

GENCOR INDUSTRIES INC  
Form 10-Q  
February 02, 2018  
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**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 DECEMBER 31, 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**  
**(State or other jurisdiction of**

**incorporated or organization)**

**5201 North Orange Blossom Trail, Orlando, Florida**  
**(Address of principal executive offices)**

**(407) 290-6000**

**59-0933147**  
**(I.R.S. Employer**

**Identification No.)**

**32810**  
**(Zip Code)**

**(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

Emerging growth 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.

<b>Class</b>	<b>Outstanding at February 1, 2018</b>
Common stock, \$.10 par value	12,181,837 shares
Class B stock, \$.10 par value	2,288,857 shares

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<b>Introductory Note: Caution Concerning Forward-Looking Statements</b>	

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 identify 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, 2017: (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 statement, except as required by law.

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



**Table of Contents****Part I. Financial Information****GENCOR INDUSTRIES, INC.****Condensed Consolidated Balance Sheets**

	<b>December 31, 2017 (Unaudited)</b>	<b>September 30, 2017</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 24,863,000	\$ 22,933,000
Marketable securities at fair value (cost \$87,605,000 at December 31, 2017 and \$86,967,000 at September 30, 2017)	88,340,000	87,886,000
Accounts receivable, less allowance for doubtful accounts of \$240,000 at December 31, 2017 and \$207,000 at September 30, 2017	1,317,000	1,184,000
Costs and estimated earnings in excess of billings	5,727,000	6,768,000
Inventories, net	16,925,000	16,687,000
Prepaid expenses & other current assets	1,250,000	1,660,000
<b>Total Current Assets</b>	<b>138,422,000</b>	<b>137,118,000</b>
Property and equipment, net of accumulated depreciation	7,376,000	5,722,000
Other assets	53,000	53,000
<b>Total Assets</b>	<b>\$ 145,851,000</b>	<b>\$ 142,893,000</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 3,315,000	\$ 1,320,000
Customer deposits	7,313,000	8,628,000
Accrued expenses	2,799,000	2,426,000
<b>Total Current Liabilities</b>	<b>13,427,000</b>	<b>12,374,000</b>
Deferred and other income taxes	875,000	1,601,000
<b>Total Liabilities</b>	<b>14,302,000</b>	<b>13,975,000</b>
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, par value \$.10 per share; authorized 300,000 shares; none issued		

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Common stock, par value \$.10 per share; 15,000,000 shares authorized; 12,181,837 shares and 12,154,829 shares issued and outstanding at December 31, 2017 and September 30, 2017, respectively	1,218,000	1,215,000
Class B Stock, par value \$.10 per share; 6,000,000 shares authorized; 2,288,857 and 2,263,857 shares issued and outstanding at December 31, 2017 and September 30, 2017, respectively	229,000	226,000
Capital in excess of par value	11,457,000	11,178,000
Retained earnings	118,645,000	116,299,000
Total Shareholders Equity	131,549,000	128,918,000
Total Liabilities and Shareholders Equity	\$ 145,851,000	\$ 142,893,000

*See accompanying Notes to Condensed Consolidated Financial Statements*

**Table of Contents****GENCOR INDUSTRIES, INC.****Condensed Consolidated Statements of Income***(Unaudited)*

	<b>For the Quarters Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
Net revenue	\$ 23,122,000	\$ 15,783,000
Costs and expenses:		
Production costs	18,039,000	11,633,000
Product engineering and development	700,000	416,000
Selling, general and administrative	2,692,000	2,190,000
	21,431,000	14,239,000
Operating income	1,691,000	1,544,000
Other income (expense), net:		
Interest and dividend income, net of fees	293,000	41,000
Realized and unrealized gains on marketable securities, net	161,000	407,000
Other	4,000	
	458,000	448,000
Income before income tax expense (benefit)	2,149,000	1,992,000
Income tax expense (benefit)	(197,000)	598,000
Net income	\$ 2,346,000	\$ 1,394,000
Basic Income per Common Share:		
Net income per share	\$ 0.16	\$ 0.10
Diluted Income per Common Share:		
Net income per share	\$ 0.16	\$ 0.10

