NATIONAL PRESTO INDUSTRIES INC
Form 10-Q
August 10, 2018

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 July 1, 2018

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 1-2451

NATIONAL PRESTO INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

WISCONSIN	39-0494170
(State or other jurisdiction of incorporation	(I.R.S. Employer Identification No.)
or organization)	

3925 NORTH HASTINGS WAY	
EAU CLAIRE, WISCONSIN	54703-3703
(Address of principal executive offices)	(Zip Code)

(Registrant's telephone number, including area code) 715-839-2121

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer 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

There were 6,978,446 shares of the Issuer's Common Stock outstanding as of August 1, 2018.

TABLE OF CONTENTS

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

July 1, 2018 and December 31, 2017

(Dollars in thousands)

	July 1, 2018 (Unaudited)		December 31, 2017	
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents		$ 36,610		$ 11,222
Marketable securities		129,439		144,252
Accounts receivable, net		43,266		65,220
Inventories:				
Finished goods	$ 26,536		$ 27,242	
Work in process	65,569		72,219	
Raw materials	5,543	97,648	4,978	104,439
Income tax receivable		607		-
Assets held for sale		528		6,189
Other current assets		6,852		7,186
Total current assets		314,950		338,508
PROPERTY, PLANT AND EQUIPMENT	$ 108,795		$ 103,538	
Less allowance for depreciation	60,395	48,400	58,370	45,168
GOODWILL		11,485		11,485
INTANGIBLE ASSETS, net		1,170		3,330
NOTES RECEIVABLE		6,858		6,750
DEFERRED INCOME TAXES		977		995
OTHER ASSETS		5,696		5,637
		$ 389,536		$ 411,873

The accompanying notes are an integral part of the condensed consolidated financial statements.

NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

July 1, 2018 and December 31, 2017

(Dollars in thousands)

	July 1, 2018 (Unaudited)		December 31, 2017	
LIABILITIES AND STOCKHOLDERS' EQUITY				
LIABILITIES				
CURRENT LIABILITIES:				
Accounts payable		$ 29,535		$ 28,445
Federal and state income taxes		-		3,750
Accrued liabilities		12,654		13,092
Liabilities held for sale		-		210
Total current liabilities		42,189		45,497
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS' EQUITY				
Common stock, $1 par value:				
Authorized: 12,000,000 shares				
Issued: 7,440,518 shares	$ 7,441		$ 7,441	
Paid-in capital	9,889		9,074	
Retained earnings	344,529		364,757	
Accumulated other comprehensive loss	(21)		(86)	
	361,838		381,186	
Treasury stock, at cost	14,491		14,810	
Total stockholders' equity		347,347		366,376
		$ 389,536		$ 411,873

The accompanying notes are an integral part of the condensed consolidated financial statements.

NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Three and Six Months Ended July 1, 2018 and July 2, 2017

(Unaudited)

(In thousands except per share data)

	Three Months Ended		Six Months Ended	
	2018	2017	2018	2017
Net sales	$ 79,227	$ 74,561	$ 156,053	$ 147,415
Cost of sales	59,782	57,001	116,331	109,729
Gross profit	19,445	17,560	39,722	37,686
Selling and general expenses	5,631	5,418	11,782	11,178
Intangibles amortization	1,416	5	2,161	372
Operating profit	12,398	12,137	25,779	26,136
Other income	997	980	1,892	1,930
Earnings from continuing operations before provision for income taxes	13,395	13,117	27,671	28,066
Provision for income taxes from continuing operations	2,619	4,176	5,901	9,152
Earnings from continuing operations	$ 10,776	$ 8,941	$ 21,770	$ 18,914
Earnings (loss) from discontinued operations, net of tax	(1)	771	(9)	8,953
Net earnings	$ 10,775	$ 9,712	$ 21,761	$ 27,867
Weighted average shares outstanding:				
Basic and diluted	7,006	6,990	7,002	6,985
Earnings per share, basic and diluted:				
From continuing operations	$ 1.54	$ 1.28	$ 3.11	$ 2.71
From discontinued operations	0.00	0.11	0.00	1.28
Net earnings per share	$ 1.54	$ 1.39	$ 3.11	$ 3.99
Comprehensive income:				
Net earnings	$ 10,775	$ 9,712	$ 21,761	$ 27,867
Other comprehensive income, net of tax:				
Unrealized gain (loss) on available-for-sale securities	21	(5)	65	23
Comprehensive income	$ 10,796	$ 9,707	$ 21,826	$ 27,890
Cash dividends declared and paid per common share	$ 0.00	$ 0.00	$ 6.00	$ 5.50

The accompanying notes are an integral part of the condensed consolidated financial statements.

NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Six Months Ended July 1, 2018 and July 2, 2017

(Unaudited)

(Dollars in thousands)

	2018	2017
Cash flows from operating activities:		
Net earnings	$ 21,761	$ 27,867
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for depreciation	2,057	3,912
Intangibles amortization	2,161	372
Provision for doubtful accounts	12	14
Non-cash retirement plan expense	379	357
Gain on involuntary conversion of machinery and equipment	-	(1,997)
Gain on disposal of property, plant and equipment	-	(2)
Gain on divestiture of business	-	(11,413)
Other	139	133
Changes in operating accounts:		
Accounts receivable, net	21,469	29,060
Inventories	6,791	(21,191)
Other assets and current assets	275	(3,099)
Accounts payable and accrued liabilities	(847)	(9,675)
Federal and state income taxes	(4,371)	(8,656)
Net cash provided by operating activities	49,826	5,682
Cash flows from investing activities:		
Marketable securities purchased	(59,771)	(109,465)
Marketable securities - maturities and sales	74,666	65,250
Proceeds from divestiture of business, net of cash paid	3,660	64,033

Purchase of property, plant and equipment	(4,001)	(4,509)
Proceeds from insurance settlement	2,474	-
Sale of property, plant and equipment	1	1
Net cash provided by investing activities	17,029	15,310
Cash flows from financing activities:		
Dividends paid	(41,989)	(38,405)
Proceeds from sale of treasury stock	528	519
Other	(6)	(114)
Net cash used in financing activities	(41,467)	(38,000)
Net increase (decrease) in cash and cash equivalents	25,388	(17,008)
Cash and cash equivalents at beginning of period	11,222	27,034
Cash and cash equivalents at end of period	$ 36,610	$ 10,026

The accompanying notes are an integral part of the condensed consolidated financial statements.

NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE A – BASIS OF PRESENTATION

The consolidated interim financial statements included herein are unaudited and have been prepared by the Company pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”). In the opinion of management of the Company, the consolidated interim financial statements reflect all the adjustments which were of a normal recurring nature necessary for a fair presentation of the results of the interim periods. The condensed consolidated balance sheet as of December 31, 2017 is summarized from audited consolidated financial statements, but does not include all the disclosures contained therein and should be read in conjunction with the 2017 Annual Report on Form 10-K. Interim results for the period are not indicative of those for the year.

On January 3, 2017, the Company and its wholly-owned subsidiary, Presto Absorbent Products, Inc. (“PAPI”), entered into an asset purchase agreement wherein substantially all PAPI assets were sold and certain liabilities were assigned to Drylock Technologies, LTD. (“Drylock”) in exchange for $68,448,000. The proceeds amount differs from the amount previously disclosed because of the customary post-closing adjustments that were finalized during the second quarter of 2017, totaling $1,448,000. The asset purchase agreement also provided for additional proceeds of $4,000,000 upon the sale of certain delayed assets, consisting of machinery and equipment that were the subject of an involuntary conversion. The sale of the delayed assets was consummated during the second quarter of 2018 and resulted in no gain or loss. As a result of this transaction, the Company classified its results of operations for all periods presented to reflect its Absorbent Products business as a discontinued operation and classified the assets and liabilities of its Absorbent Products business as held for sale. See Note J for further discussion.

NOTE B – RECLASSIFICATIONS

In addition to the reclassifications mentioned in Note A above, certain reclassifications have been made to the prior periods’ financial statements to conform to the current period’s financial statement presentation. These reclassifications did not affect net earnings or stockholders’ equity as previously reported.

NOTE C – REVENUES

The Company’s revenues are derived from short-term contracts and programs that are typically completed within 3 to 24 months and are recognized in accordance with ASC Topic 606, Revenue from Contracts with Customers. The standard was adopted on January 1, 2018 and did not result in any change to the Company’s pattern of revenue recognition. The Company’s contracts each contain one or more performance obligations: the physical delivery of distinct ordered product or products. The Company provides an assurance type product warranty on its products to the original owner. In addition, for the Housewares/Small Appliances segment, the Company estimates returns of seasonal products and returns of newly introduced products sold with a return privilege. Stand-alone selling prices are set forth in each contract and are used to allocate revenue to the corresponding performance obligations. For the Housewares/Small Appliances segment, contracts include variable consideration, as the prices are subject to customer allowances, which principally consist of allowances for cooperative advertising, defective product, and trade discounts. Customer allowances are generally allocated to the performance obligations based on budgeted rates agreed upon with customers, as well as historical experience, and yield the Company’s best estimate of the expected value for the variable consideration.

The Company's contracts in the Defense segment are primarily with the U.S. Department of Defense (DOD) and DOD prime contractors. As a consequence, this segment's business essentially depends on the product needs and governmental funding of the DOD. Substantially all of the work performed by the Defense segment directly or indirectly for the DOD is performed on a fixed-price basis. Under fixed-price contracts, the price paid to the contractor is awarded based on competition at the outset of the contract and therefore, with the exception of limited escalation provisions on specific materials, is generally not subject to any adjustments reflecting the actual costs incurred by the contractor.

Revenue is recognized at a point in time. For the Housewares/Small Appliance segment, revenue is generally recognized as the completed, ordered product is shipped to the customer from the Company’s warehouses. For the relatively few situations in which revenue should be recognized when product is received by the customer, the Company adjusts revenue accordingly. For the Defense segment, revenue is recognized when the customer has legal title and formally documents that it has accepted the products. In some situations, the customer may obtain legal title and accept the products at the Company’s facilities, arranging for transportation at a later date, typically in one to four weeks. The Company does not consider the short-term storage of the customer owned products to be a material performance obligation, and no part of the transaction price is allocated to it.

