

AULT INC
Form 10-Q/A
October 20, 2005

FORM 10-Q/A

(Amendment No. 1 to Form 10-Q)

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

ŷ

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

For the quarterly period ended August 29, 2004

Commission file number 0-12611

AULT INCORPORATED

MINNESOTA

(State or other jurisdiction of
incorporation or organization)

41-0842932

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

7105 Northland Terrace

Minneapolis, Minnesota 55428-1028

(Address of principal executive offices)

Registrant's telephone number: **(763) 592-1900**

Indicate by check mark whether 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, and (2) has been subject to such filing requirements for the past 90 days.

Edgar Filing: AULT INC - Form 10-Q/A

YES

NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).

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 of Common Stock
No par value

**Outstanding at
October 10, 2005**
4,861,192 shares

AULT INCORPORATED

FORM 10-Q/A

FOR THE QUARTER ENDED AUGUST 29, 2004

Restatement

Edgar Filing: AULT INC - Form 10-Q/A

This Amendment No. 1 on Form 10-Q/A (Form 10-Q/A) to the Company's Quarterly Report on Form 10-Q for the three months ended August 29, 2004, initially filed with the Securities and Exchange Commission (the SEC) on October 1, 2004, (Original Filing) reflects a restatement of the consolidated financial statements of Ault Incorporated (the Company) for the quarter ended August 29, 2004, as discussed in Note 1 to the consolidated financial statements. The determination to restate these financial statements and other financial information was made as a result of management's identification, in connection with the preparation of the Company's financial statements for the year ended May 29, 2005, of accounting errors at the Company's China subsidiary related to inventory build-up and relief, and inadequate reconciliation of intercompany accounts. The adjustments totaled \$236,000 for the three-month period ending August 29, 2004, and increased the Company's net loss applicable to common shareholders to \$119,000 from a gain of \$117,000 as originally reported. Further information on the restatement adjustments can be found on Note 1 to the accompanying consolidated financial statements. The effects of the restatement on fiscal year 2004 can be found in Note 1 to the consolidated financial statements filed on the Company's May 30, 2004 annual report on Form 10-K/A, and Note 16 to the consolidated financial statements filed on the Company's May 29, 2005 annual report on Form 10-K.

This Form 10-Q/A amends and restates Items 1, 2 and 4 of Part I of the Original Filing. In addition, currently dated certifications from the Company's Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, are included with this filing.

PART 1. FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

AULT INCORPORATED & SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in Thousands, Except Share and Amounts Per Share)

| | (Unaudited) Three Months Ended | |
|--|-----------------------------------|--------------------------------|
| | Restated August 29, 2004 | Restated August 31, 2003 |
| Net Sales | \$ 10,336 | \$ 8,431 |
| Cost of Goods Sold | 7,575 | 6,565 |
| Gross Profit | 2,761 | 1,866 |
| Operating Expenses: | | |
| Marketing | 784 | 798 |
| Design Engineering | 721 | 745 |
| General & Administrative | 1,299 | 1,297 |
| Plant Closing Costs | 98 | 98 |
| | 2,804 | 2,938 |
| Operating Loss | (43) | (1,072) |
| Non Operating Income (Expense): | | |
| Interest Expense | (88) | (115) |
| Other | 13 | 19 |
| | (75) | (96) |
| Loss Before Income Taxes | (118) | (1,168) |
| Income Tax Expense | 1 | |
| Loss From Continuing Operations | (119) | (1,168) |
| Discontinued Operations | 36 | 61 |
| Net Loss | (83) | (1,107) |
| Redeemable Convertible Preferred Stock Dividends | (36) | (36) |
| Net Loss Applicable to Common Stockholders | \$ (119) | \$ (1,143) |
| Net Basic and Diluted Loss Per Common Share: | | |
| Continuing Operations | \$ (0.03) | \$ (0.26) |

Edgar Filing: AULT INC - Form 10-Q/A

| | | | | |
|---|----|-----------|----|-----------|
| Discontinued Operations | | 0.01 | | 0.01 |
| Loss Per Common Share | \$ | (0.02) | \$ | (0.25) |
| Common and equivalent shares outstanding: | | | | |
| Basic | | 4,787,937 | | 4,657,421 |
| Diluted | | 4,787,937 | | 4,657,421 |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AULT INCORPORATED & SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

| | (Unaudited) | |
|---|--------------------------------|-----------------|
| | Restated August 29, 2004 | May 30, 2004 |
| Assets: | | |
| Current Assets | | |
| Cash and Cash Equivalents | \$ 1,425 | \$ 837 |
| Trade Receivables, Less Allowance for Doubtful Accounts of \$381 at August 29, 2004; \$291 at May 30, 2004 | 6,143 | 5,903 |
| Inventories | 4,643 | 4,898 |
| Prepaid and Other Expenses | 1,229 | 946 |
| Assets related to discontinued operations | 7,310 | 6,401 |
| Total Current Assets | 20,750 | 18,985 |
| Property Equipment and Leasehold Improvements: | | |
| Land | 729 | 729 |
| Building and Leasehold Improvements | 4,059 | 4,059 |
| Machinery and Equipment | 5,594 | 5,586 |
| Office Furniture | 425 | 402 |
| Data Processing Equipment | 1,451 | 1,451 |
| | 12,258 | 12,227 |
| Less Accumulated Depreciation | 6,259 | 6,101 |
| Net Property Equipment and Leasehold Improvements | 5,999 | 6,126 |
| Other Assets | | |
| Non-Current Assets Related To Discontinued Operations | 136 | 146 |
| | 4,462 | 4,578 |
| Total Assets | \$ 31,347 | \$ 29,835 |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AULT INCORPORATED & SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

