

Omega Flex, Inc.
Form 10-K
March 28, 2008
UNITED STATES OF AMERICA

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2007

Or

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

For the transition period from _____ to _____

Commission File Number **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)

Registrant's telephone number, including area code

610-524-7272

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Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common

Name of each exchange on which registered
The NASDAQ Stock Market LLC

Securities registered pursuant to section 12(g) of the Act:

Not applicable

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of voting and non-voting common shares held by non-affiliates of the registrant as of June 30, 2007, the last business day of the most recently completed second quarter of 2007 was \$61,316,409.

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APPLICABLE ONLY TO REGISTRANTS 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 Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

The number of shares of the registrant's common stock issued and outstanding as of March 28, 2008 was 10,108,287.

Portions of the registrant's definitive proxy statement relating to the registrant's 2007 Annual Meeting of Shareholders to be filed hereafter are incorporated by reference into Part III (Items 10-14) of this Report on Form 10-K and certain Exhibits to previous filings with the Securities and Exchange Commission are incorporated by reference into Part IV, Item 15 of this Report on Form 10-K.

PART I

Item 1 - BUSINESS

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K that are not historical facts -- but rather reflect our current expectations concerning future results and events -- constitute forward-looking statements. The words believes, expects, intends, plans, anticipates, intend, estimate, potential, continue, hopes, likely, will, and similar expressions, or the negative of these terms, identify such forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements of Omega Flex, 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 annual report statement. We undertake 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.

GENERAL

DESCRIPTION OF OUR BUSINESS

Overview of the Company

We are a leader in the manufacture and sale of flexible metal hose for applications in conveying various liquids and gases within a number of diverse industries, including construction, transportation, steel, pharmaceutical, and petrochemical. The various product lines include corrugated metal hoses in a broad range of sizes and alloys, including three grades of stainless steel, bronze, Inconel and Hastelloy. We also manufacture a wide range of pressure reinforcing braids for our hoses in both metallic and synthetic constructions. These products are used in a wide variety of applications primarily for the processing industries, transportation industry, medical and semiconductor markets, and for instrumentation, as well as the construction industry.

Industry Overview

The flexible metal hose industry is highly fragmented and diverse, with over 10 companies producing flexible metal hose in the United States, and at least that many in Europe and Asia. Because of its simple and ubiquitous nature, flexible metal hose can be applied and has been applied to a number of different applications across a broad range of industries.

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The major market categories for flexible metallic hose include automotive, aerospace, residential and commercial construction, and general industrial. Omega Flex participates in the latter two, which in the aggregate represent about 50% of the total market opportunity for flexible metallic hose. The major use of corrugated stainless steel tubing in the residential and commercial construction markets is primarily for flexible gas piping and gas appliance

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connectors and secondarily as pump connectors and seismic loops to isolate vibration in mechanical piping systems in commercial buildings. The general industrial market includes all of the processing industries, the most important of which include primary steel, petrochemical, pharmaceutical, and specialty applications for transfer of fluids at both extremely low and high temperatures, (such as the conveying of cryogenic liquids) and a highly fragmented OEM market, as well as a maintenance and repair market.

None of our competitors is dominant in more than one market. We are a leading supplier of flexible metal hose in each of the two broad markets in which we participate. Our assessment of our overall competitive position is based on several factors. The flexible gas piping market in the U.S. is currently concentrated in the residential housing market, and based on the reports issued by the national trade groups on housing construction, the level of acceptance of flexible gas piping in the construction market, and the average usage of flexible gas piping in a residential building, we are able to estimate with a high level of accuracy the size of the total gas piping market, and, based on our sales, our position within that market. For other applications, industry trade groups collect and report on the size of the relevant market, and we can estimate our percentage of the relevant market based on our sales as compared to the market as a whole.