The timing of revenue recognition, billings, and cash collections results in billed accounts receivable, and customer advances and deposits (contract liabilities) on the Company's Condensed Consolidated Balance Sheets. For the Defense segment, the Company occasionally receives advances or deposits from certain customers before revenue is recognized, resulting in contract liabilities. These advances or deposits do not represent a significant financing component. As of July 1, 2018 and December 31, 2017, $8,346,000 and $8,364,000, respectively, of contract liabilities were included in Accounts Payable on the Company's Condensed Consolidated Balance Sheets. The Company recognized revenue of $528,000 during the six-month period ended July 1, 2018 that was included in the Defense segment contract liability at the beginning of that period. The Company monitors its estimates of variable consideration, which includes customer allowances for cooperative advertising, defective product, and trade discounts, and returns of seasonal and newly introduced product, all of which pertain to the Housewares/Small Appliances segment, and periodically makes cumulative adjustments to the carrying amounts of these contract liabilities as appropriate. During both the three and six month periods ended July 1, 2018 and July 2, 2017, there were no material adjustments to the aforementioned estimates. There were no amounts of revenue recognized during the same periods related to performance obligations satisfied in a previous period. The portion of contract transaction prices allocated to unsatisfied performance obligations, also known as the contract backlog, in the Company's Defense segment were $324,937,000 and $308,173,000 as of July 1, 2018 and December 31, 2017, respectively. The Company anticipates that the unsatisfied performance obligations will be fulfilled in an 18 to 24-month period. The performance obligations in the Housewares/Small Appliances segment have original expected durations of less than one year.

The Company's principal sources of revenue are derived from two segments: Housewares/Small Appliance and Defense, as shown in Note E. Management utilizes the performance measures by segment to evaluate the financial performance of and make operating decisions for the Company.

NOTE D – EARNINGS PER SHARE

Basic earnings per share is based on the weighted average number of common shares and participating securities outstanding during the period. Diluted earnings per share also includes the dilutive effect of additional potential common shares issuable. Unvested stock awards, which contain non-forfeitable rights to dividends whether paid or unpaid ("participating securities"), are included in the number of shares outstanding for both basic and diluted earnings per share calculations.

NOTE E – BUSINESS SEGMENTS

In the following summary, operating profit represents earnings before other income and income taxes. The Company's segments operate discretely from each other with no shared manufacturing facilities. Costs associated with corporate activities (such as cash and marketable securities management) and the assets associated with such activities are included within the Housewares/Small Appliances segment for all periods presented.

	(in thousands) Housewares / Small Appliances	Defense Products	Assets Held for Sale	Total
Quarter ended July 1, 2018				
External net sales	$ 17,978	$ 61,249	$	$ 79,227
Gross profit	2,248	17,197		19,445
Operating profit (loss)	(298)	12,696		12,398
Total assets	247,352	141,656	528	389,536
Depreciation and amortization	332	2,089		2,421
Capital expenditures	3,203	297		3,500
Quarter ended July 2, 2017				
External net sales	$ 16,901	$ 57,660	$	$ 74,561
Gross profit	1,528	16,032		17,560
Operating profit (loss)	(949)	13,086		12,137
Total assets	222,165	162,439	5,335	389,939
Depreciation and amortization	308	1,870		2,178
Capital expenditures	463	1,372		1,835

	(in thousands) Housewares / Small Appliances	Defense Products	Assets Held for Sale	Total
Six Months ended July 1, 2018				
External net sales	$ 34,035	$ 122,018	$	$ 156,053
Gross profit	4,147	35,575		39,722
Operating profit (loss)	(1,173)	26,952		25,779
Total assets	247,352	141,656	528	389,536
Depreciation and amortization	668	3,550		4,218
Capital expenditures	4,912	378		5,290

Six Months ended July 2, 2017				
External net sales	$ 36,948	$ 110,467	$	$ 147,415
Gross profit	4,697	32,989		37,686
Operating profit (loss)	(402)	26,538		26,136
Total assets	222,165	162,439	5,335	389,939
Depreciation and amortization	611	3,624		4,235
Capital expenditures	923	1,589		2,512

NOTE F - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company utilizes the methods of fair value as described in Financial Accounting Standard Board ("FASB") Accounting Standard Codification ("ASC") 820, Fair Value Measurements and Disclosures, to value its financial assets and liabilities. ASC 820 utilizes a three-tier fair value hierarchy which prioritizes the inputs used in measuring fair value. These tiers include:

Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions.

The carrying amounts for cash and cash equivalents, accounts receivable, notes receivable, accounts payable, and accrued liabilities approximate fair value due to the immediate or short-term maturity of these financial instruments.

NOTE G - CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company considers all highly liquid marketable securities with an original maturity of three months or less to be cash equivalents. Cash equivalents include money market funds. The Company deposits its cash in high quality financial institutions. The balances, at times, may exceed federally insured limits. Money market funds are reported at fair value determined using quoted prices in active markets for identical securities (Level 1, as defined by FASB ASC 820).