| | (Unaudited) | |
|--|--------------------------------|-----------------|
| | Restated August 29, 2004 | May 30, 2004 |
| Liabilities and Stockholders' Equity: | | |
| Current Liabilities | | |
| Note Payable to Bank | \$ 2,155 | \$ 1,965 |
| Current Maturities of Long-Term Debt | 442 | 460 |
| Accounts Payable | 5,019 | 3,915 |
| Accrued Compensation | 751 | 777 |
| Accrued Commissions | 279 | 281 |
| Other | 412 | 487 |
| Liabilities Related to Discontinued Operations | 5,766 | 5,423 |
| Total Current Liabilities | 14,824 | 13,308 |
| Long-Term Debt, Less Current Maturities | 2,276 | 2,313 |
| Non-Current Liabilities Related to Discontinued Operations | 249 | 203 |
| Redeemable Convertible Preferred Stock, No Par Value, 2,074 Shares Issued and Outstanding | 2,074 | 2,074 |
| Stockholders' Equity: | | |
| Preferred Stock, No Par Value, Authorized, 1,000,000 Shares; | | |
| Common Shares, No Par Value, Authorized 10,000,000 Shares; Issued and Outstanding 4,765,291 on August 29, 2004; and 4,705,083 on May 30, 2004; | 21,279 | 21,173 |
| Notes Receivable arising from the sale of common stock | (45) | (45) |
| Accumulated Other Comprehensive Loss | (870) | (870) |
| Accumulated Deficit | (8,440) | (8,321) |
| | 11,924 | 11,937 |
| | \$ 31,347 | \$ 29,835 |

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AULT INCORPORATED & SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars In Thousands)

| | (Unaudited) Three Months Ended | |
|---|-----------------------------------|--------------------------------|
| | Restated August 29, 2004 | Restated August 31, 2003 |
| Cash Flows From Operating Activities: | | |
| Net Loss | \$ (83) | \$ (1,107) |
| Adjustments to Reconcile Net Loss to Net Cash Provided by (Used in) Operating Activities: | | |
| Depreciation | 158 | 271 |
| Changes in Assets and Liabilities: | | |
| (Increase) Decrease In: | | |
| Trade Receivables | (239) | (582) |
| Inventories | 80 | 258 |
| Prepaid and Other Expenses | (273) | (186) |
| Increase (Decrease) in: | | |
| Accounts Payable | 1,104 | (86) |
| Accrued Expenses | (102) | 372 |
| Discontinued Operations | (61) | 370 |
| Net Cash Provided by (Used in) Operating Activities | 584 | (690) |
| Cash Flows From Investing Activities: | | |
| Purchase of Equipment and Leasehold Improvements | (31) | (68) |
| Discontinued Operations | | (22) |
| Net Cash Used in Investment Activities | (31) | (90) |
| Cash Flows From Financing Activities: | | |
| Net Borrowings on Revolving Credit Agreements | 190 | 1,012 |
| Proceeds from Issuance of Common Stock | 70 | |
| Principal Payments on Long-Term Borrowings | (55) | (73) |
| Discontinued Operations | (170) | (85) |
| Net Cash Provided by Financing Activities | 35 | 854 |
| Effect of Foreign Currency Exchange Rate Changes on Cash | | |
| Increase in Cash and Cash Equivalents | 588 | 74 |
| Cash and Cash Equivalents at Beginning of Period | 837 | 920 |
| Cash and Cash Equivalents at End of Period | \$ 1,425 | \$ 994 |
| Non-Cash Transaction: | | |
| Issuance of Common Stock to Pay Preferred Stock Dividends | \$ 36 | \$ 36 |

AULT INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FIRST QUARTER ENDED AUGUST 29, 2004

1. Summary of Consolidation Principles, Management Plans

The accompanying consolidated financial statements include the accounts of Ault Incorporated, its wholly owned subsidiaries, Ault Shanghai, Ault Xianghe Co. Ltd, and Ault Korea Corporation. All intercompany transactions have been eliminated. The foreign currency translation adjustment represents the translation into United States dollars of the Company's investment in the net assets of its foreign subsidiaries in accordance with the provisions of FASB Statement No. 52.

The balance sheet of the Company as of August 29, 2004, and the related statements of operations and cash flows for the three months ended August 29, 2004 and August 31, 2003 have been prepared without being audited. In the opinion of the management, these statements reflect all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the position of Ault Incorporated and subsidiaries as of August 29, 2004, and the results of operations and cash flows for all periods presented.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. Therefore, these statements should be read in conjunction with the financial statements and notes thereto included in the Company's May 30, 2004 Form 10-K/A.

The results of operations for the interim periods are not necessarily indicative of results that will be realized for the full fiscal year.

Management plans The financial statements have been prepared on a going-concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company sustained net losses applicable to common stock of \$5,545,646 in 2004 and \$7,692,073 in 2003 and at May 30, 2004 had an accumulated deficit of \$8,321,044. The Company utilized \$949,680 of cash for operating activities in 2004. In the first quarter of fiscal 2005, the Company has recorded net loss applicable to common stockholders of \$119,000. The Company has provided \$584,000 of cash for operating activities in the first quarter of fiscal year 2005. Future operations may require the Company to borrow additional funds. The Company has a financing agreement, which includes a \$7,000,000 line-of-credit agreement through December 4, 2006. There was an outstanding balance on this line-of-credit at August 29, 2004 of \$2,156,000. The Company believes they can remain in compliance with covenants in the financing agreement, as amended, throughout fiscal 2005.

Based on available funds, current plans and business conditions management believes that the Company's available cash, borrowings and amounts generated from operations, will be sufficient to meet the Company's cash requirements for the next 12 months and the foreseeable future. The assumptions underlying this belief include, among other things, that there will be no material adverse developments in the business or market in general. There can be no assurances however that those assumed events will occur. If management's plans are not achieved, there

may be further negative effects on the results of operations and cash flows, which could have a material adverse effect on the Company.