Furthermore, the customer base for the products that we sell is widely known, as is the identity of the manufacturers aligned with those customers. Independent manufacturers' sales representatives have good estimates and in many cases, factual information on the volume of purchases of customers in their territories. Because there are gross differences in the market shares of many of the competing manufacturers, it is possible to reasonably assess shared positions. Large national accounts also have a sense as to shared positions as well, because they have relationships with most of the competing manufacturers and will share opinions. Lastly, the term "leading" implies a host of factors other than sales volume and market share position. This includes the range and capability of the product line, history of product development and new product launches, all of which information is in public domain. Based on this alone, we are without question the undisputed leader in at least one of the two major market segments in which we participate.

Development of Business

We were incorporated in 1976 under the name of Tofle America, Inc. as the subsidiary of a Japanese manufacturer of flexible metal hose. For a number of years, we were a manufacturer of flexible metal hose that was sold primarily to customers using the hose for incorporation into finished assemblies for industrial applications. We later changed our name to Omega Flex, Inc., and in 1996, we were acquired by Mestek, Inc. In 1997, we introduced our first new product TracPip® corrugated stainless steel tubing for use in carrying fuel gas within residential, commercial and industrial buildings. Our growth since 1997 has been primarily as a result of the growth in the use and acceptance of corrugated stainless steel tubing as an alternative to the traditional black iron pipe throughout the construction industry, and through the development of our AutoFlare® patented fittings and accessories to the corrugated stainless steel tubing that differentiate our systems from those of our competitors. In 2004, we introduced a brand of corrugated stainless steel tubing under the registered trademark CounterStrike® that is designed to be more resistant to damage caused by transient arcing of electrical energy. In 2007, we introduced a new version of CounterStrike® CSST that is 6 times more effective than the original version. In January 2005, Mestek announced its intention to distribute its equity ownership in our common stock to the Mestek shareholders. A registration statement for the Omega Flex

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common stock was filed with the Securities and Exchange Commission and the registration statement was declared effective on July 22, 2005. We also listed our common stock on NASDAQ National Market (now the NASDAQ Global Market) under the stock symbol OFLX, and began public trading of our common stock on August 1, 2005. All Mestek shareholders as of the record date for the distribution received one share of Omega Flex common stock for each share of Mestek common stock owned as of the record date. We are now a totally separate company from Mestek, and we do not use or share any material assets or service of Mestek in conducting our business. Our operating plans for 2008 are to continue to grow the distribution and sale of our TracPipe® flexible gas piping and industrial products, as well as to nurture new product development.

Overview of Current Business

Products

We have had the most success within the residential construction industry where our TracPipe® and CounterStrike® flexible gas piping have enjoyed wide acceptance due to their reliability and durability. Within that industry, the flexible gas piping products that we offer and similar products offered by our competitors have sought to overcome the use of black iron pipe that has traditionally been used by the construction industry in the United States and Canada for the piping of fuel gases within a building. Prior to the introduction of the first corrugated stainless steel piping system in 1989, nearly all construction in the United States and Canada used traditional black iron pipe for gas piping. However, the advantages of corrugated stainless steel tubing in areas subject to high incidence and likelihood of seismic events had been first demonstrated in Japan. In a seismic event, the corrugated stainless steel tubing was shown to withstand the stresses on a piping system created by the shifting and movement of a seismic event better than rigid pipe. However, the advantages of corrugated stainless steel tubing over the traditional black iron pipe also include lower overall installation costs because the corrugated stainless steel tubing can be installed in long uninterrupted lines within the building.

The flexibility of the tube allows it to be bent by hand without any tools when a change in direction in the line is required. In contrast, black iron pipe requires that each bend in the pipe have a separate fitting attached. This requires the installer to thread the ends of the black iron pipe, apply an adhesive to the threads, and then screw on the fitting, all of which is labor intensive and costly, including testing and rework if the work is not done properly. As a result of these advantages, corrugated stainless steel tubing now commands slightly over one-half of the market for fuel gas piping in new and remodeled residential construction in the United States, and the use of rigid iron pipe and to a lesser degree copper tube, accounts for the remainder of the market.