*See accompanying Notes to Condensed Consolidated Financial Statements*

**Table of Contents****GENCOR INDUSTRIES, INC.****Condensed Consolidated Statements of Cash Flows***(Unaudited)*

	<b>For the Quarters Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>Cash flows from operating activities:</b>		
Net income	\$ 2,346,000	\$ 1,394,000
<b>Adjustments to reconcile net income to cash provided by operating activities:</b>		
Purchases of marketable securities	(53,513,000)	(177,343,000)
Proceeds from sale and maturity of marketable securities	53,177,000	177,196,000
Change in fair value of marketable securities	(118,000)	(301,000)
Deferred income taxes	(726,000)	46,000
Depreciation and amortization	300,000	310,000
Provision for doubtful accounts		50,000
Stock-based compensation	18,000	18,000
<b>Changes in assets and liabilities:</b>		
Accounts receivable	(133,000)	266,000
Costs and estimated earnings in excess of billings	1,041,000	(1,770,000)
Inventories	(238,000)	(903,000)
Prepaid expenses & other current assets	410,000	62,000
Accounts payable	1,995,000	448,000
Customer deposits	(1,315,000)	3,033,000
Accrued expenses	373,000	79,000
<b>Total adjustments</b>	<b>1,271,000</b>	<b>1,191,000</b>
<b>Cash flows provided by operating activities</b>	<b>3,617,000</b>	<b>2,585,000</b>
<b>Cash flows from investing activities:</b>		
Capital expenditures	(1,954,000)	(252,000)
<b>Cash flows used in investing activities</b>	<b>(1,954,000)</b>	<b>(252,000)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from stock option exercises	267,000	10,000
<b>Cash flows provided by financing activities</b>	<b>267,000</b>	<b>10,000</b>
<b>Net increase in cash and cash equivalents</b>	<b>1,930,000</b>	<b>2,343,000</b>
<b>Cash and cash equivalents at:</b>		

Beginning of period	22,933,000	18,219,000
End of period	\$ 24,863,000	\$ 20,562,000

*See accompanying Notes to Condensed Consolidated Financial Statements*

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**GENCOR INDUSTRIES, INC.**

**Notes to Condensed Consolidated Financial Statements**

**For the Quarter Ended December 31, 2017**

*(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. Operating results for the quarter ended December 31, 2017 are not necessarily indicative of the results that may be expected for the year ending September 30, 2018.

The accompanying Condensed Consolidated Balance Sheet at September 30, 2017 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, 2017.

**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. 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, corporate bonds, government securities, and cash and money funds are substantially based on quoted market prices (Level 1). Corporate bonds are valued using market standard valuation methodologies, including: discounted cash flow methodologies, and 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 are provided by the Company's professional investment management firm.

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The following table sets forth, by level, within the fair value hierarchy, the Company's assets measured at fair value as of December 31, 2017:

	Fair Value Measurements			Total
	Level 1	Level 2	Level 3	
Equities	\$ 10,777,000	\$	\$	\$ 10,777,000
Mutual Funds	8,730,000			8,730,000
Exchange-Traded Funds	4,508,000			4,508,000
Corporate Bonds		16,387,000		16,387,000
Government Securities	42,499,000			42,499,000
Cash and Money Funds	5,439,000			5,439,000
<b>Total</b>	<b>\$ 71,953,000</b>	<b>\$ 16,387,000</b>	<b>\$</b>	<b>\$ 88,340,000</b>

Net unrealized losses recognized during the quarter ended December 31, 2017 on trading securities still held as of December 31, 2017 were \$(184,000). There were no transfers of investments between Level 1 and Level 2 during the quarter ended December 31, 2017.

The following table sets forth by level, within the fair value hierarchy, the Company's assets measured at fair value as of September 30, 2017:

	Fair Value Measurements			Total
	Level 1	Level 2	Level 3	
Equities	\$ 11,338,000	\$	\$	\$ 11,338,000
Mutual Funds	7,155,000			7,155,000
Exchange-Traded Funds	3,417,000			3,417,000
Corporate Bonds		7,196,000		7,196,000
Government Securities	54,542,000			54,542,000
Cash and Money Funds	4,238,000			4,238,000
<b>Total</b>	<b>\$ 80,690,000</b>	<b>\$ 7,196,000</b>	<b>\$</b>	<b>\$ 87,886,000</b>

Net unrealized gains recognized during the quarter ended December 31, 2016 on trading securities still held as of December 31, 2016 were \$153,000. There were no transfers of investments between Level 1 and Level 2 during the quarter ended December 31, 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 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 carrying value of inventories three to four years old are reduced by 50%, while the carrying value of inventories four to five years old are reduced by 75%, and the carrying value of inventories greater than five years old are 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.

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Net inventories at December 31, 2017 and September 30, 2017 consist of the following:

	<b>December 31, 2017</b>	<b>September 30, 2017</b>
Raw materials	\$ 11,001,000	\$ 9,407,000
Work in process	1,234,000	3,098,000
Finished goods	4,674,000	4,166,000
Used equipment	16,000	16,000
	<b>\$ 16,925,000</b>	<b>\$ 16,687,000</b>

**Note 4 Costs and Estimated Earnings in Excess of Billings**

Costs and estimated earnings in excess of billings on uncompleted contracts as of December 31, 2017 and September 30, 2017 consist of the following:

	<b>December 31, 2017</b>	<b>September 30, 2017</b>
Costs incurred on uncompleted contracts	\$ 14,252,000	\$ 10,250,000
Estimated earnings	4,221,000	3,161,000
	<b>18,473,000</b>	<b>13,411,000</b>
Billings to date	12,746,000	6,643,000
Costs and estimated earnings in excess of billings	<b>\$ 5,727,000</b>	<b>\$ 6,768,000</b>

**Note 5 Earnings per Share Data**

The following table sets forth the computation of basic and diluted earnings per share for the quarters ended December 31, 2017 and 2016:

	<b>December 31, 2017</b>	<b>December 31, 2016</b>
Net income	\$ 2,346,000	\$ 1,394,000
Common Shares:		
Weighted-average common shares outstanding	14,458,000	14,380,000
Effect of dilutive stock options	265,000	209,000
Weighted-average diluted shares outstanding	<b>14,723,000</b>	<b>14,589,000</b>

## Basic:

Net income per share	\$	0.16	\$	0.10
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## Diluted:

Net income per share	\$	0.16	\$	0.10
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Basic earnings per share is based on the weighted-average number of shares outstanding. Diluted earnings per share is 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 ended December 31, 2017 were 401,000, which equates to 265,000 dilutive common stock equivalents. Weighted-average shares issuable upon the exercise of stock options included in the diluted earnings per share calculation for the quarter ended December 31, 2016 were 482,000, which equated to 209,000 dilutive common stock equivalents. Weighted-average shares issuable upon the exercise of stock options, which were not included in the diluted earnings per share calculations because they were anti-dilutive, were zero for the quarters ended December 31, 2017 and 2016.

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

Approximately 5.7% of net revenues in the quarter ended December 31, 2017 and 10.0% of net revenues for the quarter ended December 31, 2016 were from entities owned by a global company.

Four other customers accounted for 19.3%, 13.9%, 12.6% and 12.0% of net revenues, respectively, for the quarter ended December 31, 2017. Net revenues for each of these four customers were less than 1% during the prior year comparative periods.

**Note 7 Income Taxes**

On December 22, 2017, the U.S. Tax Cuts and Jobs Act (the Tax Reform Act ) was signed into law by President Donald Trump. The Tax Reform Act significantly lowered the U.S. corporate income tax rate from 35% to 21% effective January 1, 2018, while also repealing the deduction for domestic production activities, implementing a territorial tax system and imposing repatriation tax on deemed repatriated earnings of foreign subsidiaries. U.S. GAAP requires that the impact of tax legislation be recognized in the period in which the law was enacted. As a result of the Tax Reform Act, the Company recorded a tax benefit of \$0.7 million due to re-measurement of its deferred tax liability, in the three months ended December 31, 2017. The tax benefit represents the Company's current best estimates. The amounts incorporate assumptions made based upon the Company's current interpretation of the Tax Reform Act and may change as the Company receives additional clarification and implementation guidance.

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**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, synthetic fuels, 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.

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 2015 projected funding, with annual increases between 2.0% and 2.5% from 2016 through 2020.

California's Senate Bill 1 (SB1), the Road Repair and Accountability Act of 2017, was signed into law on April 28, 2017. The legislative package invests \$54 billion over the next decade to fix roads, freeways and bridges in communities across California and puts more dollars towards transit and safety. These funds will be allocated to state and local projects.

The Canadian government has also enacted major infrastructure stimulus programs. In 2007, the Building Canada Plan provided \$33 billion in infrastructure funding through 2014. The 2014 New Building Canada Fund is one component within the \$53 billion 2014 New Building Canada Plan. The 2014 New Building Canada Fund provided funding for infrastructure projects at the national, provincial and local levels.

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.

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### Results of Operations

#### *Quarter Ended December 31, 2017 versus December 31, 2016*

Net revenues for the quarters ended December 31, 2017 and December 31, 2016 were \$23,122,000 and \$15,783,000, respectively, an increase of \$7,339,000 or 46.5%. The FAST Act, along with plans to increase domestic infrastructure spending at the federal level, has resulted in an increase in asphalt plant and component orders. Domestic highway contractors continue to have a positive outlook supported by favorable market conditions.

As a percent of sales, gross profit margins were 22.0% in the quarter ended December 31, 2017, compared to 26.3% in the quarter ended December 31, 2016. Gross profit margins declined as the Company increased its manufacturing overhead to support the significantly higher production, as annual revenues have doubled over the past two years.

Product engineering and development expenses increased \$284,000 for the quarter ended December 31, 2017 as compared to the quarter ended December 31, 2016, due to increased staffing to meet the higher demands for our engineered products. Selling, general and administrative ( SG&A ) expenses increased \$502,000 to \$2,692,000 for the quarter ended December 31, 2017, compared to the quarter ended December 31, 2016. Headcount additions, higher sales commissions, and increased advertising and trade show expenses to capitalize on the renewed optimism within the highway construction industry contributed to most of the increase in SG&A expenses.