Restatement The consolidated financial statements as of and for the fiscal quarter ended August 29, 2004 were restated as a result of the Company's identification, in connection with the preparation of the Company's financial statements for the fiscal year ended May 29, 2005, of accounting errors at the Company's China subsidiary related to inventory build-up and relief and inadequate reconciliation of intercompany accounts. The accounting errors resulted in a misstatement in inventories, current assets, total assets, accumulated deficit, total shareholders' equity, cost of goods sold, gross profit, general and administrative expense, total operating expenses, operating loss, loss before taxes, net loss, net loss applicable to common stockholders, and net loss per share. There were also related adjustments to the Company's consolidated statement of cash flows and consolidated statement of stockholders' equity.

Effects on Consolidated Balance Sheet as of August 29, 2004

(Dollars in thousands)

| | As previously reported | (1) As restated |
|----------------------------|---------------------------|--------------------|
| Inventories | \$ 9,378 | \$ 8,435 |
| Total current assets | 21,579 | 20,750 |
| Total assets | 32,176 | 31,347 |
| Accumulated deficit | (7,611) | (8,440) |
| Total stockholders' equity | 12,753 | 11,924 |

Effects on Consolidated Statement of Operations for fiscal quarter-ended August 29, 2004

(Dollars in thousands, except per share amounts)

| | As previously reported | (1) As restated |
|---|---------------------------|--------------------|
| Sales | \$ 13,139 | \$ 13,253 |
| Cost of goods sold | 9,576 | 9,898 |
| Gross profit | 3,563 | 3,355 |
| General and administrative | 1,433 | 1,461 |
| Total operating expenses | 3,271 | 3,299 |
| Operating income (loss) | 292 | 56 |
| Income (loss) before income taxes | 161 | (75) |
| Net income (loss) | 153 | (83) |
| Net income (loss) applicable to common stockholders | 117 | (119) |
| Net earnings (loss) per share basic | 0.02 | (0.02) |
| Net earnings (loss) per share diluted | 0.02 | (0.02) |

(1) The restated amounts do not reflect the adjustment for discontinued operations as discussed below.

Discontinued operations - On May 20, 2005, the Company completed the sale of its wholly owned subsidiary, Ault Korea Corporation (Ault Korea), to JEC Korea Co., Ltd (JEC) for \$3.7 million. The agreement includes the receipt of \$1,472,000 in cash and a secured note in the amount of \$2,250,000. The transaction resulted in a loss of approximately \$2,442,000 and the reclassification of the Korean subsidiary activity as discontinued operations for all periods presented.

The sale includes all assets and liabilities of Ault Korea Corporation and the use of the Ault Korea name in Korea for a period of three years. Ault Korea includes the property in Seoul, South Korea and approximately 110 employees. As part of the terms of the agreement, JEC has the rights to sell power conversion products in Korea while Ault will have rights to sell the same power conversion products throughout the rest of the world. Prior to this transaction, JEC was a supplier of Ault, but otherwise no material relationship existed between Ault and JEC, or their respective affiliates, directors or officers, or any associates of their directors and officers.

Edgar Filing: AULT INC - Form 10-Q/A

The secured note receivable is scheduled to be paid in four equal installments of \$562,500 in December 2005, June 2006, December 2006 and the final installment in June 2007.

Edgar Filing: AULT INC - Form 10-Q/A

Revenues and results of operations for the Korean subsidiary for the three month period presented include the following:

(in thousands)

| | Quarter Ended August 29, 2004 | Quarter Ended August 31, 2003 |
|-------------------------------------|--|--|
| Net Sales | \$ 2,916 | \$ 2,386 |
| Income from Discontinued Operations | 36 | 61 |

The balance sheet information of discontinued operations includes the following:

| (in thousands) | August 29, 2004 |
|--|------------------------|
| Current Assets related to Discontinued Operations: | |
| Cash | \$ 395 |
| Accounts Receivable | 2,356 |
| Inventories | 3,792 |
| Prepaid and Other Expenses | 767 |
| Total Current Assets | \$ 7,310 |
| Non-Current Assets Related to Discontinued Operations: | |
| Property, Plant and Equipment, net | \$ 4,462 |
| Other Assets | |
| Total Non-Current Assets | \$ 4,462 |
| Current Liabilities Related to Discontinued Operations: | |
| Notes Payable to Bank | \$ 2,510 |
| Accounts Payable | 2,580 |
| Accrued Compensation | 676 |
| Total Current Liabilities | \$ 5,766 |
| Non-Current Liabilities Related to Discontinued Operations: | |
| Other Long-Term Liabilities | \$ 249 |

2. Stock Compensation

The Company's 1986 and 1996 stock option plan has reserved 600,000 and 1,500,000 common shares, respectively, for issuance under qualified and nonqualified stock options for its key employees and directors. Option prices are the market value of the stock at the time the option was granted. Options become exercisable as determined at the date of grant by a committee of the Board of Directors. Options expire ten years after the date of grant unless an earlier expiration date is set at the time of grant.

