

Omega Flex, Inc.
Form 10-Q
August 09, 2006
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2006**

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 **000-51372**

Omega Flex, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of incorporation or organization)
451 Creamery Way, Exton, PA
(Address of principal executive offices)

23-1948942
(I.R.S. Employer Identification No.)
19341
(Zip Code)

(610) 524-7272

Registrant's telephone number, including area code

Edgar Filing: Omega Flex, Inc. - Form 10-Q

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of The Exchange Act).

Yes No

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS

DURING THE PRECEDING FIVE YEARS.

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 12 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by the courts.

The number of shares of the registrant's common stock issued and outstanding as of July 25, 2006 was 10,153,633.

OMEGA FLEX, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE SIX-MONTHS ENDED JUNE 30, 2006

INDEX

| PART I - FINANCIAL INFORMATION | <u>Page No.</u> |
|---|------------------------|
| Item 1 Financial Statements | |
| Condensed consolidated balance sheets at June 30, 2006 (unaudited) and December 31, 2005 (audited) | 3 |
| Condensed consolidated statements of operations for the three-months ended June 30, 2006 and 2005 and the six-months ended June 30, 2006 and 2005 (unaudited) | 4 |
| Condensed consolidated statements of cash flows for the six-months ended June 30, 2006 and 2005 (unaudited) | 5 |
| Notes to the condensed consolidated financial statements (unaudited) | 6 |
| Item 2- Management's Discussion and Analysis of Financial Condition and Results of Operations | 14 |
| Item 3 Quantitative and Qualitative Information About Market Risks | 22 |
| Item 4 Controls and Procedures | 22 |
| PART II - OTHER INFORMATION | |
| Item 1 Legal Proceedings | 23 |
| Item 3 Default on Senior Securities | 23 |
| Item 5 Other Information | 24 |
| Item 6 - Exhibits and Reports on Form 8-K | 25 |
| SIGNATURE | 26 |

PART I - FINANCIAL INFORMATION**Item 1 - Financial Statements****OMEGA FLEX, INC.****CONSOLIDATED BALANCE SHEETS**

| | June 30, <u>2006</u> (unaudited) (Dollars in thousands) | December 31 <u>2005</u> |
|--|--|------------------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and Cash Equivalents | 8,631 | 9,882 |
| Accounts Receivable - less allowances of \$75 and \$69 respectively | 10,219 | 11,938 |
| Inventories | 7,143 | 6,228 |
| Deferred taxes | 252 | 252 |
| Other Current Assets | <u>164</u> | <u>457</u> |
| Total Current Assets | 26,409 | 28,757 |
| Property and Equipment - net | 6,115 | 5,749 |
| Goodwill | 3,526 | 3,526 |
| Note Receivable from Mestek | 3,250 | 3,250 |
| Other Long Term Assets | <u>432</u> | <u>432</u> |
| Total Assets | \$39,732 ===== | \$41,714 ===== |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Current Portion of Long-Term Debt | --- | \$186 |
| Accounts Payable | 789 | 1,554 |
| Accrued Compensation | 1,508 | 2,631 |
| Accrued Commissions | 531 | 638 |
| Accrued Sales Incentives | 3,011 | 5,299 |
| Other Accrued Liabilities | <u>2,019</u> | <u>1,324</u> |
| Total Current Liabilities | 7,858 | 11,632 |
| Long-Term Debt | --- | 3,225 |
| Deferred Taxes | 715 | 639 |
| Other Long-Term Liabilities | <u>210</u> | <u>209</u> |
| Total Liabilities | <u>8,783</u> | <u>15,705</u> |
| Minority Interests | <u>34</u> | <u>23</u> |
| Shareholders' Equity: | | |
| Common Stock 10,153,633 shares issued | 102 | 102 |
| Paid in Capital | 11,739 | 11,739 |

Edgar Filing: Omega Flex, Inc. - Form 10-Q

| | | |
|--|---------------|---------------|
| Retained Earnings | 18,416 | 13,873 |
| Accumulated Other Comprehensive Income | <u>658</u> | <u>272</u> |
| Total Shareholders' Equity | <u>30,915</u> | <u>25,986</u> |
| Total Liabilities and Shareholders' Equity | \$39,732 | \$41,714 |
| | ===== | ===== |

See Accompanying Notes to Consolidated Financial Statements.

OMEGA FLEX, INC.

CONSOLIDATED STATEMENTS OF INCOME

(unaudited)

| | For the three-months ended June 30, | | For the six-months ended June 30, | |
|---|--|----------------|--------------------------------------|----------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| (Dollars in thousands, except earnings per Common Share) | | | | |
| Net Sales | \$17,908 | \$15,265 | \$35,223 | \$28,533 |
| Cost of Goods Sold | <u>8,621</u> | <u>7,712</u> | <u>16,872</u> | <u>14,190</u> |
| Gross Profit | 9,287 | 7,553 | 18,351 | 14,343 |
| Selling Expense | 2,907 | 2,394 | 5,432 | 4,826 |
| General and Administrative Expense | 2,350 | 1,962 | 5,027 | 3,647 |
| Engineering Expense | <u>533</u> | <u>311</u> | <u>943</u> | <u>632</u> |
| Operating Profit | 3,497 | 2,886 | 6,949 | 5,238 |
| Interest Income, Net | 108 | 23 | 187 | 87 |
| Other Income, Net | <u>160</u> | <u>1</u> | <u>215</u> | <u>8</u> |
| Income Before Income Taxes | 3,765 | 2,910 | 7,351 | 5,333 |
| Income Tax Expense | <u>1,463</u> | <u>1,230</u> | <u>2,808</u> | <u>2,265</u> |
| Net Income | <u>\$2,302</u> | <u>\$1,680</u> | <u>\$4,543</u> | <u>\$3,068</u> |
| Basic Earnings per Common Share: | | | | |
| Net Income | \$0.23 | \$0.17 | \$0.45 | \$0.30 |
| Basic Weighted Average Shares Outstanding | 10,154 | 10,154 | 10,154 | 10,154 |
| Diluted Earnings per Common Share: | | | | |
| Net Income | \$0.23 | \$0.17 | \$0.45 | \$0.30 |
| Diluted Weighted Average Shares Outstanding | 10,154 | 10,154 | 10,154 | 10,154 |
| Dividends Declared per Share | --- | --- | --- | \$0.92 |

See Accompanying Notes to Consolidated Financial Statements.