The Company has classified all marketable securities as available-for-sale which requires the securities to be reported at estimated fair value, with unrealized gains and losses, net of tax, reported as a separate component of stockholders' equity. Highly liquid, tax-exempt variable rate demand notes with put options exercisable in three months or less are classified as marketable securities.

At July 1, 2018 and December 31, 2017, cost for marketable securities was determined using the specific identification method. A summary of the amortized costs and fair values of the Company’s marketable securities at the end of the periods presented is shown in the following table. All of the Company’s marketable securities are classified as Level 2, as defined by FASB ASC 820, with fair values determined using significant other observable inputs, which include quoted prices in markets that are not active, quoted prices of similar securities, recently executed transactions, broker quotations, and other inputs that are observable. There were no transfers into or out of Level 2 during the six months ended July 1, 2018.

	(In Thousands) MARKETABLE SECURITIES			
	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
July 1, 2018				
Tax-exempt Municipal Bonds	$ 27,602	$ 27,575	$ -	$ 27

Variable Rate Demand Notes	101,864	101,864	-	-
Total Marketable Securities	$ 129,466	$ 129,439	$ -	$ 27
December 31, 2017				
Tax-exempt Municipal Bonds	$ 30,103	$ 29,994	$ -	$ 109
Variable Rate Demand Notes	114,258	114,258	-	-
Total Marketable Securities	$ 144,361	$ 144,252	$ -	$ 109

Proceeds from maturities and sales of available-for-sale securities totaled $11,353,000 and $38,415,000 for the three month periods ended July 1, 2018 and July 2, 2017, respectively, and totaled $74,666,000 and $65,250,000 for the six month periods then ended, respectively. There were no gross gains or losses related to sales of marketable securities during the same periods. Net unrealized gains (losses) included in other comprehensive income were $27,000 and $(8,000) before taxes for the three month periods ended July 1, 2018 and July 2, 2017, respectively, and were $82,000 and $34,000 before taxes for the six month periods then ended, respectively. No unrealized gains or losses were reclassified out of accumulated other comprehensive income during the same periods.

The contractual maturities of the marketable securities held at July 1, 2018 are as follows: $26,741,000 within one year; $14,523,000 beyond one year to five years; $7,231,000 beyond five years to ten years, and $80,944,000 beyond ten years. All of the instruments in the beyond five year ranges are variable rate demand notes which can be tendered for cash at par plus interest within seven days. Despite the stated contractual maturity date, to the extent a tender is not honored, the notes become immediately due and payable.

NOTE H – OTHER ASSETS

Other Assets includes prepayments that are made from time to time by the Company for certain materials used in the manufacturing process in the Housewares/Small Appliances segment. The Company expects to utilize the prepayments and related materials over an estimated period of up to two years. As of July 1, 2018 and December 31, 2017, $10,126,000 and $11,567,000 of such prepayments, respectively, remained unused and outstanding. At July 1, 2018 and December 31, 2017, $4,430,000 and $5,930,000, respectively, of these amounts were included in Other Current Assets, representing the Company's best estimate of the expected utilization of the prepayments and related materials during the twelve-month periods following those dates.

NOTE I – COMMITMENTS AND CONTINGENCIES

The Company is involved in largely routine litigation incidental to its business. Management believes the ultimate outcome of the litigation will not have a material effect on the Company's consolidated financial position, liquidity, or results of operations.

NOTE J – DISCONTINUED OPERATIONS

On January 3, 2017, the Company and its wholly-owned subsidiary, Presto Absorbent Products, Inc. ("PAPI"), entered into an asset purchase agreement wherein substantially all PAPI assets were sold and certain liabilities were assigned to Drylock Technologies, LTD. ("Drylock") in exchange for $68,448,000. The proceeds amount differs from the amount previously disclosed because of the customary post-closing adjustments that were finalized during the second quarter of 2017, totaling $1,448,000. The asset purchase agreement also provided for additional proceeds of $4,000,000 upon the sale of certain delayed assets, consisting of machinery and equipment that were the subject of an involuntary conversion. The sale of the delayed assets was consummated during the second quarter of 2018 and resulted in no gain or loss. As a result of this transaction, the Company classified its results of operations for all periods presented to reflect its Absorbent Products business as a discontinued operation and classified the assets and liabilities of its Absorbent Products business as held for sale. The Company's pre-tax gain on sale of $11,413,000, net of one-time transaction costs, was recorded in the first six months of 2017 within earnings from discontinued operations. This amount differs from the gain previously reported as a result of the post-closing adjustments mentioned above that were finalized in the second quarter of 2017.