The Company has adopted the disclosure-only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*. Accordingly, no compensation cost has been recognized for the stock option plan, as all options were issued with exercised prices at or above fair value. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards in 2004 and 2003 consistent with the provisions of SFAS No. 123, the Company's net earnings (loss) and net earnings (loss) per share would have changed to the pro forma amounts indicated below:

Amounts in thousands, except per share amounts

| | Aug. 29 2004 | Period Ending | Aug. 31 2003 |
|---|-----------------|---------------|-----------------|
| Net Earnings (loss) applicable to stockholders: | | | |
| as reported | \$ | (119) | \$ (1,143) |
| pro forma | | (150) | (1,222) |
| per share, basic, as reported | | (0.02) | (0.25) |
| per share, diluted, as reported | | (0.02) | (0.25) |
| per share, basic, pro forma | | (0.03) | (0.26) |
| per share, diluted, pro forma | | (0.03) | (0.26) |

3. Inventories

The components of inventory (in thousands) at August 29, 2004 and May 30, 2004 are as follows:

| | August 29, 2004 | May 30, 2004 |
|-----------------|--------------------|-----------------|
| Raw Materials | \$ 2,522 | \$ 2,870 |
| Work-in-process | 97 | 116 |
| Finished Goods | 2,024 | 1,912 |
| | \$ 4,643 | \$ 4,898 |

4. Warranty

Edgar Filing: AULT INC - Form 10-Q/A

The Company offers its customers a three-year warranty on products. Warranty expense is determined by calculating the historical relationship between sales and warranty costs and applying the calculation to the current period's sales. Based on warranty repair costs and the rate of return, the Company periodically reviews and adjusts its warranty accrual. Actual repair costs are offset against the reserve. The following table shows the fiscal 2005 year-to-date activity for the Company's warranty accrual (in thousands):

| | | |
|----------------------------|----|-----|
| Beginning Balance | \$ | 125 |
| Charges and Costs Accrued | | 16 |
| Less Repair Costs Incurred | | (1) |
| Ending Balance | \$ | 140 |

5. Plant Closing

On July 17, 2003, the Company announced the consolidation of its manufacturing operations. The consolidation includes the closing of its Minneapolis production operations, eliminating approximately 40 jobs in assembly, equipment maintenance, procurement and administrative support and the integration of production into Ault's other manufacturing plants. Ault's engineering, documentation, safety certification/reliability, sales, marketing and administrative services will remain at the Minneapolis headquarters facility. The consolidation was complete in February 2004 with the last payment for related liabilities made in August 2004.

A summary of the restructuring activity during the three-month period ending August 29, 2004 is as follows:

| | Balance at May 30, 2004 | Current Period Plant Closing Charges | Cash Payments | Restructuring Liabilities at August 29, 2004 |
|----------------------------|----------------------------|--|------------------|--|
| Employee termination costs | \$ 15,000 | \$ 0 | \$ 15,000 | \$ 0 |

6. Debt

The Company has a financing agreement, which includes a \$7,000,000 revolving line-of-credit agreement through December 4, 2006. Interest on advances is at the prime rate plus 2% (prime plus 5% default rate) for fiscal year 2005. The rate at August 29, 2004 was 6.25% and on August 31, 2003 was 11.00%. All advances are due on demand and are secured by all assets of the Company. The Company's financing agreement contains financial covenants. These covenants require the Company, among other things, to maintain a minimum capital base, and also impose certain limitations on additional capital expenditures and the payment of dividends. At the end of fiscal 2004, the Company's actual net book worth and income before taxes did not meet the minimum of the credit agreement. The Company received a waiver and amendment for these covenants. Following the July 2004 waiver, the Company believes the provisions imposed by this credit agreement are achievable based on the Company's expected operating results for the next year. The availability of the line is based on the outstanding receivables of the Company; the amount available at August 29, 2004 was \$3,961,000. There were advances outstanding on the revolving line of credit of \$2,156,000 and \$1,965,000 at August 29, 2004 and May 30, 2004.

Long-term debt (in thousands) including current maturities contain the following:

| | August 29, 2004 | May 30, 2004 |
|---|--------------------|-----------------|
| 8.05% term loan, due in monthly installments of \$28,756, including interest to February 2015, collateralized by the Company's headquarters building in Minneapolis | \$ 2,427 | \$ 2,465 |
| 5.3% uncollateralized term loan, due in January 2005 | 290 | 290 |
| 7.94% term loan, due in monthly installments of \$6,144 including interest to September 2004, secured by furniture | 1 | 18 |
| Total | 2,718 | 2,773 |
| Less Current Maturities | 442 | 460 |
| | \$ 2,276 | \$ 2,313 |

7. Stockholders Equity

| | | Three Months Ended August 29, 2004 (\$000) |
|--|--------------|---|
| Total Stockholders Equity | May 30, 2004 | \$ 11,937 |
| Net (Loss) | | \$ (83) |
| Net change in Foreign currency translation adjustment | | |
| Comprehensive (Loss) | | \$ (83) |
| Preferred Stock Dividends Declared | | (36) |
| Preferred Stock Dividends Paid with Common Stock | | 36 |
| Issue 47,875 shares of common stock in accordance with stock purchase plan | | 70 |
| Total Stockholders Equity | | \$ 11,924 |

8. Net Earnings Per Common Share

Basic and diluted earnings per share are presented in accordance with SFAS No. 128, *Earnings per Share*. The Redeemable Convertible Preferred Stock had no effect on diluted weighted average shares outstanding, as they were anti-dilutive.

| | Three Months Ended | |
|--|---------------------------|------------------------|
| | August 29, 2004 | August 31, 2003 |
| Earnings (Loss) Applicable to Common Shareholders (in thousands) | \$ (119) | \$ (1,143) |
| Basic Weighted Average Shares Outstanding | 4,787,937 | 4,657,421 |
| Diluted Weighted Average Shares Outstanding | 4,787,937 | 4,657,421 |
| Basic Earnings (Loss) per Share | (0.02) | (0.25) |
| Diluted Earnings (Loss) per Share | (0.02) | (0.25) |

ITEM 2 - MANAGEMENT DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

This amended Quarterly Report on Form 10-Q/A for the fiscal quarter ended August 29, 2004, amends and restates financial statements and related financial information for the fiscal quarter ended August 29, 2004. The determination to restate these financial statements and other financial information was made as a result of the Company's identification, in connection with the preparation of the Company's financial statements for the fiscal year ended May 29, 2005, of accounting errors at the Company's China subsidiary related to inventory build-up and relief and inadequate reconciliation of intercompany accounts. Further information on the restatement can be found in Note 1 to the accompanying consolidated financial statements, Note 1 to the consolidated financial statements filed on the Company's May 30, 2004 annual report on Form 10-K/A, and Note 16 to the consolidated financial statements filed on the Company's May 29, 2005 annual report on Form 10-K.