OMEGA FLEX, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

For the six-months ended

| | June 30, | |
|---|-------------------------------|--------------------|
| | <u>2006</u> | <u>2005</u> |
| | (Dollars in thousands) | |
| Cash Flows from Operating Activities: | | |
| Net Income | \$4,543 | \$3,068 |
| Adjustments to Reconcile Net Income to | | |
| Net Cash Provided by Operating Activities: | | |
| Depreciation and Amortization | 200 | 334 |
| Stock Based Compensation Expense | --- | 501 |
| Provision for Losses on Accounts Receivable, net of write-offs and recoveries | 29 | 6 |
| Change in Minority Interests | 11 | 13 |
| Changes in Assets and Liabilities: | | |
| Accounts Receivable | 1,690 | 196 |
| Inventory | (915) | (1,152) |
| Accounts Payable | (765) | (165) |
| Accrued Compensation | (1,123) | (712) |
| Intercompany Receivable from Mestek, Inc. | --- | 2,285 |
| Other Liabilities | (1,623) | (3,006) |
| Other Assets | <u>293</u> | <u>147</u> |
| Net Cash Provided by Operating Activities | <u>2,340</u> | <u>1,515</u> |
| Cash Flows from Investing Activities: | | |
| Capital Expenditures | <u>(566)</u> | <u>(539)</u> |
| Net Cash Used in Investing Activities | <u>(566)</u> | <u>(539)</u> |
| Cash Flows from Financing Activities: | | |
| Principal Payments Under Long Term Debt Obligations | <u>(3,411)</u> | <u>(93)</u> |
| Net Cash Used in Financing Activities | <u>(3,411)</u> | <u>(93)</u> |
| Net Increase (Decrease) in Cash and Cash Equivalents | (1,637) | 883 |
| Translation effect on cash | 386 | (141) |
| Cash and Cash Equivalents Beginning of Period | <u>(9,882)</u> | <u>280</u> |
| Cash and Cash Equivalents End of Period | \$8,631 | \$1,022 |
| | ===== | ===== |
| Schedule of Non-Cash Financing Activities | | |
| Dividend To Mestek treated as reduction of receivable | --- | 8,041 |
| Dividend recorded as a reduction of Put Liability | --- | 1,309 |
| | \$--- | \$9,350 |
| | ===== | ===== |

See Accompanying Notes to Consolidated Financial Statements.

OMEGA FLEX, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

Description of Business

The Company is a leading manufacturer of flexible metal hose, which is used in a variety of applications to carry gases and liquids within their particular applications. These applications include carrying liquefied gases in certain processing applications, fuel gases within residential and commercial buildings and vibration absorbers in high vibration applications. Our industrial flexible metal piping is used to carry other types of gases and fluids in a number of industrial applications where the customer requires the piping to have both a degree of flexibility and/or an ability to carry corrosive compounds or mixtures, or to carry at both very high and very low (cryogenic) temperatures.

The Company manufactures flexible metal hose at its facility in Exton, Pennsylvania, and sells its product through distributors, wholesalers and to original equipment manufacturers (OEMs) throughout North America, and in certain European markets.

The accompanying consolidated financial statements include the accounts of Omega Flex, Inc. (Omega) and its subsidiaries (collectively the Company). The Company s unaudited consolidated financial statements for the quarter ended June 30, 2006 have been prepared in accordance with generally accepted accounting principles for interim financial information, and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes that may be required by generally accepted accounting principles for complete financial statements. All material inter-company accounts and transactions have been eliminated in consolidation. In the opinion of management, the financial statements include all material adjustments (all of a normal and recurring nature) necessary for a fair presentation of the Company s financial position, results of operations and cash flows. Other than its subsidiaries, Exton Ranch, Inc., a Delaware corporation, and Omega Flex Limited, an English corporation, the Company has no equity or debt investments in any other entities.

2. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the

Edgar Filing: Omega Flex, Inc. - Form 10-Q

financial statements and the reported amounts of revenues and expenses during the

-6-

reporting periods. The most significant estimates and assumptions relate to revenue recognition, accounts receivable valuations, inventory valuations, goodwill valuation, intangible asset valuations, warranty costs, investments, accounting for income taxes and the realization of deferred tax assets. Actual amounts could differ significantly from these estimates.

Revenue Recognition

The Company's revenue recognition activities relate almost entirely to the manufacture and sale of flexible metal hose and pipe. Under generally accepted accounting principles, revenues are considered to have been earned when the Company has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. The following criteria represent preconditions to the recognition of revenue:

Persuasive evidence of an arrangement for the sale of product or services must exist.

Delivery has occurred or services rendered.

The sales price to the customer is fixed or determinable.

Collection is reasonably assured.

The Company generally recognizes revenue upon shipment in accordance with the above principles.

Earnings per Common Share

Basic earnings per share have been computed using the weighted average number of common shares outstanding. Basic and diluted weighted average shares outstanding have been adjusted for all periods to give retroactive effect to the stock split which was completed on June 23, 2005, as more fully described in Note 3.

Stock Based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), *Share-Based Payment*, (SFAS 123R), using the statement's modified prospective application method. Prior to January 1, 2006, the Company followed SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock based Compensation Transition and Disclosure, an amendment to FASB Statement No. 123*, which required entities to recognize as expense over the vesting period the fair value of stock-based awards on the date of grant or measurement date. For employee stock-based awards, however, SFAS Nos. 123 and 148 allowed entities to continue to apply the intrinsic value method under the provisions of Accounting Principles Board (APB) Opinion No. 25 and provide pro forma net earnings disclosures as if the fair-value-based method defined in SFAS No. 123 had been applied. The Company elected to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosures of SFAS Nos. 123 and 148 for periods as required prior to January 1, 2006.

Edgar Filing: Omega Flex, Inc. - Form 10-Q

Under the provisions of SFAS 123R, the Company recognizes the estimated fair value of stock based compensation in the consolidated statement of operations over the requisite service

-7-

period of each option granted. Under the modified prospective application method of SFAS 123R, the Company applies the provisions of SFAS 123R to all awards granted or modified after January 1, 2006. The Company had no stock options outstanding at December 31, 2005 and made no option grants in the quarters or six month periods ended June 30, 2006 and 2005. Accordingly, there was no compensation expense recorded in 2006 and the adoption of SFAS 123R had no impact on the Company's financial statements.

