TUCOWS INC /PA/
Form 10-Q
May 11, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006

OR

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

For the transition period from to

Commission file number 0-28284

TUCOWS INC.

(Exact Name of Registrant as Specified in Its Charter)

Pennsylvania	**23-2707366**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

96 Mowat Avenue,
Toronto, Ontario M6K 3M1, Canada

(Address of Principal Executive Offices) (Zip Code)

(416) 535-0123

(Registrant s Telephone Number, Including Area Code)

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

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

Large Accelerated Filer o Accelerated Filer o Non-Accelerated Filer ý

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

As of May 8, 2006, there were 72,048,130 outstanding shares of common stock, no par value, of the registrant.

TUCOWS INC.

Form 10-Q Quarterly Report

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PART I.
FINANCIAL INFORMATION

Item 1. Financial Statements

Tucows Inc.

Consolidated Balance Sheets

(Dollar amounts in U.S. dollars)

	March 31, 2006 (unaudited)	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 11,120,593	$ 17,348,088
Short-term investments	72,000	1,771,569
Restricted cash	612,500	60,000
Interest receivable	1,980	39,574
Accounts receivable, net of allowance for doubtful accounts of $61,250 as of March, 2006 and $51,250 as of December 31, 2005	3,266,971	1,439,329
Prepaid expenses and deposits	2,489,602	1,999,820
Prepaid fees for domain name registry and other Internet services fees, current portion	19,791,804	18,175,988
Deferred tax asset, current portion	1,000,000	1,000,000
Total current assets	38,355,450	41,834,368
Prepaid fees for domain name registry and other Internet services fees, long-term portion	8,399,171	7,701,939
Deferred acquisition costs		46,034
Property and equipment	3,906,981	1,542,671
Deferred tax asset, long-term portion	2,000,000	2,000,000
Intangible assets	2,099,247	1,006,080
Goodwill	5,008,428	1,951,067
Investment	353,737	353,737
Cash held in escrow	2,347,217	621,412
Total assets	$ 62,470,231	$ 57,057,308
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 2,147,862	$ 1,655,195
Accrued liabilities	2,905,178	1,417,035
Customer deposits	2,424,471	2,276,637
Deferred revenue, current portion	29,082,673	26,790,166
Accreditation fees payable, current portion	758,597	651,811
Total current liabilities	37,318,781	32,790,844
Deferred revenue, long-term portion	11,995,519	11,079,537
Accreditation fees payable, long-term portion	119,263	94,785

Stockholders equity				
Preferred stock - no par value, 1,250,000 shares authorized; none issued and outstanding				
Common stock - no par value, 250,000,000 shares authorized; 72,014,173 shares issued and outstanding as of March 31, 2006 and 71,945,303 shares issued and outstanding as of December 31, 2005		12,434,712		12,403,422
Additional paid-in capital		50,132,066		50,061,866
Deficit		(49,530,110)		(49,373,146)
Total stockholders equity		13,036,668		13,092,142
Total liabilities and stockholders equity	$	62,470,231	$	57,057,308

See accompanying notes to unaudited consolidated financial statements

Tucows Inc.

Consolidated Statements of Operations

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended March 31, 2006		2005	
	(unaudited)			
Net revenues	$	15,287,120	$	11,801,706
Cost of revenues (*) (including depreciation of $524,919 and amortization of $38,540 for the three months ended March 31, 2006 and depreciation of $81,937 and amortization of $19,290 for the three months ended March 31, 2005)		10,491,313		7,322,432
Gross profit		4,795,807		4,479,274
Operating expenses:				
Sales and marketing (*)		1,459,156		1,352,454
Technical operations and development (*)		2,320,716		1,322,785
General and administrative (*)		1,619,053		1,390,762
Depreciation of property and equipment		37,050		159,936
Amortization of intangible assets		93,293		39,750
Total operating expenses		5,529,268		4,265,687
Income from operations		(733,461)		213,587
Other income:				
Interest income, net		102,891		77,248
Other income		473,606		
Total other income		576,497		77,248
(Loss) income before provision for income taxes		(156,964)		290,835
Provision for (recovery of) income taxes				(151,975)
Net (loss) income for the period	$	(156,964)	$	442,810
Basic (loss) earnings per common share	$		$	0.01
Shares used in computing basic (loss) earnings per common share		71,980,393		66,883,487
Diluted (loss) earnings per common share	$		$	0.01
Shares used in computing diluted (loss) earnings per common share		71,980,393		71,604,368

(*) Stock-based compensation has been included in operating expenses as follows:

Cost of revenues	$	2,400	$
Sales and marketing	$	17,400	$
Technical operations and development	$	23,700	$
General and administrative	$	26,700	$

See accompanying notes to unaudited consolidated financial statements

Tucows Inc.