BUSINESS OVERVIEW

Edgar Filing: AULT INC - Form 10-Q/A

Ault's power conversion products are used to adapt alternating current (AC) to provide a source of power at various levels up to more than one kilowatt of continuous power for a wide variety of electronic equipment. A significant amount of the Company's products are located outside the equipment they power as a wall plug-in or as in-line components. Both of these styles are generally referred to as external power conversion products. A smaller percentage of the Company's products are located inside the equipment they power and are generally known as internal power conversion devices. Each product configuration, external and internal, offers distinct advantages to the OEM buyer. Internal power products are more generally accepted among design engineers across all segments of the electronic original equipment market (EOEM). Internal power has traditionally been the norm in product design and, in terms of range, it provides greater latitude especially in applications beyond 100 watts. External power still ranks as a high growth area in the power supply industry due to the increasing emphasis on smaller and portable products that perform increasingly sophisticated functions. Ault's business strategy is to offer OEMs in these markets an expanding line of high-quality power conversion products, diverse design engineering expertise and customized customer services.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of the financial condition and results of operations are based on the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are defined as those involving significant judgments and uncertainties which could potentially result in materially different results under different assumptions and conditions. Application of these policies is particularly important to the portrayal of the financial condition and results of operations. The Company believes the accounting policies described below meet these characteristics. All significant accounting policies are more fully described in the notes to the consolidated financial statements included in the Company's annual report on Form 10-K/A.

Revenue Recognition The Company's policy is to recognize revenue for product sales when title transfers and risk of loss has passed to the customer, which is generally upon acceptance of the product by the overseas freight carrier. Judgments are required in evaluating the credit worthiness of our customers. Credit is not extended to customers and revenue is not recognized until the Company has determined that the risk of uncollectibility is minimal.

Inventory Valuation Inventory is written down for estimated surplus and discontinued inventory items. The amount of the write-down is determined by analyzing historical and projected sales information, plans for discontinued products and other factors. Changes in sales volumes due to unexpected economic or competitive conditions are among the factors that would result in materially different amounts for this item.

Allowance for Doubtful Accounts An allowance is established for estimated uncollectible accounts receivable. The required allowance is determined by reviewing customer accounts and making estimates of

amounts that may be uncollectible. Factors considered in determining the amount of the reserve include the age of the receivable, the financial condition of the customer, general business, economic and political conditions, and other relevant facts and circumstances. Unexpected changes in the aforementioned factors would result in materially different amounts for this item.

Product Warranties The Company's products are sold with warranty provisions that require it to remedy deficiencies in quality or performance over a specified period of time, 36 months, at no cost to the Company's customers. The Company's policy is to establish warranty reserves at levels that represent its estimate of the costs that will be incurred to fulfill those warranty requirements at the time that revenue is recognized. The Company believes that its recorded liabilities are adequate to cover its future cost of materials, and overhead for the servicing of its products sold through that date. If there is an actual product failure, or material or service delivery costs differ from the Company's estimates, its warranty liability would need to be revised accordingly.

Deferred Taxes The Company accounts for income taxes in accordance with SFAS NO. 109, Accounting for Income Taxes, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between book and tax basis of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is likely that some portion or the entire deferred tax asset will not be realized. Based upon prior taxable income and estimates of future taxable income, the Company has determined that it is likely that a portion of the net deferred tax asset will not be fully realized in the future. Thus a valuation allowance has been established. If actual taxable income varies from these estimates, the Company may be required to change the valuation allowance against the deferred tax assets resulting in a change in income tax expense (benefit), which will be recorded in the consolidated statement of operations.

MANAGEMENT PLANS

Edgar Filing: AULT INC - Form 10-Q/A

In July 2003, Ault announced the decision to consolidate manufacturing operations. Ault was one of the last power supply companies to maintain manufacturing in the United States. The decision to consolidate was driven by a goal to return to profitability by the end of the fourth quarter of fiscal 2004 as well as the desire to continue a high level of service to global OEM customers.

Last fiscal year was spent on the execution of the consolidation plan. The first phase of the consolidation went smoothly which included the closing of our US-based production in Minneapolis. This phase was completed in February 2004. The Company is benefiting in the following ways:

World Class Manufacturing Ault Xianghe (China) is developing into a world-class facility. China's annual volume output has more than tripled due to the transition of many product families from North America over the past year and the transfer of the Power General internal power supplies resulting from the acquisition in fiscal 2003. Ault has also worked diligently to build a strong infrastructure by enhancing global IT capabilities for purchasing, design engineering and manufacturing. Ault Xianghe has also achieved ISO certification and had several successful audit visits from top OEM (original equipment manufacturer) customers.

Reduced Lead Times Ault customers across all segments of the electronics industry appear to have one common need --- orders with JIT (just-in-time) delivery dates. This trend prompted the Company to look for ways in all product categories to reduce lead times on top-selling power supplies. The goal is to reduce lead times on standard part numbers in the switch-mode power supply category to an average of 5 weeks. Most competitors are still averaging 8 weeks. The Company believes meeting customers' needs for quick-turn orders will earn Ault more business from current accounts as well as providing a competitive edge in earning new business.

Improved Margins - Gross margin has increased several percent over the prior period. Current year margin increased because of the cost reductions resulting from the transition of US manufacturing as well as increased sales volume from North America and Korea.

Sales Review

Edgar Filing: AULT INC - Form 10-Q/A

Ault has traditionally been a major power supplier to the OEMs in the telecommunications market. This market hit bottom in calendar 2002, it is now recovering with several niches performing well. One of these

niches is the Power over Ethernet market. Dubbed PoE, Power over Ethernet is designed to supply power to any device on a local area network.