Currency Translation

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at exchange rates prevailing on the balance sheet date. The Statement of Operations is translated at average exchange rates. Net foreign currency transactions are reported in the results of operations in U.S. dollars at average exchange rates. Adjustments resulting from the translation of financial statements are excluded from the determination of income and are accumulated in a separate component of shareholders' equity.

Income Taxes

The Company elected in prior years and up to the date of the Spin-Off as described in Note 3 below to file its federal income tax return as part of the Mestek, Inc. consolidated return. Mestek and the Company account for the Company's federal tax liabilities on the separate company basis method in accordance with SFAS No. 109, "Accounting for Income Taxes". Under this method the Company recorded tax expense and related deferred taxes and tax benefits in a manner comparable to that which it would have recorded if it were not affiliated with Mestek.

The Company will file a separate Federal income tax return for the five months of 2005 in which it was a separate company, and for 2006 in its entirety.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain.

Other Comprehensive (Loss) Income

For the year ended December 31, 2005, and for the quarter ended June 30, 2006, respectively, the components of Other Comprehensive (Loss) Income consisted solely of foreign currency translation adjustments.

Reclassification

Reclassifications are made periodically to previously issued financial statements to conform to the current year presentation.

3. DISTRIBUTION FROM MESTEK, INC (Spin-Off)

On January 19, 2005, Mestek, Inc. (Mestek) and the Company announced that Mestek intended to distribute its 86% equity interest in the Company in a Spin-Off, *pro rata*, to all of Mestek's public shareholders as of a record date, which was subsequently established at June 23, 2005, (the Spin-Off). The Spin-Off was preceded by an amendment on April 19, 2005 to the Company's articles of incorporation to authorize a maximum of 20 million shares of common stock. The board of directors declared a share split on the Company's common stock on June 23, 2005 that resulted in a share split of 1 to 10,153.633 in order to effect a 1 for 1 share distribution under the Spin-Off. All references to shares and per share amounts in these Financial Statements have been retroactively restated to give effect to the stock split at the 1 to 10,153.633 ratio. In conjunction with the Spin-Off, the Company filed several preliminary registration statements on Form 10 with the Securities and Exchange Commission under the Securities Exchange Act of 1934. On July 22, 2005, the Company filed its definitive registration statement on Form 10 with the Securities and Exchange Commission and completed the Spin-Off on July 29, 2005. The Company's common shares began trading on the NASDAQ National Market under the trading symbol OFLX on August 1, 2005.

In connection with the Spin-Off the Company executed certain agreements governing its relationship with Mestek subsequent to the date of the Spin-Off. These include:

A Separation and Distribution Agreement which relates to the events surrounding the distribution of Omega common shares to Mestek shareholders and certain aspects of the relationship between the companies thereafter.

A Tax Responsibility Allocation Agreement which relates to the allocation of tax liabilities between Mestek and the Company subsequent to the Spin-Off.

An Indemnification and Insurance Matters Agreement which provides for mutual indemnification relating to the respective company's liabilities and definitions relating to insurance rights and obligations.

A Transitional Services Agreement by which Mestek will continue to provide to the Company certain corporate services, including legal, financial and tax services, in exchange for a fixed annual fee of approximately \$70,000.

A Confidential Nondisclosure Agreement which imposes certain duties of confidentiality on the Company and Mestek.

All of the above agreements are described in greater detail in the Form 10 filing which has been made with the Securities and Exchange Commission by the Company in connection with the Spin-Off.

On January 12, 2005, the Company paid a dividend of \$9,350,000 to its shareholders of record as of January 1, 2005. Consistent with their shareholdings, 10% of the dividend was received by Kevin Hoben, President and Chief Executive Officer and 4% by Mark Albino, Executive Vice President (both treated as a reduction of the accrued put obligation), and 86%, or \$8,041,000 was received by Mestek, and charged against Retained Earnings. On July 1, 2005 and in anticipation of the Spin-Off, the Company stopped lending its daily cash receipts to Mestek, Inc., its 86% shareholder, in order to accumulate cash reserves necessary for working capital purposes prior to the effective date of the Spin-Off. At the effective date of the Spin-Off, Mestek remained indebted to the Company in the amount of \$3,250,000 which was converted on the effective date of the Spin-Off to a 3-year note receivable from Mestek bearing interest at 100 basis points above the then prevailing 3 year US Treasury note yield.

The Company, Mestek, Inc., and the above officers entered into a shareholder agreement in 1996 that imposed certain restrictions on the transfer of any shares acquired by such officer in connection with the Omega Flex 1996 Stock Option Plan, and that also provided for rights by the Company to call, or the officers to put, such shares to or from the other party at a per share price based upon the Company book value. The shareholder agreement was terminated immediately preceding the effective date of the Spin-Off as explained in Note 7.

4. INVENTORIES

| | June 30, <u>2006</u> (unaudited) (dollars in thousands) | December 31, <u>2005</u> |
|-----------------|--|-------------------------------------|
| Finished Goods | \$5,253 | \$4,280 |
| Raw Materials | <u>1,890</u> | <u>948</u> |
| Total Inventory | <u>\$7,143</u> ===== | <u>\$6,228</u> ===== |

5. SHAREHOLDERS EQUITY

As of December 31, 2004, the Company had authorized common stock of 1,000 shares with par value of \$60 per share. As of December 31, 2004, Mestek, Inc. owned 860 shares of the Company's common stock, or 86%, and Kevin R. Hoben and Mark F. Albino, the President and Executive Vice President of the Company respectively, collectively owned the remaining 14% of the Company's common stock. As explained more fully in Note 3, on June 23, 2005 the Company authorized a split of its common shares at a ratio of 1 to 10,153.633 in connection with the planned Spin-Off of Omega Flex common shares to Mestek Stockholders. All references to shares and per share amounts in these Financial Statements have been retroactively restated to give effect to the stock split at the above ratio.

