \$100,000 will be used to return the amount of the reduction. The effect of this plan on the first quarter was to reduce expenses by \$40,000.

Table of Contents

To improve liquidity, the Company completed a sale of substantially all of its consumer receivables to Citizens Finance Company in April 2005. During fiscal 2006, the Company also plans efforts to increase liquidity through better inventory management.

Table of Contents

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

GENERAL

Shopsmith manufactures and sells woodworking products. Our core product, the Mark V, is sold directly to consumers through demonstration sales events and indirectly to consumers through distributors (primarily Lowe's where Shopsmith also conducts sales demonstrations) along with smaller amounts through other efforts. Mark V sales demonstrations are performed at state fairs, at home shows, and in shopping malls. Other woodworking products and accessories are sold through mail and internet channels. Shopsmith recognizes revenue for these orders at the time of product shipment.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The financial condition and results of operations for Shopsmith presented in the Consolidated Financial Statements, accompanying notes, and management's discussion and analysis are dependent upon the Company's accounting policies. The selection and application of these accounting policies involve judgments, estimates, and uncertainties that are susceptible to change. The Company's significant accounting policies are discussed in Note 2 of the notes to the Consolidated Financial Statements included in the Company's annual report to shareholders for the year ended April 2, 2005. In management's opinion, the Company's critical accounting policies include the allowance for doubtful accounts, accrued recourse liability and deferred tax valuation allowance.

Allowance For Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. Customer accounts are stratified by type of account, original credit rating, and recent payment history. Estimated loss rates are then applied to these groups. Deterioration of our customers' ability to make payments could require additions to the allowance.

Accounts repurchased under the recourse provision, discussed below, are carried in trade accounts receivable, net of an allowance for doubtful accounts, while the Company attempts to collect them.

Accrued Recourse Liability

Certain retail installment contracts sold to financial institutions through the fiscal year ended March 31, 2001 included a recourse provision. Under this recourse provision, Shopsmith is obligated to purchase the installment contract if the customer defaults on their obligation to the financial institution. The Company's liability for future recourse obligations has been estimated using factors based on the value and rate of change of the value of the outstanding accounts, the rate and changes in the rate of repurchases required under the recourse provision, as well as estimates of amounts collectable after the accounts are repurchased. If these factors would deteriorate, additional accruals would be necessary and would affect future operating results. The Company adopted Statement of Position 03-03 in April 2005. Purchases of loans under a recourse provision are now recorded at fair value at repurchase date, instead of gross less an allowance for doubtful accounts.

Deferred Tax Valuation Allowance

The Company has recorded a valuation allowance against its net deferred tax assets based on its evaluation of the realizability of the future tax benefits of deferred tax assets. The effect of the allowance is to reduce to zero the carrying value of the potential tax benefit arising from the possibility of offsetting the Company's cumulative operating losses against future taxable income.

Table of Contents

Results of Operations

Fiscal 2006 first quarter sales decreased to \$2,603,000, or 6.6%, from \$2,787,000 during the same period a year ago. The primary reason for the decline was decreased sales through demonstrations within Lowe's stores.

Gross margin rates for the fiscal 2006 first quarter increased by 1.4 percentage points compared to the same period last year. Operating expenses decreased by \$260,294 to \$1,580,000 in the fiscal 2006 first quarter from \$1,840,000 in last year's first quarter. The most significant factors in the decrease in operating expenses were a decrease in the number of Mark V sales demonstration events and lower sales representative training costs.

Provisions for recoverable federal income taxes are based on estimated annual effective rates, less a valuation allowance. No tax benefit or expense is reported for the period ended July 2, 2005, as they were offset by changes in the valuation allowance.

The lower level of sales was more than offset by the reduction in selling expenses. This reduced the Company's net loss to \$282,000, or \$.11 per diluted share, in the quarter ended July 2, 2005, compared to a net loss of \$457,000, or \$.18 per diluted share, for the same period of last year.

Liquidity and Financial Position

Cash used in operations totaled \$778,000 for the three months ended July 2, 2005, compared with \$218,000 used in operations for the same period of the preceding year. During the period, cash was used to decrease accounts payable balances, as well as to fund the period's net loss.

To improve liquidity, the Company sold substantially all of its consumer revolving credit receivables to Citizens Finance Company in April 2005 for \$1,139,000. The Company plans to finance ongoing customer purchases through Citizens Finance Company.

As described in Note 4 to the Company's Consolidated Financial Statements, On June 3, 2005, the Company executed a Loan Agreement (the Revolving Credit Agreement) with National City Bank. Under the loan documents, the Company may borrow the lesser of (i) \$600,000 or (ii) the sum of 80% of accounts receivable due from Lowe's Companies. Interest on the Revolving Credit Agreement is charged at one and one-half percent over the Bank's prime rate. The maturity date on the agreement is August 15, 2005. All loans under the Revolving Credit Agreement are at the discretion of National City Bank. At July 2, 2005, \$250,592, was outstanding under the Revolving Credit Agreement. This amount also represents the maximum available under the Revolving Credit Agreement at July 2, 2005.

The Revolving Credit Agreement contains the following financial covenants:

2.1 Tangible Net Worth. The Company's Tangible Net Worth shall not at any time be less than the required amount of One Million One Hundred Thirty-five Thousand and 00/100 dollars (\$1,135,000.00), tested quarterly.