From its introduction in 1997, TracPipe® flexible gas piping has grown to be our primary product line, with other applications representing a minor portion of our business. While we remain firmly committed to maintaining a presence in the other applications and markets for flexible metal hose (both because of the opportunities in those applications and because they suggest new markets and new applications), we have increasingly become an organization oriented to the manufacture and distribution of flexible gas piping products. The growth in the flexible gas piping application domestically has superseded the prior technologies represented by traditional black iron pipe or copper tube. We plan to continue our growth through continued inroads against older technologies, in both the residential and commercial markets, in the United States and overseas in geographic areas that have access to natural gas distribution systems.

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In 2004, we introduced a new brand of flexible gas piping sold under the registered trademark CounterStrike®. CounterStrike® is designed to be more resistant to damage from transient electrical arcing. This feature is particularly desirable in areas that are subject to high levels of lightning strikes, such as the Southeast, and the Ohio Valley. In a lightning strike, the electrical energy of the lightning can energize all metal systems and components in a building. This electrical energy in attempting to reach ground may arc between metal systems that have different electrical resistance, and arcing can cause damage to the metal systems. In standard CSST systems, an electrical bond between the CSST and the building's grounding electrode would address this issue, but lightning is an extremely powerful and unpredictable force. CounterStrike® CSST is designed to be electrically conductive to disperse the energy of any electrical charge over the entire surface of the CounterStrike® line. In 2007, we introduced a new version of CounterStrike® CSST that was tested to be 6 times more resistant to damage from electrical arcing than the original version, and between 50 to 400 times more effective than standard CSST products. As a result of its robust performance, the new version of CounterStrike® has been warmly received in the market, and is a validation of our market leadership in the industry.

As noted below, our flexible metal hose is used in a wide variety of applications besides flexible gas piping. Our involvement in these markets is important because just as the flexible gas piping applications have sprung from our expertise in manufacturing annular metal hose, so other applications may also evolve from our participation in the industry. For example, we currently have several development projects underway in various stages for several new applications, including transportation, high purity gases, and underground pre-sleeved applications. Our transportation products require some additional development and testing for the product to begin to reach its potential and begin full commercialization. Our high purity gas and underground pre-sleeved applications are still in development.

Flexible metal hose is also used in a wide variety of industrial and processing applications where the unique characteristics of the flexible hose in terms of its flexibility, and its ability to absorb vibration and thermal expansion and contraction, has unique benefits over rigid piping. For example, in certain pharmaceutical processing applications, the process of developing the specific pharmaceutical may require rapid freezing of various compounds through the use of liquefied gases, such as liquefied nitrogen, helium or Freon. The use of flexible metal tubing is particularly appropriate in these types of applications. Flexible metal hose can accommodate the thermal expansion caused by the liquefied gases carried by it through the hose, and the total length of the hose will not significantly vary. In contrast, fixed or rigid metal pipe would expand and contract along its length as the liquid gases passed through it, causing stresses on the pipe junctions that would over time fatigue and fail. Alternatively, within certain industrial or commercial applications using steam, either as a heat source or in the industrial process itself, the pumps used to transfer the liquid or steam within the system are subject to varying degrees of vibration. Flexible metal hoses can be used as connections between the pump and the intake of the fluids being transferred to eliminate the vibration effects of the pumps on the piping transfer system.

In late 2007, after several years of development and testing, we also unveiled our newest product, DoubleTrac® flexible underground petroleum piping, which is used for piping of automobile filling stations and other underground petroleum piping applications. The DoubleTrac® piping is installed underground between the main storage tank and the dispensing pump. The DoubleTrac® piping offers several benefits that are important to its customers; zero

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permeability of the liquid fuel through the sidewall of the pipe, and ease of installation. Currently, most underground petroleum piping in the United States uses rigid fiberglass pipe that requires fittings at junctions, changes in direction, or the end of the pipe sections. The fiberglass pipe also has some permeability of fuel through the sidewall of the rigid pipe. DoubleTrac[®] resolves both of these issues through the use of a double-wall flexible pipe that uses a primary interior layer of stainless steel that has a zero permeation level, together with a secondary outer barrier layer of durable plastic. The DoubleTrac[®] pipe can be installed in long continuous lengths, eliminating the labor costs and delays associated with rigid pipe. The DoubleTrac[®] pipe also has a system for continuous leak detection in the unlikely event the inner stainless steel layer is breached. DoubleTrac[®] has recently received all necessary product approvals from Underwriters Laboratories, and is fully compliant with the UL971 product standard. We expect full commercialization of DoubleTrac[®] to begin in 2008.