The Company has paid two special dividends on its common stock, but these special dividends were declared and paid prior to the date that our common stock was registered with the Securities and Exchange Commission and began trading on the NASDAQ National Market in

August, 2005. The first dividend was declared and paid to shareholders of record as of October 13, 2004, and the amount of the dividend was \$0.886 per share on a fully diluted basis and after giving effect to the forward split as part of the distribution, as described in Note 3 under the caption "Spin-Off". On January 12, 2005, the second dividend was paid to record shareholders as of January 1, 2005, and was \$0.92 per share on a fully diluted basis and after giving effect to the forward split as part of the distribution. The 2005 dividend totaling \$9,350,000 was recorded as a reduction to retained earnings for the portion related to Mestek, its 86% shareholder, and the remaining 14% portion relating to Mr. Hoben and Mr. Albino was recorded as a reduction to Common Stock Subject to Put Obligation in Current Liabilities as described in Note 7. Our future decisions concerning the payment of dividends on our common stock will depend upon our results of operations, financial condition and capital expenditure plans, as well as such other factors as the Board of Directors, in its sole discretion, may consider relevant.

6. COMMITMENTS AND CONTINGENCIES

Commitments:

The Company is obligated under Indemnity Agreements executed on behalf of 11 of the Company's Officers and Directors. Under the terms of the Agreement, the Company is contingently liable for costs which may be incurred by the Officers and Directors in connection with claims arising by reason of these individuals' roles as Officers and Directors.

As of December 31, 2005, the Company was a guarantor of the debt of its wholly-owned subsidiary, Exton Ranch, Inc., related to the mortgage note established on April 16, 2004 with Sovereign Bank for the purchase of the Company's main operating facility in Exton, Pennsylvania. However, on April 27, 2006, the Company paid the entire outstanding principal balance (and accrued interest) of the \$3.348 million Mortgage Note that was obtained from Sovereign Bank in 2004.

The Company has entered into salary continuation agreements with two employees which provide for monthly payments to each of the employee or his designated beneficiary upon the employee's retirement or death. The payment benefits range from \$1,000 per month to \$3,000 per month with the term of such payments limited to 15 years after the employee's retirement at age 65. The agreements also provide for survivorship benefits if the employee dies before attaining age 65; and severance payments if the employee is terminated without cause, the amount of which is dependent on the length of company service at the date of termination. The net present value of the retirement payments is included in Other Long-term Liabilities. The Company has obtained and is the beneficiary of two whole life insurance policies in respect of the two employees, and the cash surrender value of such policies (included in Other Assets) exceeds the net present value of the Company's obligations for the retirement payments at June 30, 2006.

Contingencies:

The Company retains significant obligations under its commercial insurance policies for losses occurring in the policy years in which it was a subsidiary of Mestek, Inc. For the policy year ending October 1, 2004, the Company retained liability for the first \$2,000,000 per occurrence of commercial general liability claims (including product liability claims), subject to

an agreed aggregate. For losses occurring in the policy year ended October 31, 2003, the Company retained liability for the first \$500,000 per occurrence of commercial general liability claims (including product liability claims), subject to an agreed aggregate. In addition, for 2004 and 2003 the Company retained liability for the first \$250,000 per occurrence of workers compensation coverage, subject to an agreed aggregate. However, for policy years beginning on July 22, 2005, (the effective date of the Spin-Off) the Company retained liability for the first \$25,000 per occurrence of commercial liability claims (including products liability claims), subject to an agreed aggregate, and the Company is currently insured on a first dollar basis for workers compensation subject to statutory limits. The Company maintains reserves for its obligations under these various policies based on claim experience and the reserves established by the insurers in relation to these claims. The reserve balances at June 30, 2006 and December 31, 2005 were not material in amount.

Prior to the Spin-Off, the Company self-insured a substantial portion of the health benefits provided for its employees and maintained reserves in this regard and relied upon a recognized actuarial consulting firm to help it set and maintain these reserves. After the Spin-Off, the Company's liability is limited to \$30,000 per case and an aggregate of \$600,000 annually.

The Company was obligated as a guarantor with respect to the debt of Mestek, Inc. under Mestek's primary commercial bank line of credit. As of the effective date of the Spin-Off (as disclosed in Note 3), the guaranty was cancelled and is no longer in effect.

The Company is subject to several legal actions and proceedings in which various monetary claims are asserted. Management, after consultation with its corporate legal department and outside counsel, does not anticipate that any ultimate liability arising out of all such litigation and proceedings will have a material adverse effect on the financial condition of the Company, except as set forth below.

The Company is engaged in a litigation matter that was filed in the Clark County Circuit Court, in Arkansas, alleging that the Company's corrugated stainless steel tubing product, TracPipe®, and similar products manufactured by several other manufacturers, also named as defendants in the case, is defective, or that instructions, warnings and training in the installation of corrugated stainless steel tubing are defective, against potential damage to the corrugated stainless steel tubing systems caused by the near-by lightening strikes. The plaintiffs in this case have named three other corrugated stainless steel tubing manufacturers, and one plumber residing in Arkansas, as defendants in this matter, and are seeking class action certification as representatives of all similarly situated persons in the United States, or in the alternative, in Arkansas and Texas, pursuant to the Arkansas rules of civil procedure. The case is currently in discovery, and no determinations have been made whether to certify the class either within the United States, or within the states of Texas and Arkansas. The Company believes that the plaintiffs' claims are entirely without merit and are defending the matter vigorously. At this time, there is no ability to estimate the cost of defense or potential damages related to this matter.

Warranty Commitments:

Gas transmission products such as those made by the Company carry potentially serious personal injury risks in the event of failures in the field. As a result, the Company has extensive internal testing and other quality control procedures and historically the Company has not had a meaningful failure rate in the field due to the extensive nature of these quality controls. Due to the Company's quality systems, the warranty expense is *de minimis*, and accordingly, the Company expenses warranty costs on an as incurred basis.

7. STOCK OPTION PLANS

The Company adopted a stock option plan (the Plan), effective July 1, 1996 which provided for the granting of both Incentive and Non-Qualified Stock Options (as those terms are defined in the Internal Revenue Code) of up to (pre-split) 200 shares of stock to certain employees of the Company for the purchase of the Company's common stock at fair market value as of the date of grant. The Plan was approved by Mestek, Inc., then the Company's sole shareholder. Options to purchase an aggregate of (pre-split) 140 shares of the common stock of the Company, representing a 14% equity share were granted to two executives, Kevin Hoben, President and Mark Albino, Executive Vice President, effective July 1, 1996. The options vested over a five-year period commencing May 1, 1999 and ending on May 1, 2004. All of the options granted were exercised on October 13, 2004, in connection with which the Company received the \$1,260,000 exercise price. Through a separate agreement, the option holders (now shareholders in the Company) had a put right after exercise which allowed them to sell their shares to the Company at an amount based upon book value and the Company had a corresponding call option at an amount based upon book value. In accordance with APB 25, the

Company has reflected pre-tax charges to earnings for the second quarter ended June 30, 2006 and 2005, of \$0 and \$501,000, respectively, for the compensation value in those periods of the options granted. These charges, which reflected the potential obligations of the Company relative to the put rights, were credited to Common Stock Subject to Put Obligation. In July 2005 in coordination with the Spin-Off described in Note 3 the Company and Mr. Hoben and Mr. Albino mutually terminated their respective call and put rights at which time the Company reclassified the remaining liability (approximately \$2,743,000) to the put rights to Paid In Capital. No stock options were outstanding at or after December 31, 2005.