The following table summarizes the results of the Absorbent Products business within discontinued operations for each of the periods presented:

(in thousands) (unaudited)	Three Months Ended July 1, 2018	July 2, 2017	Six Months Ended July 1, 2018	July 2, 2017
Net sales	$ -	$ -	$ -	$ 421
Cost of sales	-	(17)	(11)	(485)
Selling and general expenses	-	2	-	(24)
Gain on divestiture, net	-	709	-	11,413
Other income	-	430	-	2,078
Earnings (loss) from discontinued operations before provision for income taxes	-	1,124	(11)	13,403
Provision for (benefit from) income taxes from discontinued operations	1	353	(2)	4,450
Earnings (loss) from discontinued operations, net of tax	$ (1)	$ 771	$ (9)	$ 8,953

The following table summarizes the major classes of assets and liabilities of the Absorbent Products business held for sale for each of the periods presented:

(in thousands)	July 1, 2018 (Unaudited)	December 31, 2017
Accounts receivable, net	$ 528	$ 2,529
Property, plant and equipment, net	-	3,660
Assets held for sale	$ 528	$ 6,189
Accounts payable	$ -	$ 210
Liabilities held for sale	$ -	$ 210

The Consolidated Statements of Cash Flows do not present the cash flows from discontinued operations separately from cash flows from continuing operations. Cash used in operating activities from discontinued operations was $692,000 and $5,625,000 for the six months ended July 1, 2018 and July 2, 2017, respectively. Cash provided by investing activities related to discontinued operations was $6,134,000 and $62,036,000 for the six months ended July 1, 2018 and July 2, 2017, respectively.

In connection with the asset purchase agreement discussed above, the Company entered into a 10-year lease agreement with Drylock for a portion of its manufacturing and warehouse facilities. The lease agreement provided for total annual payments of $1,288,000 initially. It also provides Drylock an option for early termination of the lease after the initial five years and an option to modify the space subject to the agreement. Drylock elected the latter option as of June 30, 2017. The agreement allows as well for adjustments to the rental payments based on certain price indices. The Company also entered into a transition services agreement with Drylock, which terminated at the end of 2017. The amounts received from Drylock for transition services and rental income are recorded in Other Income on the Consolidated Statements of Comprehensive Income.

NOTE K – RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In January 2017, the FASB issued ASU No. 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which eliminates the performance of Step 2 from the goodwill impairment test. In performing its annual or interim impairment testing, an entity will instead compare the fair value of the reporting unit with its carrying amount and recognize any impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss. The standard is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 provides guidance for estimating credit losses on certain types of financial instruments, including trade receivables, by introducing an approach based on expected losses. The expected loss approach will require entities to incorporate considerations of historical information, current information and reasonable and supportable forecasts. ASU 2016-13 also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The guidance is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The guidance requires a modified retrospective transition method and early adoption is permitted. The Company does not expect the adoption of ASU 2016-13 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required. The Company continues to evaluate the impact of the adoption of ASU 2016-02 on its consolidated financial statements, which includes a comprehensive review of its current leasing arrangements.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-looking statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this Form 10-Q, in the Company's 2017 Annual Report to Shareholders, in the Proxy Statement for the annual meeting held on May 15, 2018, and in the Company's press releases and oral statements made with the approval of an authorized executive officer are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There are certain important factors that could cause results to differ materially from those anticipated by some of the statements made herein. Investors are cautioned that all forward-looking statements involve risks and uncertainty. In addition to the factors discussed herein and in the Notes to Consolidated Financial Statements, among the other factors that could cause actual results to differ materially are the following: consumer spending and debt levels; interest rates; continuity of relationships with and purchases by major customers; product mix; the benefit and risk of business acquisitions; competitive pressure on sales and pricing; development and market acceptance of new products; increases in material, freight/shipping, tariffs, or production cost which cannot be recouped in product pricing; delays or interruptions in shipping or production; reliance on third-party suppliers in Asia; shipment of defective product which could result in product liability claims or recalls; work or labor disruptions stemming from a unionized work force; changes in government requirements, military spending, and funding of government contracts, which could result in, among other things, the modification or termination of existing contracts; dependence on subcontractors or vendors to perform as required by contract; the efficient start-up and utilization of capital equipment investments; political actions of federal and state governments which could have an impact on everything from the value of the U.S dollar vis-à-vis other currencies to the availability of affordable labor and energy; and information technology system failures or security breaches. Additional information concerning these and other factors is contained in the Company's Securities and Exchange Commission filings.

Discontinued Operations

On January 3, 2017, the Company and its wholly-owned subsidiary, Presto Absorbent Products, Inc. ("PAPI"), entered into an asset purchase agreement wherein substantially all PAPI assets were sold and certain liabilities were assigned to Drylock Technologies, LTD. As a result of this transaction, the Company classified its results of operations for all periods presented to reflect its Absorbent Products business as a discontinued operation and classified the assets and liabilities of its Absorbent Products business as held for sale. The operations of PAPI previously comprised the Company's Absorbent Products segment.

Comparison of Second Quarter 2018 and 2017

Readers are directed to Note E to the Consolidated Financial Statements, “Business Segments,” for data on the financial results of the Company’s two business segments for the quarters ended July 1, 2018 and July 2, 2017.

On a consolidated basis, net sales increased by $4,666,000 (6%), gross profit increased by $1,885,000 (11%), selling and general expenses increased by $213,000 (4%) and intangibles amortization increased by $1,411,000. Other income increased by $17,000 (2%), while earnings from continuing operations before provision for income taxes increased by $278,000 (2%), and earnings from continuing operations increased by $1,835,000 (21%). Earnings from discontinued operations, net of tax, decreased by $772,000 (100%). Details concerning these changes can be found in the comments by segment below.