Consolidated Statements of Cash Flows

(Dollar amounts in U.S. dollars)

(unaudited)

	Three months ended March 31, 2006	2005
Cash provided by (used in):		
Operating activities:		
Net (loss) income for the year	$ (156,964)	$ 442,810
Items not involving cash:		
Depreciation of property and equipment	561,969	241,873
Amortization of intangible assets	131,833	59,040
Unrealized change in the fair value of forward exchange contracts	182,944	107,628
Stock-based compensation	70,200	
Change in non-cash operating working capital:		
Interest receivable	37,594	256
Accounts receivable	(1,827,642)	(151,853)
Prepaid expenses and deposits	3,413	327,336
Prepaid fees for domain name registry and other Internet services fees	(2,313,048)	(2,002,215)
Accounts payable	492,667	42,962
Accrued liabilities	1,327,080	(1,010,791)
Customer deposits	147,834	(78,127)
Deferred revenue	3,044,520	2,505,489
Accreditation fees payable	131,264	170,857
Cash provided by operating activities	1,833,664	655,265
Financing activities:		
Proceeds received on exercise of stock options	28,009	181,023
Cash provided by financing activities	28,009	181,023
Investing activities:		
Additions to property and equipment	(886,279)	(200,908)
Decrease in investment in short-term investments	1,699,569	
(Increase) decrease in restricted cash - being margin security against forward exchange contracts	(552,500)	460,398
Acquisition of Hosted Messaging Assets, net of cash acquired	(6,583,454)	
(Increase) decrease in cash held in escrow	(1,766,504)	(3,716)
Cash (used in) provided by investing activities	(8,089,168)	255,774
(Decrease) increase in cash and cash equivalents	(6,227,495)	1,092,062
Cash and cash equivalents, beginning of period	17,348,088	13,914,988
Cash and cash equivalents, end of period	$ 11,120,593	$ 15,007,050
Supplemental cash flow information:		
Interest paid	$	$ 300

See accompanying notes to unaudited consolidated financial statements

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS AND BASIS OF PRESENTATION:

Tucows Inc., a Pennsylvania corporation (referred to throughout this report as the Company , Tucows , we , us or through similar expressions), provides Internet services and downloadable software through a global network of service providers, including web hosting companies and other providers of services over the Internet. Tucow s services include domain registration services, digital certificates, billing, provisioning and customer care software solutions, email and anti-spam services, blogware and website building tools.

The accompanying unaudited interim consolidated balance sheet, and the related statements of operations and cash flows reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position of Tucows and its subsidiaries as at March 31, 2006 and the results of operations and cash flows for the interim periods ended March 31, 2006 and 2005.

The accompanying interim consolidated financial statements have been prepared by Tucows without audit, in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC) and do not include all information and notes normally provided in annual financial statements. Except as outlined in note 2, these interim financial statements follow the same accounting policies and methods of application used in the annual financial statements and should be read in conjunction with the audited financial statements and notes thereto of Tucows for the year ended December 31, 2005 included in Tucows 2005 Annual Report on Form 10-K filed with the SEC on March 17, 2006.

Tucows considers investments in highly liquid instruments purchased with an original maturity of 90 days or less to be cash equivalents. Tucows maintains its cash balances in highly rated financial institutions. At times, such cash balances exceed the Federal Deposit Insurance Corporation limit.

Tucows short-term investments are invested in United States Treasury Bonds, Certificates of Deposit and Commercial Papers. These short-term investments are reported at amortized cost, while any accrued interest on these investments is included in Other Income within Tucows Consolidated Statements of Operations, and in Accounts Receivable, on Tucows Consolidated Balance Sheets.

Certain comparatives have been reclassified to conform with the current year s presentation.