This technology has a broad range of applications including IP phones, security cameras, RFID tag readers, PDAs, access control systems and smart signs.

Ault has developed two single port, midspan power products to meet the needs of PoE users. The Company anticipates that as Power over Ethernet technology grows, the demand for our products will continue to rise over the next 12-18 months.

Ault has also transitioned the China sales team. There were two significant shifts in strategy: 1) Hire more seasoned salespeople that have contacts and experience in the local electronics market; and 2) focus efforts on Ault's traditional segments of the communications and medical equipment markets. Ault is pursuing and closing business for applications in the data communications/telecommunications market that include high-end set-top boxes, routers and video phones. The future plan includes expanding business with current OEM customers as well as targeting other leaders in the growing communications and medical equipment market segments throughout China. The intent is to leverage Ault's global reputation, long history of power supply design success and local presence to win additional business.

The financial statements have been prepared on a going-concern basis, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company sustained net losses applicable to common stock of \$5,545,646 in 2004 and \$7,692,073 in 2003 and at May 30, 2004 had an accumulated deficit of \$8,321,044. The Company utilized \$949,680 of cash for operating activities in 2004. In the first quarter of fiscal 2005, the Company has recorded net loss applicable to common stock of \$119,000. The Company has provided \$584,000 of cash for operating activities in the first quarter of fiscal year 2005. Future operations may require the Company to borrow additional funds. The Company has a financing agreement, which includes a \$7,000,000 line-of-credit agreement through December 4, 2006. There was an outstanding balance on this line-of-credit at August 29, 2004 of \$2,156,000. The Company believes they can remain in compliance with covenants in the financing agreement, as amended, throughout fiscal 2005.

Based on available funds, current plans and business conditions management believes that the Company's available cash, borrowings and amounts generated from operations, will be sufficient to meet the Company's cash requirements for the next 12 months and the foreseeable future. The assumptions underlying this belief include, among other things, that there will be no material adverse developments in the business or market in general. There can be no assurances however that those assumed events will occur. If management's plans are not achieved, there may be further negative effects on the results of operations and cash flows, which could have a material adverse effect on the Company.

RESULTS OF OPERATIONS

Recent Events During June 2005 the Company became aware of accounting errors in its China operations that resulted in an understatement of the loss applicable to common stockholders of \$593,000 for fiscal year 2004 and \$236,000 for the first quarter of fiscal year 2005 compared to results that were originally reported. The sale of the Company's Korean subsidiary in May 2005, required adjustments to the financial statements to present Korean operations as discontinued operations .

First Quarter Ended August 29, 2004

Edgar Filing: AULT INC - Form 10-Q/A

| (\$000) | | Fiscal 2005 | | Fiscal 2004 | | Favorable / (Unfavorable) | |
|----------------|----|----------------|----|----------------|----|---------------------------|---------|
| | | | | | | Amount | Percent |
| Net Sales | \$ | 10,336 | \$ | 8,431 | \$ | 1,905 | 23% |
| Operating Loss | | (43) | | (1,072) | | 1,029 | 96% |

Net sales were \$10,336,000 for the first quarter of fiscal 2005 up from \$8,431,000 for the first quarter of fiscal 2004. The increase is due to the continued activity in North America, with an increase in sales to existing customers and new customers.

The gross margin for fiscal 2005 was 26.7%, compared to 22.1% for fiscal 2004. Margins increased primarily due to the closure of manufacturing in the United States. Transferring the manufacturing to China, reduced production costs by \$318,000.

Operating expenses decreased in the first quarter of fiscal 2005 to \$2,804,000 from \$2,938,000 in the first quarter of fiscal 2004. The reduction of expenses in the first quarter of fiscal 2005 is primarily related to the cost of closing the United States manufacturing in fiscal 2004 of \$98,000. The increase in the allowance for doubtful accounts increased expenses by \$80,000 from fiscal 2004 but was offset by a reduction in freight expenses. It is anticipated that operating expenses will remain consistent throughout fiscal year 2005.

Order Backlog: The Company's order backlog at August 29, 2004 totaled \$8,176,000 compared to \$10,027,000 at May 30, 2004. The order backlog represents sales for approximately eleven weeks.

Non-Operating Income and Expense: Non-operating expense is \$75,000 for the first quarter of fiscal 2005 compared to \$96,000 for the same period in fiscal 2004. Non-operating expenses primarily consists of interest expense. The Company incurred interest expenses of \$88,000 in the first three months of fiscal 2005 and \$115,000 in the same period of fiscal 2004. Interest expense decreased due to the lower principal balance on the bank credit facilities and long-term borrowings.

Income Tax: The Company had a pre-tax loss of \$118,000 for the three-month period in fiscal 2005 on which it accrued \$1,000 income tax expense relating to amounts due for state and foreign taxes. For the three-month period in fiscal 2004 the Company had a pre-tax loss of \$1,168,000 on which it accrued no consolidated income tax benefit. The effective tax rate is 0.8% for the first quarter of 2005, and 0% for the same period in fiscal 2004. In the first quarter of fiscal 2004 the Company did not take a benefit from the loss carryforwards the loss generated, and continues in fiscal 2005 to have a full valuation allowance because it is likely the Company will be unable to use such losses.

Net Income (Loss): The Company reported a basic and diluted per share loss of \$0.02 for the first quarter of fiscal 2005 based on 4,788,000 outstanding weighted average shares, compared to basic and diluted per share loss of \$0.25 for the first quarter of fiscal 2004, based on 4,657,000 outstanding weighted average shares.