Housewares/Small Appliance net sales increased by $1,077,000 from $16,901,000 to $17,978,000, or 6%, primarily attributable to an increase in shipments. Defense net sales increased by $3,589,000 from $57,660,000 to $61,249,000, or 6%, primarily reflecting an increase in units shipped.

Housewares/Small Appliance gross profit increased $720,000 from $1,528,000 to $2,248,000, primarily reflecting the increase in sales mentioned above. Defense gross profit increased $1,165,000 from $16,032,000 to $17,197,000, primarily reflecting the increase in sales mentioned above.

Selling and general expenses for the Housewares/Small Appliance segment were essentially flat. Selling and general expenses for the Defense segment increased $144,000, primarily reflecting increased compensation costs.

Intangibles amortization increased by $1,411,000. The increase primarily reflects the Defense segment's amortization of the value of an acquired government sales contract corresponding to the quarter's comparatively higher shipments from the contract's backlog. For the three months ended July 1, 2018 and July 2, 2017, the Company recorded amortization expense of $1,411,000 and $0, respectively, associated with the customer contract intangible asset.

The above items were responsible for the change in operating profit.

Other income was essentially flat.

Earnings from continuing operations before provision for income taxes increased $278,000 from $13,117,000 to $13,395,000. The provision for income taxes from continuing operations decreased from $4,176,000 to $2,619,000, which resulted in an effective income tax rate of 20% in 2018 versus 32% in 2017. The decrease in the effective income tax rate relates primarily to United States income tax reform enacted in December 2017, which included a reduction of the corporate income tax rate from 35% to 21%, beginning in 2018. Earnings from continuing operations increased $1,835,000 from $8,941,000 to $10,776,000, or 21%.

On January 3, 2017, the Company and its wholly-owned subsidiary, Presto Absorbent Products, Inc. ("PAPI"), entered into an asset purchase agreement wherein substantially all PAPI assets were sold and certain liabilities were assigned to Drylock Technologies, LTD. As a result of this transaction, the Company classified its results of operations for all periods presented to reflect its Absorbent Products business as a discontinued operation and classified the assets and liabilities of its Absorbent Products business as held for sale. Earnings (loss) from discontinued operations, net of tax, for the three months ended July 1, 2018 and July 2, 2017 were $(1,000) and $771,000, respectively. The change in earnings from discontinued operations primarily relates to the post-closing adjustments on the gain on sale of the Absorbent Products business recorded in the second quarter of 2017.

Net earnings increased $1,063,000 from $9,712,000 to $10,755,000.

Comparison of First Six Months 2018 and 2017

Readers are directed to Note E to the Consolidated Financial Statements, "Business Segments," for data on the financial results of the Company's two business segments for the first six months ended July 1, 2018 and July 2, 2017.

On a consolidated basis, sales increased by $8,638,000 (6%), gross profit increased by $2,036,000 (5%), selling and general expenses increased by $604,000 (5%) and intangibles amortization increased by $1,789,000 (481%). Other income decreased by $38,000 (2%), while earnings from continuing operations before provision for income taxes decreased by $395,000 (1%), and earnings from continuing operations increased by $2,856,000 (15%). Earnings from discontinued operations, net of tax, decreased $8,962,000 (100%). Details concerning these changes can be found in the comments by segment below.

Housewares/Small Appliance net sales decreased by $2,913,000 from $36,948,000 to $34,035,000, or 8%, primarily attributable to a decrease in shipments. Defense net sales increased by $11,551,000 from $110,467,000 to $122,018,000, or 11%, primarily reflecting an increase in units shipped.

Housewares/Small Appliance gross profit decreased $550,000 from $4,697,000 to $4,147,000, primarily reflecting the decrease in sales mentioned above. Defense gross profit increased $2,586,000 from $32,989,000 to $35,575,000, primarily reflecting the increase in sales mentioned above.

Selling and general expenses for the Housewares/Small Appliance segment increased $221,000, primarily reflecting higher employee compensation costs. Selling and general expenses for the Defense segment increased $383,000, primarily reflecting higher compensation and benefit costs.

Intangibles amortization increased by $1,789,000. The increase primarily reflects the Defense segment’s amortization of the value of an acquired government sales contract corresponding to the period’s comparatively higher shipments from the contract’s backlog. For the first six months ended July 1, 2018 and July 2, 2017, the Company recorded amortization expense of $2,150,000 and $361,000, respectively, associated with the customer contract intangible asset.

The above items were responsible for the change in operating profit.

Other income was essentially flat.

Earnings from continuing operations before provision for income taxes decreased $395,000 from $28,066,000 to $27,671,000. The provision for income taxes from continuing operations decreased from $9,152,000 to $5,901,000, which resulted in an effective income tax rate of 21% in 2018 versus 33% in 2017. The decrease in the effective income tax rate relates primarily to United States income tax reform enacted in December 2017, which included a reduction of the corporate income tax rate from 35% to 21%, beginning in 2018. Earnings from continuing operations increased $2,856,000 from $18,914,000 to $21,770,000, or 15%.