2. NEW ACCOUNTING POLICIES:

The following new accounting policy was adopted by Tucows in the three months ended March 31, 2006:

Share-based payment.

On January 1, 2006, Tucows adopted the fair value-based method for measurement and cost recognition of employee share-based compensation arrangements under the provisions of Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment (SFAS 123R), using the modified prospective application transitional approach. Previously, Tucows had elected to account for employee share-based compensation using the intrinsic value method based upon Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and related interpretations. The intrinsic value method generally did not result in any compensation cost being recorded for employee stock options since the exercise price was equal to the market price of the underlying shares on the date of grant.

Under the modified prospective transitional approach, share-based compensation is recognized for awards granted, modified, repurchased or cancelled subsequent to the date of adoption of SFAS 123R. In addition, share-based compensation is recognized, subsequent to the date of adoption of SFAS 123R, for the remaining portion of unvested outstanding awards granted prior to the date of adoption. Prior periods have not been adjusted and Tucows continues to provide pro forma disclosure as if it had accounted for employee share-based payments in all periods prior to the adoption of SFAS 123R in accordance with the fair value provisions of SFAS No. 123, Accounting for Stock-based Compensation , which is presented below.

Tucows measures share-based compensation costs on the grant date, based on the calculated fair value of the award. Tucows has elected to treat awards with graded vesting as a single award when estimating fair value. Compensation cost is recognized on a straight-line basis over the employee requisite service period, which in Tucows circumstances is the stated vesting period of the award, provided that total compensation cost recognized at least equals the pro rata value of the award that has vested. Compensation cost is initially based on the estimated number of options for which the requisite service is expected to be rendered. This estimate is adjusted to the vesting date once actual forfeitures are known.

Had Tucows adopted the fair value-based method for accounting for share-based compensation in all prior periods presented, the pro-forma impact on net income and net income per share would be as follows:

		Three months ended March 31, 2005 (unaudited)
Net income, as reported	$	442,810
Add stock-based employee compensation expense included in reported net income, net of tax		

Canadian modular housing shipments remaining unchanged

As previously noted, total domestic manufactured housing unit shipments increased approximately 17 percent. Industry unit shipments for these products increased approximately 10 percent from November 2013 to January 2014, the latest three months available, as compared to the same period the year prior. The improvement is the result of increased sales to manufactured housing communities.

Total modular housing unit shipments decreased approximately 5 percent. Current industry unit shipment data is not available. Management believes that the decrease in modular housing sales is the result of softness in demand from modular dealers and developers.

Compared to prior year, the average net sales price for domestic manufactured housing, domestic modular housing, and Canadian modular housing products increased approximately 11, 7 and 23 percent, respectively. The increase is the result of homes sold with larger square footage and greater amenities.

Recreational vehicle net sales decreased approximately 25 percent. The decrease was the outcome of the following factors:

Domestic recreational vehicle net sales decreasing approximately 28 percent

Canadian recreational vehicle net sales decreasing approximately 17 percent

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Three-Month Period Ended February 28, 2014 Compared to Three-Month Period Ended February 28, 2013 (Unaudited) (Continued)

Net Sales and Unit Shipments (Continued)

Recreational vehicle unit shipments decreased approximately 33 percent. The decrease was the outcome of the following factors:

Domestic recreational vehicle shipments decreasing approximately 38 percent

Canadian recreational vehicle shipments decreasing approximately 16 percent

Unit shipments for travel trailers and fifth wheels decreased approximately 38 percent. Industry shipments for these products increased approximately 6 percent from November 2013 to January 2014, the latest three months available, as compared to the same period the year prior. The Corporation s unit shipments lagged the industry due to various factors. Unit shipments to domestic dealers were adversely affected by some competitors maintaining larger quantities of finished goods inventory; resulting in the ability to meet dealer demand immediately. In addition, the Corporation experienced decreased demand from Canadian dealers. Finally, consumer demand is presently concentrated toward larger, higher priced models; of which the Corporation has a limited offering. Current industry unit shipment data for park models is not available.

Compared to prior year, the average net sales price per unit for recreational vehicles sold domestically increased approximately 11 percent; primarily due to models sold with larger square footage and greater amenities.