8. DEBT

Long-term Debt:

Long-term debt consisted of the following at June 30, 2006 and December 31, 2005

| | <u>2006</u> | <u>2005</u> |
|-------------------------|--------------------|--------------------|
| | | (in thousands) |
| Mortgage Note | \$--- | \$3,411 |
| Less Current Maturities | <u>---</u> | <u>(186)</u> |
| | <u>\$---</u> | <u>\$3,225</u> |
| | ===== | ===== |

On April 27, 2006, the Company's subsidiary Exton Ranch, Inc. paid the entire outstanding principal balance (and accrued interest) of the \$3,348 million Mortgage Note that was obtained from Sovereign Bank in 2004 to purchase the Company's main facility in Exton, Pennsylvania.

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

This report contains forward-looking statements, which are subject to inherent uncertainties. These uncertainties include, but are not limited to, variations in weather, changes in the regulatory environment, customer preferences, general economic conditions, increased competition, the outcome of outstanding litigation, and future developments affecting environmental matters. All of these are difficult to predict, and many are beyond the ability of the Company to control.

Certain statements in this Quarterly Report on Form 10-Q that are not historical facts, but rather reflect the Company's current expectations concerning future results and events, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words believes, expects, intends, plans, anticipates, hopes, likely, will, and similar expressions identify such forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from future results, performance or achievements expressed or implied by such forward-looking statements.

Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management's view only as of the date of this Form 10-Q. The Company undertakes no obligation to update the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, conditions or circumstances.

OVERVIEW

As disclosed in Note 1 to the financial statements, the Company is a former subsidiary of Mestek, Inc. On July 29, 2005, Mestek, Inc. effected a distribution of its 86% ownership of the Company's common stock to the Mestek record shareholders. This distribution was preceded by the filing on July 22, 2005 of a definitive registration statement of the Company's common stock on Form 10 with the Securities and Exchange Commission. The Company's common shares began trading on the NASDAQ National Market under the trading symbol OFLX on August 1, 2005. Certain effects of the distribution are reflected in the changes of financial condition of the Company for the quarter ended June 30, 2006.

The Company is a leading manufacturer of flexible metal hose, and is currently engaged in a number of different markets, including construction, manufacturing, transportation, petrochemical, pharmaceutical and other industries.

The Company's business is controlled as a single operating segment that consists of the manufacture and sale of flexible metal hose and accessories. The Company's products are concentrated in residential and commercial construction, and general industrial markets. The Company's primary product line, TracPipe® flexible gas piping, is used for gas piping within residential and commercial buildings. Through its flexibility and ease of use with patented fittings distributed under the trademark, AutoFlare®, the TracPipe® flexible gas piping allows users to substantially cut the time required to install the gas piping, as compared to traditional methods. All of the Company's hose products are manufactured at the Company's Exton, Pennsylvania facility. A majority of the Company's sales across all industries are generated through independent outside sales organizations such as sales representatives, wholesalers and distributors, or a combination of both. The Company has a broad distribution network in North America and to a lesser extent in other global markets.

CHANGES IN FINANCIAL CONDITION

On April 27, 2006, The Company paid the remaining outstanding principal balance (and accrued interest) of \$3,348,000 million on the Mortgage Note that was obtained from Sovereign Bank in 2004. The balance at December 31, 2005 was \$3,411,000.

RESULTS OF OPERATIONS**Three-months ended June 30, 2005 vs. June 30, 2004**

The Company reported comparative results from continuing operations for three-months period ended June 30, 2005 and 2004 as follows:

Three-months ended June 30,
(in thousands)

| | <u>2006</u> <u>(\$000)</u> | <u>2006</u> <u>%</u> | <u>2005</u> <u>(\$000)</u> | <u>2005</u> <u>%</u> |
|-------------------|---|---------------------------------------|---|---------------------------------------|
| Net Sales | \$17,908 | 100.0% | \$15,265 | 100.0% |
| Gross Profit | 9,287 | 51.9% | \$7,553 | 49.5% |
| Operating Profits | 3,497 | 19.5% | \$2,886 | 18.9% |

The Company's sales increased \$2,643,000 (17.3%) from \$15,265,000 in the three-months period ended June 30, 2005 as compared to \$17,908,000 in the three-months period ended June 30, 2006 due to continued strong sales of the Company's flagship TracPipe® flexible gas piping product and its patented AutoFlare® connection system. TracPipe® is a corrugated stainless steel tubing product developed especially for use in the piping and installation of gas appliances. Sales of TracPipe® flexible gas piping were sustained by relatively strong single family and multi-family residential construction activity driven by low interest rates. Of the \$2,643,000 increase in sales from three-months period ended June 30, 2005 to three-months period ended June 30, 2006, approximately two-thirds of such increase were as a result of increases in sales volume.

The Company's gross profit margins increased from 49.5% in the three-months period ended June 30, 2005 to 51.9% in the three-months period ended June 30, 2006 indicative of management's ability to find manufacturing efficiencies and effectively price our products despite inflationary pressures effecting stainless steel and other commodities.

Selling Expenses. Selling expenses consist primarily of employee salaries and associated overhead costs, commissions, and the cost of marketing programs such as advertising, trade shows and related communication costs. Selling expense was \$2,907,000 and \$2,394,000 for the three-months ended June 30, 2006 and 2005, respectively. The \$513,000 increase in selling expenses is principally due to increased sales commissions as a result of higher volume. Sales expense as a percentage of sales increased from 15.7% for the three-months ended June 30, 2005 to 16.2% for the three-months ended June 30, 2004.