On January 3, 2017, the Company and its wholly-owned subsidiary, Presto Absorbent Products, Inc. (“PAPI”), entered into an asset purchase agreement wherein substantially all PAPI assets were sold and certain liabilities were assigned to Drylock Technologies, LTD. As a result of this transaction, the Company classified its results of operations for all periods presented to reflect its Absorbent Products business as a discontinued operation and classified the assets and liabilities of its Absorbent Products business as held for sale. Earnings (loss) from discontinued operations, net of tax, for the first six months ended July 1, 2018 and July 2, 2017 were $(9,000) and $8,953,000, respectively. The change in earnings from discontinued operations primarily relates to the gain on sale of the Absorbent Products business recorded during the first six months of 2017.

Net earnings decreased $6,106,000 from $27,867,000 to $21,761,000.

Liquidity and Capital Resources

Net cash provided by operating activities was $49,826,000 and $5,682,000 for the six months ended July 1, 2018 and July 2, 2017, respectively. The principal factors contributing to the increase can be found in the changes in the components of working capital within the Consolidated Statements of Cash Flows. Of particular note during the first six months of 2018 were net earnings of $21,761,000, which included total non-cash depreciation and amortization expenses of $4,218,000. Also contributing to the cash provided were a decrease in accounts receivable levels stemming from cash collections on customer sales and a decrease in inventory levels. These were partially offset by a decrease in payable and accrual levels. Cash used in operating activities from discontinued operations was $692,000. Of particular note during the first six months of 2017 were net earnings of $27,867,000, which included total non-cash depreciation and amortization expenses of $4,284,000, and non-cash gains on the sale of the Absorbent Products business and on an involuntary conversion of machinery and equipment of $11,413,000 and $1,997,000, respectively. Also contributing to the operating cash flows for the first six months of 2017 were increases in inventory levels and deposits made with raw material suppliers included in other assets and current assets, and decreases in payable and accrual levels. These were partially offset by a decrease in accounts receivable levels stemming from cash collections on customer sales. Cash used in operating activities from discontinued operations was $5,625,000.

Net cash provided by investing activities was $17,029,000 during the first six months of 2018 as compared to $15,310,000 during the first six months of 2017. Significant factors contributing to the change were net maturities and sales of marketable securities in 2018 of $14,895,000, in contrast with net purchases in 2017 of $44,215,000; proceeds from the sale of the Absorbent Products business of $64,033,000 in 2017 as compared to proceeds of $3,660,000 in 2018 from the sale of the delayed assets described in Note A to the Consolidated Financial Statements; and proceeds from an insurance settlement of $2,474,000 in 2018. Cash provided by discontinued operations for the first six months of 2018 and 2017 were $6,134,000 and $62,036,000, respectively.

Cash flows from financing activities for the first six months of 2018 and 2017 primarily differed as a result of the comparative $0.50 per share increase in the extra dividend paid during the 2018 period. Cash flows for both six-month periods also reflected the proceeds from the sale of treasury stock to a Company sponsored retirement plan.

Working capital decreased by $20,250,000 during the first six months of 2018 to $272,761,000 at July 1, 2018 for the reasons stated above. The Company's current ratio was 7.5 to 1.0 at July 1, 2018 and 7.4 to 1.0 at December 31, 2017.

The Company expects to continue to evaluate acquisition opportunities that align with its business segments and will make further acquisitions, as well as continue to make capital investments in these segments per existing authorized projects and for additional projects, if the appropriate return on investment is projected.

The Company has substantial liquidity in the form of cash and cash equivalents and marketable securities to meet all of its anticipated capital requirements, to make dividend payments, and to fund future growth through acquisitions and other means. The bulk of its marketable securities are invested in the tax exempt variable rate demand notes described above and in fixed rate municipal notes and bonds. The Company intends to continue its investment strategy of safety and short-term liquidity throughout its investment holdings.

Critical Accounting Policies

The preparation of the Company's Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the amount of reported assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and revenues and expenses during the periods reported. Actual results may differ from those estimates. The Company reviewed the development and selection of the critical accounting policies and believes the following are the most critical accounting policies that could have an effect on the Company's reported results. These critical accounting policies and estimates have been reviewed with the Audit Committee of the Board of Directors.

Inventories

New Housewares/Small Appliance product introductions are an important part of the Company's sales to offset the morbidity rate of other Housewares/Small Appliance products and/or the effect of lowered acceptance of seasonal products due to weather conditions. New products entail unusual risks and have occasionally in the past resulted in losses related to obsolete or excess inventory as a result of low or diminishing demand for a product. There were no such obsolescence issues that had a material effect during the current period, and accordingly, the Company did not record a reserve for obsolete product. In the future should product demand issues arise, the Company may incur losses related to the obsolescence of the related inventory. Inventory risk for the Company's Defense segment is not deemed to be significant, as products are largely built pursuant to customers' specific orders.