Cost of Sales

	February 28, 2014	Percent of Net Sales*	February 28, 2013	Percent of Net Sales*	Increase (Decrease)
	(Dollars in Thousands)				
Housing	$ 27,506	99	$ 21,999	99	$ 5,507
Recreational vehicles	11,412	103	14,516	98	(3,104)
Consolidated	$ 38,918	100	$ 36,515	99	$ 2,403

* The percentages for housing and recreational vehicles are based on segment net sales. The percentage for consolidated cost of sales is based on total net sales.

Housing cost of sales increased as a result of increased unit shipments. Included in cost of sales are approximately $839,000 of expenses attributable to the commencement of operations of the Mansfield, Texas facility. This location had third quarter net sales of approximately $128,000.

Recreational vehicle cost of sales decreased due to declining unit shipments. As a percentage of net sales, recreational vehicle cost of sales increased due to certain manufacturing costs remaining fixed amid declining sales.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Three-Month Period Ended February 28, 2014 Compared to Three-Month Period Ended February 28, 2013 (Unaudited) (Continued)

Selling and Administrative Expenses

	February 28, 2014	Percent of Net Sales	February 28, 2013	Percent of Net Sales	Increase
	(Dollars in thousands)				
Selling and administrative expenses	$ 5,891	15	$ 5,861	16	$ 30

Selling and administrative expenses, in dollars, increased as a result of approximately $182,000 of costs associated with the Mansfield, Texas facility. As a percentage of net sales, selling and administrative expenses decreased as a result of increased net sales.

Gain on Sale of Idle Property and Equipment

In the third quarter of fiscal 2014, the Corporation sold its idle manufactured housing facility located in Halstead, Kansas was sold for a gain of $300,000.

Loss Before Income Taxes

	February 28, 2014	Percent of Net Sales*	February 28, 2013	Percent of Net Sales*
	(Dollars in Thousands)			
Housing	$ (3,841)	(14)	$ (3,132)	(14)
Recreational vehicles	(1,709)	(15)	(1,721)	(12)
General corporate expense	(487)	(1)	(537)	(1)
Gain on sale of idle property, plant and equipment	300	(1)		
Operating loss	(5,737)	(15)	(5,390)	(15)
Interest income	25		25	
Loss before income taxes	$ (5,712)	(15)	$ (5,365)	(15)

* The percentages for housing and recreational vehicles are based on segment net sales. The percentage for general corporate expenses, interest income, total operating loss and loss before incomes taxes are based on total net sales.

The operating loss for the housing segment increased primarily due to the loss incurred at the Mansfield, Texas facility resulting from the commencement of operations.

Recreational vehicle net loss remained relatively unchanged due to decreased selling and administrative expenses.

General corporate expenses decreased primarily due to a reduction in staffing.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Three-Month Period Ended February 28, 2014 Compared to Three-Month Period Ended February 28, 2013 (Unaudited) (Continued)

Loss Before Income Taxes **(Continued)**

Interest income for third quarter of fiscal 2014 consisted of interest from the Corporation s note receivable. Interest income for the third quarter of fiscal 2013 consisted of approximately $23,000 from the Corporation s note receivable and approximately $2,000 from investment in U.S. Treasury Bills.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Nine-Month Period Ended February 28, 2014 Compared to Nine-Month Period Ended February 28, 2013 (Unaudited)

Net Sales and Unit Shipments

	February 28, 2014	Percent	February 28, 2013	Percent	Increase (Decrease)
			(Dollars in thousands)		
Net Sales					
Domestic Manufactured Housing	$ 85,537	64%	$ 63,059	49%	$ 22,478
Modular Housing					
Domestic	12,533	9	14,632	11	(2,099)
Canadian	4,165	3	3,880	3	285
	16,698	12	18,512	14	(1,814)
Total Housing	102,235	76	81,571	63	20,664
Recreational Vehicles					
Domestic	26,554	20	37,517	29	(10,963)
Canadian	5,240	4	9,654	8	(4,414)
Total Recreational Vehicles	31,794	24	47,171	37	(15,377)
Total Net Sales	$ 134,029	100%	$ 128,742	100%	$ 5,287
Unit Shipments					
Domestic Manufactured Housing	1,747	44	1,355	28%	392
Modular Housing					
Domestic	197	5	222	5	(25)
Canadian	64	2	63	1	1
	261	7	285	6	(24)
Total Housing	2,008	51	1,640	34	368
Recreational Vehicles					
Domestic	1,613	41	2,516	53	(903)
Canadian	337	8	600	13	(263)
Total Recreational Vehicles	1,950	49	3,116	66	(1,166)
Total Unit Shipments	3,958	100%	4,756	100%	(798)