As a result of the improved revenues, the Company had higher operating income of \$1,691,000 for the quarter ended December 31, 2017 versus operating income of \$1,544,000 for the quarter ended December 31, 2016.

For the quarter ended December 31, 2017, interest and dividend income, net of fees, from the investment portfolio was \$293,000 as compared to \$41,000 in the quarter ended December 31, 2016. The increase was due to additional interest income from investments in corporate bonds. The net realized and unrealized gains on marketable securities were \$161,000 for the quarter ended December 31, 2017 versus \$407,000 for the quarter ended December 31, 2016.

The effective income tax rate for the quarter ended December 31, 2017 was a benefit of (9.2%) compared to expense of 30.0% for the quarter ended December 31, 2016. The 2017 benefit resulted from a \$0.7 million adjustment to the net deferred tax liability as a result of applying the lower corporate tax rates to comply with the recently enacted Tax Reform.

Net income for the quarter ended December 31, 2017 was \$2,346,000 or \$0.16 basic and diluted earnings per share versus net income of \$1,394,000 or \$0.10 basic and diluted earnings per share for the quarter ended December 31, 2016.

### Liquidity and Capital Resources

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

The Company had no long-term debt outstanding at December 31, 2017 or September 30, 2017. The Company does not currently require a credit facility. As of December 31, 2017, the Company had funded \$135,000 in cash deposits at insurance companies to cover collateral needs.

As of December 31, 2017, the Company had \$24,863,000 in cash and cash equivalents, and \$88,340,000 in marketable securities, including \$42,499,000 in government securities, \$16,387,000 in corporate bonds, \$10,777,000 in equities, \$8,730,000 in mutual funds, \$4,508,000 in exchange-traded funds and \$5,439,000 in cash and money

funds. The marketable securities are invested through a global professional investment management firm. These securities may be liquidated at any time into cash and cash equivalents.

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The Company's backlog was \$50.2 million at December 31, 2017, compared to \$40.8 million at December 31, 2016. The Company's working capital (defined as current assets less current liabilities) was equal to \$125.0 million at December 31, 2017 and \$124.7 million at September 30, 2017. 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. Cash provided by operations during the quarter ended December 31, 2017 was \$3,617,000. Costs and estimated earnings in excess of billings decreased \$1,041,000 and customer deposits decreased \$1,315,000, reflecting the percentage of completion and timing of recognition of revenues on jobs-in-progress at December 31, 2017. Accounts payable increased from increased raw material purchases for production to meet the growth in customer orders.

Cash used in investing activities for the quarter ended December 31, 2017 of \$1,954,000 related to capital expenditures, primarily new manufacturing machinery for handling and processing raw materials. Cash provided by financing activities of \$267,000 for the quarter ended December 31, 2017 related to proceeds from the exercise of stock options.

## Seasonality

The Company is concentrated in the manufacturing of asphalt plants and related components, which is typically subject to a seasonal slow-down during the third and fourth quarters of the calendar year.

## 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, 2017: (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, 2017, 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.

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**Table of Contents***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 December 31, 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/ownership is transferred or service is performed, persuasive evidence of an arrangement exists, the selling price is fixed or determinable, and collectability is reasonably assured.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers: (Topic 606)* ( ASU 2014-09 ), amending its accounting guidance related to revenue recognition. Under this ASU and subsequently issued amendments, revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard is effective for annual periods beginning after December 15, 2017. The Company plans to adopt the new standard in fiscal 2019. The Company does not expect the adoption of this standard to have a material impact on its results of operations and is currently evaluating which one of the two retrospective methods will be used for implementation.

Provisions for estimated returns and allowances and other adjustments are provided for in the same period the related sales are recorded. Returns and allowances, which reduce product revenue, are estimated using historical experience.

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 selling, general and administrative 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 are reduced by 50%, while the cost basis of inventories four to five years old are reduced by 75%, and the cost basis of inventories greater than five years old are 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.

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*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 and represent the change in the fair value of investment holdings during the period.

*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

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**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

The Company operates manufacturing facilities and sales offices at two locations 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. Periodically, 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 December 31, 2017 and September 30, 2017, the Company had no debt outstanding and there was no credit facility in place. The Company does not currently require a credit facility but continues to evaluate its needs and options for such a facility.

The Company's marketable securities are invested in cash and money funds, equities, mutual funds, exchange-traded funds, corporate bonds, and government securities through a professional investment advisor. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of 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.

**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 has 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 ended December 31, 2017 that 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 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, 2017, as filed with the SEC on December 6, 2017.

**Item 6. Exhibits**

## (a) Exhibits

31.1	<u>Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended</u>
31.2	<u>Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended</u>
32	<u>Certifications of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U. S. C. Section 1350.</u>
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

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**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

February 2, 2018

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

February 2, 2018