General and Administrative Expenses. General and administrative expenses consist primarily of employee salaries, benefits for administrative, executive and finance personnel, legal and accounting, and corporate general and administrative services. General and administrative expenses were \$2,350,000 and \$1,962,000 for the three-months ended June 30, 2006 and 2005, respectively. The \$388,000 increase in expenses is attributable to legal costs

Edgar Filing: Omega Flex, Inc. - Form 10-Q

(\$426,000); management compensation and staffing expenses (\$204,000); accounting and audit fees, (\$105,000); all of which increases were partially mitigated by \$273,000 of Stock Option Expense and \$128,000 associated with legal and regulatory expenses incurred in the *Spin-Off* from Mestek, Inc., both of which were incurred in 2005 only. Various other fluctuations netted an increase of approximately \$54,000 in general and administrative expenses. For the preceding reasons, general and administrative expense, as a percentage of sales, increased from 12.9% for the three-months ended June 30, 2005 to 13.1% for the three-months ended June 30, 2006.

Engineering Expense. Engineering expenses consist of development expenses associated with the development of new products and enhancements to existing products, and manufacturing engineering costs. Engineering expenses were \$533,000 and \$311,000 for the three-months ended June 30, 2006 and 2005 respectively. The \$222,000 increase in engineering expenses is due to an increase in engineering staffing and expenditures associated with the certification and qualification of new products. Accordingly, engineering expenses as a percentage of sales grew to 3.0% for the three-months ended June 30, 2006 from 2.0% for the three-months ended June 30, 2005.

Reflecting the factors mentioned above, Operating Profit margins increased \$611,000 from \$2,886,000 in the three-months period ended June 30, 2005 to \$3,497,000 in the three-months period ended June 30, 2006.

Interest Income-Net. Interest income-net includes interest income on the note receivable from Mestek and interest income on our interest-bearing investments, reduced by interest expense associated with the Company's variable rate first mortgage on our manufacturing facility. On April 27, 2006 the Company repaid the entire outstanding principal balance (and accrued interest) of the \$3.348 million mortgage note that was obtained from Sovereign Bank in 2004 to purchase the Company's main facility in Exton, Pennsylvania.

Other Income-Net. Other Income-net primarily consists of realized foreign currency exchange gains (losses) on Omega Flex Limited payments for accounts payable, interest and management fee to Omega Flex, Inc., its parent corporation.

Income Tax Expense. For three-months period ended June 30, 2005, the Company's effective income tax rate varied slightly from the statutory rates for both federal and state income taxes due to limitations on deductions related to Incentive Stock Options.

Six-months ended June 30, 2005 vs. June 30, 2004

The Company reported comparative results from continuing operations for six-months period ended June 30, 2005 and six-months ended June 30, 2004 as follows:

Six-months ended June 30, (in thousands)

| | <u>2006</u> <u>(\$000)</u> | <u>2006</u> <u>%</u> | <u>2005</u> <u>(\$000)</u> | <u>2005</u> <u>%</u> |
|-------------------|---|---------------------------------------|---|---------------------------------------|
| Net Sales | \$35,223 | 100.0% | \$28,533 | 100.0% |
| Gross Profit | \$18,351 | 52.1% | \$14,343 | 50.3% |
| Operating Profits | \$6,949 | 19.7% | \$5,238 | 18.4% |

Edgar Filing: Omega Flex, Inc. - Form 10-Q

The Company's sales increased \$6,690,000 or 23.4% from \$28,533,000 in the six-months period ended June 30, 2005 as compared to \$35,223,000 in the six-months period ended June 30, 2006 due to continued strong sales of the Company's flagship TracPipe® flexible gas piping product and its patented AutoFlare[®] connection system. TracPipe[®] is a corrugated stainless steel tubing product developed especially for use in the piping and installation of gas appliances. Sales of TracPipe[®] flexible gas piping were sustained by relatively strong single family and multi-family residential construction activity driven by historically low interest rates. Approximately 86% of the \$6,690,000 increase in sales from six-months period ended June 30, 2005 to six-months period ended June 30, 2006 was volume related.

The Company's gross profit margins have increased from 50.3% in the six-months period ended June 30, 2005 to 52.1% in the six-months period ended June 30, 2006 indicative of management's ability to find manufacturing efficiencies and effectively price our products despite inflationary pressures affecting stainless steel and other commodities.

Selling Expenses. Selling expense was \$5,432,000 and \$4,826,000 for the six-months ended June 30, 2006 and 2005, respectively. The \$606,000 increase in selling expenses is due to increased sales commissions and freight costs. Sales expense as a percentage of sales was favorable at 15.4% for the six-months ended June 30, 2006 versus 16.9% for the six-months ended June 30, 2005.

General and Administrative Expenses. General and administrative expenses were \$5,027,000 and \$3,647,000 for the six-months ended June 30, 2006 and 2005, respectively. The \$1,380,000 increase in expenses is attributable to legal costs and management compensation partially mitigated by a reduction in legal and regulatory costs incurred in the *Spin-Off* from Mestek, Inc., which costs were incurred in 2005 only. For the preceding reasons, general and administrative expense, as a percentage of sales, increased from 12.8% for the six-months ended June 30, 2005 to 14.3% for the six-months ended June 30, 2006.

Engineering Expense. Engineering expenses were \$943,000 and \$632,000 for the six-months ended June 30, 2006 and 2005 respectively. The \$311,000 increase in engineering expenses is largely due to expenditures associated with the certification and qualification of new products. Engineering expenses as a percentage of sales were 2.7% for the six-months ended June 30, 2006 and 2.2% for the six-months ended June 30, 2005.

Reflecting the factors mentioned above, Operating Profit margins increased \$1,711,000 from \$5,238,000 in the six-months period ended June 30, 2005 to \$6,949,000 in the six-months period ended June 30, 2006.

Interest Income-Net. Interest income-net includes interest income on the note receivable from Mestek and interest income on our interest-bearing investments, reduced by interest expense associated with the Company's variable rate first mortgage on our manufacturing facility. On April 27, 2006 the Company repaid the entire outstanding principal balance (and accrued interest) of the \$3,348 million Mortgage Note that was obtained from Sovereign Bank in 2004 to purchase the Company's main facility in Exton, Pennsylvania.

Other Income-Net. Other Income-net primarily consists of realized foreign currency exchange gains (losses) on Omega Flex Limited payments for accounts payable, interest and management fee to Omega Flex, Inc., its parent corporation.