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Nine-Month Period Ended February 28, 2014 Compared to Nine-Month Period Ended February 28, 2013 (Unaudited) (Continued)

Net Sales and Unit Shipments (Continued)

Housing net sales increased approximately 25 percent. The increase was the outcome of the following factors:

- Domestic manufactured housing net sales increasing approximately 36 percent
- Domestic modular housing net sales decreasing approximately 14 percent
- Canadian modular housing net sales increasing approximately 7 percent

Housing unit shipments increased approximately 22 percent. The increase was the outcome of the following factors:

- Domestic manufactured housing shipments increasing approximately 29 percent
- Domestic modular shipments decreasing approximately 11 percent
- Canadian modular shipments increasing approximately 2 percent

As previously noted, total domestic manufactured housing unit shipments increased approximately 29 percent. Industry unit shipments for these products increased approximately 12 percent from May 2013 to January 2014, the latest nine months available, as compared to the same period the year prior. The improvement is the result of increased sales to manufactured housing communities.

Total modular housing unit shipments decreased approximately 8 percent. Current industry unit shipment data is not available. Management believes that the decrease in modular housing sales is the result of softness in demand from modular dealers and developers.

Compared to prior year, the average net sales price for domestic manufactured housing and Canadian modular housing products increased approximately 5 percent and 6 percent, respectively. The increase is primarily as a result of homes sold with larger square footage and greater amenities. The average net sales price for domestic modular housing products decreased approximately 3 percent; resulting from homes sold with less square footage and fewer amenities.

Recreational vehicle net sales revenue decreased approximately 33 percent. The decrease the outcome of the following factors:

Domestic recreational vehicle net sales decreasing approximately 29 percent

Canadian recreational vehicle net sales decreasing approximately 46 percent

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Nine-Month Period Ended February 28, 2014 Compared to Nine-Month Period Ended February 28, 2013 (Unaudited) (Continued)

Net Sales and Unit Shipments (Continued)

Recreational vehicle unit shipments decreased approximately 37 percent. The decrease was the outcome of the following factors:

Domestic recreational vehicle shipments decreasing approximately 36 percent

Canadian recreational vehicle shipments decreasing approximately 44 percent

Unit shipments for travel trailers and fifth wheels decreased approximately 40 percent. Industry shipments for these products increased approximately 9 percent from May 2013 to January 2014, the latest nine months available, as compared to the same period the year prior. The Corporation s unit shipments lagged the industry due to various factors. Unit shipments to domestic dealers were adversely affected by some competitors maintaining larger quantities of finished goods inventory; resulting in the ability to meet dealer demand immediately. In addition, the Corporation experienced decreased demand from Canadian dealers. Finally, consumer demand is presently concentrated toward larger, higher priced models; of which the Corporation has a limited offering. Current industry unit shipment data for park models is not available.

Compared to prior year, the average net sales price per unit for recreational vehicles sold domestically increased approximately 8 percent; primarily due to models sold with larger square footage and greater amenities.

Cost of Sales

	February 28, 2014	Percent of Net Sales*	February 28, 2013	Percent of Net Sales*	Increase Decrease
	(Dollars in Thousands)				
Housing	$ 95,285	93	$ 77,476	95	$ 17,809
Recreational vehicles	31,340	99	45,062	96	(13,722)
Consolidated	$ 126,625	94	$ 122,538	95	$ 4,087

* The percentages for housing and recreational vehicles are based on segment net sales. The percentage for consolidated cost of sales is based on total net sales.