2.2 Net Income. The Company's Net Income shall not at any time be less than negative Two Hundred Thirty-five Thousand and 00/100 (-\$235,000.00), tested quarterly

As of July 2, 2005, the Company was not in compliance with the above two financial covenants, having a tangible net worth of \$1,072,151 and a year-to-date net loss of \$282,341. The Company has notified the lender of such noncompliance, but now waiver has been obtained. Failure to obtain a waiver could materially affect the Company's financial position, liquidity, and operations.

In connection with the Revolving Credit Agreement, Mr. John R. Folkerth, Chairman and Chief Executive Officer of the Company, delivered to Provident Bank (National City Bank is successor to Provident Bank) a Continuing Unconditional Guaranty pursuant to which Mr. Folkerth guaranteed repayment of \$200,000 of the indebtedness then or thereafter owing by the Company to the Bank. In consideration of that Guaranty, the Company has agreed to pay to Mr. Folkerth an annual fee of \$3,000 (being 1.5% of the guaranteed amount).

On June 29, 2004, the Company refinanced a mortgage on its office and manufacturing facility, with a mortgage loan from Provident Bank in the amount of \$2,000,000 (the New Mortgage Loan). Interest on the New Mortgage Loan is at one-quarter percent over the Bank's prime rate. The loan documents require monthly payment of interest and monthly payments of principal from \$8,000 to \$10,000. In August 2009, the remaining balance on the note of approximately \$1,477,000 will become due.

Table of Contents

Under the terms of the New Mortgage Loan, default under the Revolving Credit Agreement can trigger default under the New Mortgage Loan. In the event of default, the Bank may declare the New Mortgage Loan immediately due and payable. As of July 2, 2005, the Company was not in compliance with the financial covenants of the Revolving Credit Agreement. As a result of this covenant violation, the mortgage debt has been classified as a current liability as of July 2, 2005. The Company has requested a forbearance agreement from National City Bank (successor to Provident Bank) concerning the mortgage loan, but no such agreement is yet in place.

The New Mortgage Loan and the revolving credit loans are collateralized by a mortgage on, or security interest in, substantially all assets of the Company.

On August 11, 2005, the Company reached verbal agreement with Greystone Metro Factors regarding a factoring arrangement covering the Company's receivables from Lowe's. The funding from this agreement is planned to replace the funding from the Revolving Credit Agreement with National City Bank which expires August 15, 2005.

The Company has been dependent upon the Revolving Credit Agreement to fund operations during periods of negative cash flow. Termination of the Revolving Credit Agreement, without establishment of a substitute credit facility, would create significant liquidity issues for the Company.

The Company's current ratio was 0.67 to 1 at July 2, 2005 and 0.60 to 1 at April 2, 2005. The debt to equity ratio decreased to 4.11 to 1 at July 2, 2005 from 4.12 to 1 at April 2, 2005. Losses during the three months ended July 2, 2005 have contributed to a tightening of liquidity which in turn has caused the Company to defer payments to vendors beyond the Company's customary payment practice.

The Company believes that profitability is critical to ensuring adequate liquidity in both the current and future fiscal years.

Contractual Obligations

As noted in management's discussion of liquidity and financial position, the mortgage debt, shown here as long-term debt, has been classified as a current obligation on the consolidated balance sheets.

	Total	Scheduled payments due by period			More than 5 Years
		Less than 1 Year	1-3 Years	3-5 Years	
Contractual Obligations					
Revolving Line of Credit	\$ 250,592	\$250,592	\$	\$	\$
Long-Term Debt	1,902,558	101,652	216,708	1,584,198	
Operating Leases	223,378	73,385	120,770	29,223	
Total	\$2,376,528	\$425,629	\$337,478	\$1,613,421	\$

Forward Looking Statements

The foregoing discussion and the Company's consolidated financial statements contain certain forward-looking statements that involve risks and uncertainties, including but not limited to the following: (i) the operating cash flows together with currently available working capital may be inadequate to finance the operating needs of the Company; (ii) cancellation by Lowe's of the in-store sales program; (iii) the Company may fail to obtain a waiver for its failure to meet the financial covenants contained its Loan Agreement with National City Bank, in which event the Bank may declare all amounts owed by the Company to the Bank under the revolving credit and mortgage loan facilities to be immediately due and payable; (iv) the Company's future results may fail to meet the financial covenants contained in its Loan Agreement with National City Bank; (v) the Bank may decline to make further advances under the revolving credit facility; (vi) the Company may be unable to extend or refinance the revolving credit facility when the revolving credit loans mature on August 15, 2005; and (vii) actual losses related to doubtful accounts and recourse liabilities (discussed under Critical Accounting Policies and Estimates) may exceed current estimates.

Table of Contents

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

The Company's Chairman and Chief Executive Officer, John R. Folkerth, and the Company's Chief Financial Officer, Mark A. May, have evaluated the Company's disclosure controls and procedures as of the end of the period covered by this Report. Based on that evaluation, Messrs. Folkerth and May have concluded that the Company's disclosure controls and procedures are effective.

(b) Changes in Internal Controls Over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the first quarter of the Company's fiscal year that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 3. Default Upon Senior Securities

As discussed in the Liquidity and Financial Position section of Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in Item 2 of this report, at July 2, 2005, the Company was not in compliance with its financial covenants (relating to net worth and net income) contained in its Revolving Credit Agreement with National City Bank.

Item 6. Exhibits

- 31.1 Certification of the Chief Executive Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 31.2 Certification of the Chief Financial Officer pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHOPSMITH, INC.

By: /s/ Mark A. May

Mark A. May

Vice President of Finance (Principal
Financial
and Accounting Officer)

Date: August 15, 2005

Page 15