Income Tax Expense. For six-months period ended June 30, 2005, the Company's effective income tax rate varied slightly from the statutory rates for both federal and state income taxes due to limitations on deductions related to Incentive Stock Options.

CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES

Financial Reporting Release No. 60, released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 2 of the Notes to the Consolidated Financial Statements includes a summary of the significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. The following is a brief discussion of the Company's more significant accounting policies.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition, accounts receivable valuations, inventory valuations, goodwill valuation, intangible asset valuations, product liability costs, workers compensation claims reserves, health care claims reserves, and accounting for income taxes. Actual amounts could differ significantly from these estimates.

Our critical accounting policies and significant estimates and assumptions are described in more detail as follows:

Revenue Recognition

The Company's revenue recognition activities relate almost entirely to the manufacture and sale of its flexible metal hose and related products. Under generally accepted accounting principles, revenues are considered to have been earned when the Company has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. With respect to sales of the Company's products, the following criteria represent preconditions to the recognition of revenue:

- * persuasive evidence of an arrangement must exist;
- * delivery has occurred or services rendered;
- * the sales price to the customer is fixed or determinable; and
- * collection is reasonably assured.

The Company generally recognizes revenue upon shipment in accordance with the above principles.

Accounting for Income Taxes

Up to the date of the Spin-Off, the Company elected to file its federal income tax return as part of the Mestek, Inc. parent company, consolidated return. Mestek and Omega accounted for Omega's federal tax liabilities on the separate company basis method in accordance with FAS 109, Accounting for Income Taxes. Under this method Omega recorded tax expense and related deferred taxes and tax benefits in a manner comparable to that which it would record if it were not affiliated with Mestek.

The Company will file a separate Federal income tax return for the five months of 2005 in which it was a separate and public company and will file a separate Federal income tax return for 2006 in its entirety.

By agreement, the Company will be responsible for and hold Mestek harmless from, any liability for its income taxes for all taxable periods, whether before or after the Spin-Off.

The preparation of the Company's Consolidated Financial Statements requires it to estimate its income taxes in each of the jurisdictions in which it operates, including those outside the United States which may be subject to certain risks that ordinarily would not be expected in the United States. The income tax accounting process involves estimating its actual current exposure together with assessing temporary differences resulting from differing treatment of items, such as depreciation and stock based compensation, for tax and accounting purposes. These differences result in the recognition of deferred tax assets and liabilities. The Company must then record a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. Significant management judgment is required in determining the Company's provision for income taxes, its deferred tax assets and liabilities and any valuation allowance recorded against deferred tax assets. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, it could materially impact its financial position and results of operations.

IMPACT OF INFLATION

Stainless steel and other related commodities represent a significant portion of the Company's prime costs. As such, the Company's margins are vulnerable to inflationary pressures which affect the commodity markets from time to time. Margins were not significantly impacted by such commodity cost increases in the first quarter of 2006 due to the timely implementation of price increases to our customers and to effective hedging of commodity exposures, as explained above. If the rate of inflation continues to climb in 2006, with concurrent interest rate increases, the Company expects that the construction markets and the commodity markets in which it operates could be adversely impacted, thus potentially impacting the Company's results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Six Months ended June 30, 2006

As of June 30, 2006, we had \$8.6 million in consolidated cash, cash equivalents and

Edgar Filing: Omega Flex, Inc. - Form 10-Q

short-term investments, which is \$1.3 million less than at December 31, 2005. The Company used approximately \$3.354 million of cash to repay the entire outstanding principal balance of the \$3.348 million mortgage note (and accrued interest). This was largely offset by cash generated by the Company's business operations during the first half of 2006.

Operating Activities

Cash provided by operations for the first six months of 2006 was \$2.3 million compared with \$1.5 million provided by the first six months of 2005, a \$0.8 million increase.

Investing Activities

Capital spending for the first six months ended June 30, 2006 was \$566,000, consistent with capital spending in the first six months ended June 30, 2005 which was \$539,000.

Financing

Cash used in financing activities was \$3.4 million and \$0.1 million in the first six months of 2006 and 2005, respectively. On April 27, 2006, the Company paid the entire outstanding principal balance (and accrued interest) of the \$3.348 million Mortgage Note that was obtained from Sovereign Bank in 2004.

As of June 30, 2006 and December 31, 2005, the Company had no commercial bank line of credit for working capital purposes. The Company had historically relied upon its former corporate parent, Mestek, Inc. (Mestek), to provide working capital and other credit as needed through an inter-company account relationship; however, the Company consistently transferred more cash to Mestek than it has borrowed resulting in a cumulative inter-company receivable from Mestek. The Company discontinued the coordination of its bank accounts with Mestek on or about July 5, 2005, so that the Company continued to receive all of the proceeds from the payment of its accounts receivable, and Mestek continued to pay the Company's account payables until on or about July 21, 2005, at which time the Company began paying its own accounts payable. The Company's inter-company receivable from Mestek was fixed and documented in a written promissory note upon the consummation of the Spin-Off (as described in Note 1 to the Consolidated Financial Statements), in the principal amount of \$3,250,000. The Mestek promissory note bears interest at a rate of 5.06%, and is payable in full after three

years from the effective date of the Spin-Off. The Company has accumulated approximately \$8,631,000 in cash and cash equivalents which are invested in a short-term investment facility.

The Company believes its liquidity position as of June 30, 2006 (and after the repayment in full of the Mortgage Note as disclosed in Note 8) is fully adequate to meet foreseeable future needs. The Company also believes that it will possess adequate cash reserves and will be able to obtain sufficient working capital lines of credit to meet its day-to-day needs including any acquisitions or capital expenditures it can reasonably foresee at this time.

Edgar Filing: Omega Flex, Inc. - Form 10-Q

Prior to the Spin-Off, the Company was obligated as a guarantor with respect to the debt of Mestek, Inc., its previous parent (as described in Note 3) under its primary commercial bank line of credit. As of the effective date of the distribution of the Company's common stock by Mestek, Inc. to its shareholders, the guaranty was cancelled and is no longer in effect.

-21-

CONTINGENT LIABILITIES AND GUARANTEES

See Note 6 to the Company's financial statements.