Housing cost of sales, in dollars, increased primarily as a result of increased unit shipments. Included in cost of sales are approximately $1,045,000 of expenses attributable to the commencement of operations of the Mansfield, Texas facility. As a percentage of net sales, housing cost of sales decreased due to certain manufacturing expenses remaining fixed amid rising sales.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Nine-Month Period Ended February 28, 2014 Compared to Nine-Month Period Ended February 28, 2013 (Unaudited) (Continued)

Cost of Sales (Continued)

Recreational vehicle cost of sales declined due to decreased unit shipments. As a percentage of net sales, recreational vehicle cost of sales increased as a result of certain manufacturing costs remaining fixed amid declining net sales.

Selling and Administrative Expenses

	February 28, 2014	Percent of Net Sales	February 89, 2013	Percent of Net Sales	Decrease
	(Dollars in thousands)				
Selling and administrative expenses	$ 17,245	13	$ 18,210	14	$ 965

Selling and administrative expenses, in dollars and as a percent of net sales, decreased primarily as a result of a decline in salaries and wages due to staff reductions, performance based compensation, and dealer and trade show expenses. In addition, a $250,000 decrease occurred in the expense related to the Corporation s liability for retirement and death benefits offered to certain current and former employees. The decrease occurred as a result of a change in the interest rate used in valuing the liability, and a determination by management that a lower valuation of the liability at November 30, 2013 was warranted.

Gain on Sale of Idle Property, Plant and Equipment

In the second quarter of fiscal 2014, the Corporation sold its idle manufactured housing facility located in Fair Haven, Vermont for a gain of $162,000. Likewise, in the third quarter of fiscal 2014 an idle manufactured housing facility located in Halstead, Kansas was sold for a gain of $300,000. In the second quarter of fiscal 2013, the Corporation sold two idle recreational vehicle facilities located in Hemet, California for a gain of $1,411,000.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Results of Operations Nine-Month Period Ended February 28, 2014 Compared to Nine-Month Period Ended February 28, 2013 (Unaudited) (Continued)

Loss Before Income Taxes

	February 28, 2014	Percent of Net Sales*	February 28, 2013	Percent of Net Sales*
	(Dollars in Thousands)			
Housing	$ (4,931)	(5)	$ (6,502)	(8)
Recreational vehicles	(3,696)	(12)	(3,974)	(8)
General corporate expense	(1,214)	(1)	(1,530)	(1)
Gain on sale of idle property, plant and equipment	462		1,411	1
Operating loss	(9,379)	(7)	(10,595)	(8)
Interest income	75		37	
Loss before income taxes	$ (9,304)	(7)	$ (10,558)	(8)

* The percentages for housing and recreational vehicles are based on segment net sales. The percentage for general corporate expenses, interest income, total operating loss and loss before income taxes are based on total net sales.

The operating loss for the housing segment decreased due to the effects of increased net sales, with certain manufacturing expenses remaining fixed as previously referenced.

Recreational vehicle operating loss decreased primarily due to decreased selling and administrative expenses.

General corporate expenses decreased primarily due to a $250,000 decrease in the expense related to the Corporation s liability for retirement and death benefits offered to certain current and former employees as previously referenced.

Interest income for the first nine months of fiscal 2014 consisted of interest from the Corporation s note receivable. Interest income for the first nine months of fiscal 2013 consisted of approximately $29,000 from the Corporation s note receivable and approximately $8,000 from investment in U.S. Treasury Bills.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Liquidity and Capital Resources

	February 28, 2014	May 31, 2013	Increase (Decrease)
	(Dollars in thousands)		
Cash, Restricted Cash and U.S. Treasury Bills	$ 7,275	$ 16,438	$ (9,163)
Current assets, exclusive of cash, restricted cash and U.S. Treasury Bills	$ 29,458	$ 25,199	$ 4,259
Current liabilities	$ 17,725	$ 14,207	$ 3,518
Working capital	$ 19,008	$ 27,430	$ (8,422)

Cash and U.S. Treasury Bills decreased primarily due to a net loss of approximately $9,304,000. Current assets, exclusive of cash and U.S. Treasury Bills, increased mainly due to a $2,502,000 increase in inventories, a $1,723,000 increase in accounts receivable. Inventories increased primarily as a result of raw materials purchased in anticipation of fourth quarter production, a greater amount of work in process inventory at February 28, 2014 as compared to May 31, 2013, and recreational vehicles that are awaiting shipment to dealers. Accounts receivable increased due to the timing of payments from dealers at February 28, 2014 as compared to May 31, 2013.