Self-Insured Product Liability and Health Insurance

The Company is subject to product liability claims in the normal course of business and is self-insured for health care costs, although it does carry stop loss and other insurance to cover claims once a health care claim reaches a specified threshold. The Company's insurance coverage varies from policy year to policy year, and there are typically limits on all types of insurance coverage, which also vary from policy year to policy year. Accordingly, the Company records an accrual for known claims and incurred but not reported claims, including an estimate for related legal fees in the Company's Consolidated Financial Statements. The Company utilizes historical trends and other analysis to assist in determining the appropriate accrual. There are no known claims that would have a material adverse impact on the Company beyond the reserve levels that have been accrued and recorded on the Company's books and records. An increase in the number or magnitude of claims could have a material impact on the Company's financial condition and results of operations.

Revenues

Sales are recorded net of discounts and returns for the Housewares/Small Appliance segment. Sales discounts and returns are key aspects of variable consideration, which is a significant estimate utilized in revenue recognition. Sales returns pertain primarily to warranty returns, returns of seasonal items, and returns of those newly introduced products sold with a return privilege. The calculation of warranty returns is based in large part on historical data, while seasonal and new product returns are primarily developed using customer provided information.

Impairment and Valuation of Long-lived Assets

The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Long-lived assets consist of property, plant and equipment and intangible assets, including the value of a government sales contract. Determining whether an impairment has occurred typically requires various estimates and assumptions, including determining which cash flows are directly related to the potentially impaired asset, the useful life over which cash flows will occur, the amounts of the cash flows and the asset's residual value, if any. In turn, measurement of an impairment loss requires a determination of fair value, which is based on the best information available. The Company uses internal discounted cash flows estimates, quoted market prices when available and independent appraisals, as appropriate, to determine fair value. The Company derives the required cash flow estimates from its historical experience and its internal business plans.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's interest income on cash equivalents and marketable securities is affected by changes in interest rates in the United States. Cash equivalents primarily consist of money market funds. Based on the accounting profession’s interpretation of cash equivalents under FASB ASC Topic 230, the Company’s seven-day variable rate demand notes are classified as marketable securities rather than as cash equivalents. The demand notes are highly liquid instruments with interest rates set every seven days that can be tendered to the trustee or remarketer upon seven days notice for payment of principal and accrued interest amounts. The seven-day tender feature of these variable rate demand notes is further supported by an irrevocable letter of credit from highly rated U.S. banks. To the extent a bond is not remarketed at par plus accrued interest, the difference is drawn from the bank’s letter of credit. The Company has had no issues tendering these notes to the trustees or remarketers. Other than a failure of a major U.S. bank, there are no risks of which the Company is aware that relate to these notes in the current market. The balance of the Company’s investments is held primarily in fixed and variable rate municipal bonds with a weighted average life of 0.4 years. Accordingly, changes in interest rates have not had a material effect on the Company, and the Company does not anticipate that future exposure to interest rate market risk will be material. The Company uses sensitivity analysis to determine its exposure to changes in interest rates.

The Company has no history of, and does not anticipate in the future, investing in derivative financial instruments. Most transactions with international customers are entered into in U.S. dollars, precluding the need for foreign currency cash flow hedges. As the majority of the Housewares/Small Appliance segment’s suppliers are located in China, periodic changes in the U.S. dollar and Chinese Renminbi (RMB) exchange rates do have an impact on that segment’s product costs. It is anticipated that any potential material impact from fluctuations in the exchange rate will be to the cost of products secured via purchase orders issued subsequent to the revaluation.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of the design and operation of the Company’s disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 (the “1934 Act”) as of July 1, 2018. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of that date.

There were no changes to internal controls over financial reporting during the quarter ended July 1, 2018 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

17

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

See Note I to the Consolidated Financial Statements set forth under Part I - Item 1 above.

Item 6. Exhibits

Exhibit 3(i)	Restated Articles of Incorporation - incorporated by reference from Exhibit 3 (i) of the Company's annual report on Form 10-K for the year ended December 31, 2005
Exhibit 3(ii)	By-Laws - incorporated by reference from Exhibit 3 (ii) of the Company's current report on Form 8-K dated July 6, 2007
Exhibit 9.1	Voting Trust Agreement - incorporated by reference from Exhibit 9 of the Company's quarterly report on Form 10-Q for the quarter ended July 6, 1997
Exhibit 9.2	Voting Trust Agreement Amendment - incorporated by reference from Exhibit 9.2 of the Company's annual report on Form 10-K for the year ended December 31, 2008
Exhibit 31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101	The following financial information from National Presto Industries, Inc.’s Quarterly Report on Form 10-Q for the period ended July 1, 2018, formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Balance Sheets, (ii) Consolidated Statements of Comprehensive Income, (iii) Consolidated Statements of Cash Flows, and (iv) Notes to Consolidated Financial Statements.

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.

NATIONAL PRESTO INDUSTRIES, INC.

/s/ Maryjo Cohen
Maryjo Cohen, Chair of the Board,
President, Chief Executive Officer
(Principal Executive Officer), Director

/s/ Randy F. Lieble
Randy F. Lieble, Director, Vice President,
Chief Financial Officer (Principal
Financial Officer), Treasurer

Date: August 10, 2018