LIQUIDITY AND CAPITAL RESOURCES

Edgar Filing: AULT INC - Form 10-Q/A

The following table describes the Company's liquidity and financial position on August 29, 2004, and on May 30, 2004:

| | August 29, 2004 (\$000) | | May 30, 2004 (\$000) |
|-----------------------------------|--|----|-------------------------------------|
| Working capital | \$ 5,926 | \$ | 5,677 |
| Cash | 1,425 | | 837 |
| Unutilized bank credit facilities | 1,805 | | 1,489 |

Current Working Capital Position

Edgar Filing: AULT INC - Form 10-Q/A

As of August 29, 2004, the Company had current assets of \$20,750,000 and current liabilities of \$14,824,000 representing working capital of \$5,926,000 and a current ratio of 1.4. This represents an increase in working capital from \$5,677,000 at May 30, 2004. The Company relies on its credit facilities as sources of working capital to support normal growth in revenue, capital expenditures and attainment of profit goals. The Company has not committed any funds to capital expenditures as of August 29, 2004.

Cash and Investments: As of August 29, 2004, the Company had cash and securities totaling \$1,425,000, up from \$837,000 as of May 30, 2004. This increase in cash was due to normal fluctuations in the timing of payments and receipts.

Credit Facilities: The credit arrangement with Wells Fargo Bank is an asset-based credit facility of \$7 million, secured by company assets. At August 29, 2004, there were borrowings against this facility of \$2,156,000. The financing agreement contains financial covenants. These covenants require the Company, among other things, to maintain a minimum capital base, and also impose certain limitations on additional

capital expenditures and the payment of dividends. At the end of fiscal 2004, the Company's actual net book worth and income before taxes did not meet the minimum of the credit agreement. The Company received a waiver and amendment for this covenant. Following the July 2004 amendment, the Company believes the provisions imposed by this credit agreement are achievable based on the Company's expected operating results for the next year.

CASH FLOWS FOR FISCAL 2005

Operations: Operations provided \$584,000 of cash during the first three months of fiscal 2005 due principally to the following activities:

- (a) Net loss and depreciation provided cash of \$75,000.
- (b) Decreases in inventories provided \$80,000 of cash.
- (c) Increases in prepaid expenses used \$273,000 of cash, primarily related to an increase in refundable VAT due to an increase in revenue.
- (d) Increases in accounts payable and accrued expenses provided \$1,002,000, primarily related to the timing of payments.

Investing Activities: Investing activities used net cash of \$31,000 principally relating to the purchase of tooling in the Asia facilities.

Financing Activities: Financing activities provided cash of \$35,000, primarily comprised of proceeds from the issuance of common stock for the stock purchase plan.

Effect of Foreign Currency Exchange Rate Fluctuations: The effect of translating the Chinese financial statements, which were prepared in Yuan to US dollars, had minimal effect on cash for the first three months of fiscal 2005.

Summary: **The Company's cash and working capital positions are sound and, together with its credit facilities, adequate to support the Company's strategies for the remainder of fiscal 2005 and the foreseeable future.**

Information about Products and Services: The Company's business operations are comprised of one activity—the design, manufacture and sale of equipment for converting electric power to a level used by OEMs in data communications/telecommunications and medical markets to charge batteries, and/or power equipment. The Company supports these power requirements by making available to the OEM products that have various technical features. These products are managed as one product segment under the Company's internal organizational structure and the Company does not consider any financial distinctive measures, including net profitability and segmentation of assets to be meaningful to performance assessment.

Information About Revenue by Geography

Edgar Filing: AULT INC - Form 10-Q/A

Distribution of revenue from the US, from each foreign country that is the source of significant revenue and from all other foreign countries as a group are as follows:

| | THREE MONTHS ENDED | |
|---------------|---------------------------|------------------------|
| | August 29, 2004 | August 31, 2003 |
| | (\$000) | (\$000) |
| US | \$ 7,721 | \$ 5,970 |
| China | 1,290 | 1,191 |
| UK | 494 | 707 |
| Canada | 282 | 271 |
| Other Foreign | 549 | 292 |
| Total | \$ 10,336 | \$ 8,431 |

The Company considers a country to be the geographic source of revenue if it has contractual obligations, including an obligation to pay for trade receivable invoices.

Impact of Foreign Operations and Currency changes:

The Company will experience normal valuation changes as the Chinese currency fluctuate. The effect of translating the Chinese financial statements was not significant for the first three months of fiscal 2005.

Forward Looking Statements

From time to time, in reports filed with the Securities and Exchange Commission, in press releases, and in other communications to shareholders or the investing public, the Company may make forward-looking statements concerning possible or anticipated future results of operations or business developments that are typically preceded by the words "believes", "expects", "anticipates", "intends" or similar expressions. For such forward-looking statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Shareholders and the investing public should understand that such forward-looking statements are subject to risks and uncertainties which could cause results or developments to differ significantly from those indicated in the forward-looking statements. Such risks and uncertainties include, but are not limited to, the overall level of sales by original equipment manufacturers (OEMs) in the telecommunications, data communications, computer peripherals and the medical markets; buying patterns of the Company's existing and prospective customers; the impact of new products introduced by competitors; delays in new product introductions; higher than expected expense related to sales and new marketing initiatives; availability of adequate supplies of raw materials and components; dependence on outside contractors; reliance on third party distribution; successful integration of the Power General assets; dependence on foreign operations; and other risks affecting the Company's target markets generally.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company experiences foreign currency gains and losses, which are reflected in the financial statements, due to the strengthening and weakening of the U.S. dollar against currencies of the Company's foreign subsidiaries. The Company anticipates that it will continue to have exchange gains or losses in the future.

The Company is exposed to certain market risks on the line of credit agreement because of the variable interest rate charged. Market risk is the potential loss arising from the adverse changes in market rates and prices, such as interest rates. Market risk is estimated as the potential increase in fair value resulting from a hypothetical one percent increase in interest rates which assuming an average outstanding debt balance of \$5.0 million would result in an annual interest expense increase of approximately \$50,000.