Current liabilities increased as a result of changes that occurred in accrued marketing programs and other accrued liabilities. Accrued marketing programs increased $2,104,000 due to accruals for an ongoing marketing program for manufactured housing dealers. Accruals are made monthly, and the majority of payments are made during the Corporation s fourth fiscal quarter. Other accrued liabilities increased $1,627,000 primarily due to a cash deposit received in the first quarter of fiscal 2014 for housing product to be built in subsequent fiscal quarters.

As noted in the Management s Plan section of Item 2, the Corporation is pursuing various strategies to improve financial performance. By implementing these strategies, and utilizing its cash, U.S. Treasury Bills and proceeds from life insurance loans as noted in the Subsequent Events section of Item 2, the Corporation s management believes that the Corporation will have sufficient liquidity to meet its obligations through the current fiscal year.

Impact of Inflation

The consolidated financial statements included in this report reflect transactions in the dollar values in which they were incurred and, therefore, do not attempt to measure the impact of inflation. On a long-term basis, the Corporation has demonstrated an ability to adjust selling prices in reaction to changing costs due to inflation.

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Item 2. ***Management s Discussion and Analysis of Financial Condition and Results of Operations (Continued).***

Forward Looking Information

Certain statements in this report are considered forward looking as indicated by the Private Securities Litigation Reform Act of 1995. These statements involve uncertainties that may cause actual results to materially differ from expectations as of the report date. These uncertainties include but are not limited to:

Consumer confidence and economic uncertainty

Availability of wholesale and retail financing

The health of the U.S. housing market as a whole

Federal, state and local regulations pertaining to the manufactured housing industry

Cyclical nature of the manufactured housing and recreational vehicle industries

General or seasonal weather conditions affecting sales

Potential impact of natural disasters on sales and raw material costs

Potential periodic inventory adjustments by independent retailers

Interest rate levels

Impact of inflation

Impact of rising fuel costs

Cost of labor and raw materials

Competitive pressures on pricing and promotional costs

Catastrophic events impacting insurance costs

The availability of insurance coverage for various risks to the Corporation

Market demographics

Management s ability to attract and retain executive officers and key personnel

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

Not applicable.

Item 4. ***Controls and Procedures.***

Management s Conclusions Regarding Effectiveness of Disclosure Controls and Procedures

As of February 28, 2014, the Corporation conducted an evaluation, under the supervision and participation of management including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Corporation s disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Corporation s disclosure controls and procedures are effective for the period ended February 28, 2014.

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Item 4. ***Controls and Procedures (Continued).***

Changes in Internal Control over Financial Reporting

No change in the Corporation s internal control over financial reporting (as such term is defined in Exchange Act Rule 13a-15(f)) occurred during the third quarter ended February 28, 2014 that materially affected, or is reasonably likely to materially affect, the Corporation s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. ***Legal Proceedings.***

Information with respect to this Item for the period covered by this Form 10-Q has been reported in Item 3, entitled Legal Proceedings of the Form 10-K for the fiscal year ended May 31, 2013 filed by the registrant with the Commission.

Item 1A. ***Risk Factors.***

There were no material changes in the risk factors disclosed in Item 1A of the Corporation s Form 10-K for the year ended May 31, 2013.

Item 6. ***Exhibits.***

(31.1) Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002-Rule 13a-14(a)/15d-14(a)

(31.2) Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002-Rule 13a-14(a)/15d-14(a)

(32) Certification of Chief Executive Officer and Chief Financial Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(101.INS) XBRL Instance Document.

(101.SCH) XBRL Taxonomy Extension Schema Document.

(101.CAL) XBRL Taxonomy Extension Calculation Linkbase Document.

(101.DEF)XBRL Taxonomy Extension Definition Linkbase Document.

(101.LAB) XBRL Taxonomy Extension Label Linkbase Document.

(101.PRE) XBRL Taxonomy Extension Presentation Linkbase Document.

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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.

	SKYLINE CORPORATION
DATE: April 4, 2014	/s/ Jon S. Pilarski Jon S. Pilarski Chief Financial Officer
DATE: April 4, 2014	/s/ Martin R. Fransted Martin R. Fransted Corporate Controller

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INDEX TO EXHIBITS

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