As of June 30, 2006 and December 31, 2005, the Company was a guarantor of the debt of its wholly-owned subsidiary, Exton Ranch, Inc., related to the mortgage note established on April 16, 2004 with Sovereign Bank for the purchase of the Company's main operating facility in Exton, PA., however, as disclosed in Note 8, under the caption "Debt", on April 27, 2006, the remaining \$3.348 million principal balance on the mortgage note was paid in full along with all applicable accrued interest.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

Item 3. Quantitative And Qualitative Information About Market Risks

The Company does not engage in the purchase or trading of market risk sensitive instruments. The Company does not presently have any positions with respect to hedge transactions such as forward contracts relating to currency fluctuations. No market risk sensitive instruments are held for speculative or trading purposes. For a discussion of the risk factors facing the Company, and the shareholders' investment in the Company, please refer to the Risk Factors set forth in the Company's final registration statement on Form 10-12G/A, filed with the Securities and Exchange Commission on July 22, 2005, and the Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2006, as amended.

Item 4 Controls And Procedures

- (a) Evaluation of Disclosure Controls and Procedures.

At the end of the fiscal first quarter of 2006, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The Company's disclosure controls and procedures are designed to ensure that the Company records, processes, summarizes and reports in a timely manner the information required to be disclosed in the periodic reports filed by the Company with the Securities and Exchange Commission. 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 as defined in the Rule 13a-15(e) of Securities Exchange Act of 1934. Based on that evaluation, the chief executive officer and chief financial officer have concluded that, as of the date of their evaluation, the Company's disclosure controls and procedures are effective to provide reasonable assurance of achieving the purposes described in Rule 13a-15(e), and no changes are required at this time.

Edgar Filing: Omega Flex, Inc. - Form 10-Q

(b) Changes in Internal Controls.

There was no change in the Company's internal control over financial reporting (as defined in rule 13a-15(f) of the Securities Exchange Act of 1934) identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934 that occurred

-22-

during the three-month period covered by this Report on Form 10-Q that has materially affected or is reasonably likely to materially affect the Company's internal control over financial reporting subsequent to the date the chief executive officer and chief financial officer completed their evaluation.

PART II - OTHER INFORMATION

Item 1 - Legal Proceedings

The Company is subject to several legal actions and proceedings in which various monetary claims are asserted. Management, after consultation with its corporate legal department and outside counsel, does not anticipate that any ultimate liability arising out of all such litigation and proceedings will have a material adverse effect on the financial condition of the Company, except as set forth below.

Berry, et al. v. Titeflex Corp., et al.

Case No. CV-2004-211, Circuit Court of Clark County, Arkansas, filed November 15, 2004.

Four individual residents of Arkansas and an individual Texas resident have sued the top four manufacturers of corrugated stainless steel tubing (CSST); including Omega Flex, Inc. as the manufacturer of TracPipe® brand CSST. The complaint proposes a national class action on behalf of all owners of installed CSST. Installed CSST is alleged to be defective because it is alleged to be more susceptible to failure from near-lightning strikes than traditional black iron pipe and because the manufacturers allegedly failed to warn of CSST's allegedly heightened susceptibility to such damage.

The case is currently in discovery. The Company will oppose both class certification and any request for a national class. The Company believes it has valid defenses to the issues of both class certification and product liability and the Company will contest these claims vigorously. At this time, the Company believes that no estimation of potential liability in the matter can be reasonably made. It is the nature of class action litigation in general and this matter in particular, that if there should be an adverse decision on the issue of certification of a national class of CSST owners and an adverse decision on the issue of product liability, the financial position and results of operation of the Company could be materially adversely affected.

Item 3 - Defaults Upon Senior Securities

Certain inter-company dividends paid by the Company to Mestek in 2004 and 2005, prior to the Spin-Off transaction described in more detail in Note 1 to the consolidated financial statements, caused the Company to be in technical breach of two loan covenants relating to the mortgage note for certain periods. The Company paid all amounts due under the mortgage note during the periods of the above technical breaches. On September 6, 2005 the Company received a waiver of the technical breach and revised its Loan Covenants which are more appropriate to the Company's operations as a public company. As disclosed in Note 8 to the consolidated financial statements, on April 27, 2006, our subsidiary Exton Ranch, Inc. repaid the entire outstanding principal balance (and accrued interest) of the \$3,348 million mortgage note.

Item 5 Other Information

As disclosed in the Company's Proxy Statement dated June 23, 2006, the Board of Directors currently consists of nine directors, a majority of whom are independent in accordance with Rule 4200 (15) of the NASDAQ Marketplace Rules and as determined by the Board after consideration of all applicable and relevant laws, rules and facts. Further, the Board has established 4 committees; Executive, Audit, Compensation and Nominating/Governance, and all of the directors serving on the Audit Committee and the Compensation Committee are independent. A majority of the directors serving on the Nominating/Governance Committee are likewise independent with one non-independent director, Mr. Stewart B. Reed. Mr. Stewart B. Reed does not qualify as an independent director under Rule 4200(15)(B) because of a consulting arrangement with Mestek, Inc. (the Company's former parent corporation) in each of the three preceding years; however, Mr. Stewart B. Reed is not a current officer or employee of the Company, or a family member of an officer or employee of the Company, nor does he have any relationship to or with the Company that may compromise his independence from management and the Company, or the performance of his duties as members of the Nominating/Governance Committee. Mr. Stewart B. Reed does own approximately twenty-five percent (25%) of the outstanding capital stock of the Company. Mr. Stewart B. Reed was appointed to the Nominations/Governance Committee under exceptional and limited circumstances, and the Board has determined that Mr. Stewart B. Reed's membership on the committee is required by the best interests of the Company and its shareholders. Such appointment is permitted under Rule 4350(c)(4)(C). A member appointed under this exception may not serve longer than two years.

Item 6 - Exhibits And Reports On Form 8-K

Exhibit

| <u>No.</u> | <u>Description</u> |
|-------------------|--|
| 31.1 | Certification of Chief Executive Officer of Omega Flex, Inc. pursuant to Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of Chief Financial Officer of Omega Flex, Inc. pursuant to 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer of Omega Flex, Inc., pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

(b) Reports on Form 8-K:

The Company filed a Report on Form 8-K on July 25, 2006 regarding Results of Operations and Financial Condition to report earnings for the quarter ended June 30, 2006.

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.

OMEGA FLEX, INC.
(Registrant)

Date: August 9, 2006

By: /S/ E. Lynn Wilkinson
E. Lynn Wilkinson
Vice President Finance
and Chief Financial Officer