ITEM 4 CONTROLS AND PROCEDURES

(a) **Evaluation of Disclosure Controls and Procedures**

Edgar Filing: AULT INC - Form 10-Q/A

Management, with the participation of the principal executive officer and principal financial officer, has evaluated the effectiveness of the design and operation of the disclosure controls and procedures (as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this quarterly report. Subject to the matters discussed below, management has concluded that the Company's disclosure controls and procedures are not effective to ensure that information required to be disclosed in the reports that the Company files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and that the disclosure controls are also not effective to ensure that information required to be disclosed in the Company's Exchange Act reports is accumulated and communicated to management, including the chief executive officer and chief financial officer to allow timely decisions regarding required disclosure.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of May 29, 2005, the Company did not maintain effective controls relating to transactions at its China subsidiary related to inventory build-up and relief and reconciliation of intercompany accounts.

In connection with its audit of the Company's consolidated financial statements for the year ended May 30, 2004, Grant Thornton LLP (Grant Thornton), the Company's independent accountants, advised the Audit Committee and management of internal control matters with respect to certain inventory transactions that they considered to be a material weakness as that term is defined under standards established by the Public Company Accounting Oversight Board (PCAOB). The Company considered these matters in connection with the year-end closing process and the preparation of the May 30, 2004 consolidated financial statements included in its Form 10-K. In response to the observations made by Grant Thornton, the Company will implement certain enhancements to its internal controls and procedures, which it believes address the matters raised by Grant Thornton.

China Subsidiary

The Company did not maintain effective controls over the preparation of and independent review of accounts at the China subsidiary. The Company has concluded that these control deficiencies constitute material weaknesses.

Remediation of Material Weaknesses Related to China Subsidiary

Management has taken, or is in the process of taking the following steps with respect to the control deficiencies at its China subsidiary:

The transfer of a seasoned accountant with experience in Asian operations who will be headquartered in Minneapolis, and will be the primary liaison with our China accounting staff and operations.

Commencement of a training program to upgrade the skill sets of our China accounting staff.

The hiring of an experienced China-based controller to coordinate all financial reporting, monthly physical inventory counts and verification and also be a part of the weekly conference calls with all of our operations to improve communications.

Management believes that implementation of these actions will remediate the material weaknesses described above.

Warehouse Control Deficiencies

In a cost-cutting effort in the third quarter of fiscal 2004, the Company closed down a manufacturing facility in Minneapolis and terminated a third party warehouse facility in Ireland. As part of the shutdown of the manufacturing in December 2003, certain personnel were terminated prior to the disposition of inventory at the location. The Company's haste in cost elimination resulted in having insufficient staffing to control the

Edgar Filing: AULT INC - Form 10-Q/A

disposition of the inventory. This was found to be a weakness of \$25,569 in the counting of inventory that was discovered during the course of the audit by the Company's external auditors. This should have been recorded in the third quarter.

In addition to the manufacturing shut-down, the Company also closed a third party warehouse facility to cut costs in January 2004. This too resulted in the terminations of personnel whose responsibilities included monitoring third party warehousing of customer stock inventory. Approximately \$57,581 of inventory was not adequately tracked. This error was also discovered in the course of the audit, and should have been recorded in the third quarter. Taken together the manufacturing and third party warehouse control deficiencies resulted in an adjustment of \$83,150, which should have been recorded in the third quarter. This \$83,150 adjustment was extrapolated over the Company's entire inventory, which resulted in a total adjustment of \$279,987. The Company believes that this adjustment is not material.

In connection with its audit of the Company's consolidated financial statements for the year ended May 30, 2004, Grant Thornton LLP (Grant Thornton), the Company's independent registered public accounting firm, advised the Company's audit committee and management that the adjustments described with respect to inventory constituted a material weakness as that term is defined under standards established by the Public Company Accounting Oversight Board (PCAOB).

In response to the observations made by Grant Thornton, the Company has implemented certain enhancements to its internal controls and procedures that the Company believes will address the matters raised by Grant Thornton.

Specifically, if the Company determines to enter into any future third party warehouse agreement, the Company will make sure that it has devoted adequate resources for necessary preventative and detective controls. The third party warehouse will have a weekly reconciliation between the inventory in the warehouse and the Company's inventory system. The head of sales and the head of finance will review this reconciliation. On a quarterly basis, the Company will physically count the inventory.

Similarly, before the Company closes another manufacturing location, the Company will make sure there are adequate resources in place for necessary preventative and detective controls. If the Company closes a manufacturing location, it will have the necessary resources to maintain a cycle count system until the disposition of the inventory is complete. Also there will be a physical inventory of the inventory before the end of each quarter until the disposition of the inventory is complete.

(b) Changes in Internal Control Over Financial Reporting

There have been no significant changes in internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonable likely to materially affect, the registrant's internal control over financial reporting.

PART II

ITEM 1 LEGAL PROCEEDINGS:

Not Applicable

ITEM 2 CHANGES IN SECURITIES AND USE OF PROCEEDS

(c) Recent Sales of Unregistered Securities

Not Applicable

ITEM 3 DEFAULTS UPON SENIOR SECURITIES:

Not Applicable

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not Applicable.

ITEM 5 OTHER INFORMATION

Not Applicable.

ITEM 6 EXHIBITS AND REPORTS ON FORM 8-K

(a) The following exhibits are included herein:

31.1 Certification of CEO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of CFO Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on form 8-K

A. Form 8-K filed July 28, 2004 announcing the fourth quarter fiscal 2004 financial results.

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.

AULT INCORPORATED

(REGISTRANT)

DATED: October 14, 2005

/s/ Frederick M. Green
Frederick M. Green, President
Chief Executive Officer and
Chairman

DATED: October 14, 2005

/s/ William J. Birmingham
William J. Birmingham
Interim Chief Financial Officer