Manufacturing

In each instance, whether the application is for corrugated stainless steel tubing for fuel gases, flexible metal hose for handling specialty chemicals or gases, flexible underground petroleum piping, or unique industrial applications requiring ability to withstand wide variations in temperature and vibration, all of our success rests on the metal hose made by Omega Flex. Most of our flexible metal hoses range in diameter from 1/4" to 2" while certain applications require diameters of up to 14". All of our smaller diameter pipe (2" inner diameter and smaller) is made by a proprietary process that is known as the rotary process. The proprietary process that we use to manufacture our annular hose is the result of a long-term development effort begun in 1995. Through continuous improvement, we have over the years developed and fine-tuned the process so that we can manufacture annular flexible metal hose on a high speed, continuous process. We believe that our own rotary process for manufacturing annular corrugated metal hose is the most cost efficient method in the industry, and that our rotary process provides us with a unique advantage in many of the industries in which we participate. As a result, we are able to provide our product on a demand basis. In 2007, we achieved a delivery performance to the scheduled ship date of over 96%. The quick inventory turnover reduces our costs for in-process inventory, and further contributes to our gross margin levels. We have also improved our productivity on an historical basis.

Raw Materials

We use various materials in the manufacture of our products, primarily stainless steel for our flexible metal hose and plastics for our jacketing material on TracPipe[®] and CounterStrike[®] flexible gas piping. We also purchase all of our proprietary AutoFlare[®] brass fittings for use with the TracPipe[®] and CounterStrike[®] flexible gas piping. Although we have multiple sources qualified for all of our major raw materials and components, we have historically used one or two sources of supply for such raw materials and components. Our current orders for stainless steel and fittings are each placed with one or two suppliers. If any one of these sources of supply were interrupted for any reason, then we would have to devote additional time and expense in obtaining the same volume of supply from our other qualified sources. This potential transition, if it were to occur, could affect our operations and financial results during the period of such transition. Commodities markets in general and stainless steel in particular has had significant upward price movement in 2007, resulting in increasing costs to manufacture products and, in some cases, a tightening supply. Although somewhat relaxed in late 2007, we believe that with our purchase commitments for stainless steel, polyethylene and for our proprietary fittings, that

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we have adequate sources of supply for these raw materials and components for 2008. We have not had significant difficulty in obtaining the raw materials, component parts or finished goods from our suppliers in prior years. We believe that constriction in the supply of stainless steel will continue until additional global capacity becomes available. Continued volatility in the commodities marketplace and competitive conditions in the sale of our products may not allow us to pass along raw materials or component part price increases to our customers.

Business Seasonality

The demand for our TracPipe® and CounterStrike® flexible gas piping product may be affected by the construction industry's demand, which generally may slacken in the winter months of each year due to cold and inclement weather. Accordingly, sales growth is usually higher in the spring, summer and fall, while sales in the winter may be static or rise only modestly. However, the effect of the winter weather may be offset by the increase in demand for flexible gas piping products in general as more contractors and installers choose to use flexible gas piping rather than black iron pipe.

Customers

We sell our products to customers scattered across a wide and diverse set of industries from construction to pharmaceutical with approximately 4,600 customers. These sales channels include sales through independent sales representatives, distributors, original equipment manufacturers, direct sales, and sales through our website on the internet. We utilize various distribution companies in the sale of our TracPipe® flexible gas piping, and these distribution customers in the aggregate represent a material portion of our business. In particular, our customer, Ferguson Enterprises, and its various branches, represents 19% of our net sales and 17% of our accounts receivable balance at December 31, 2007. All of this business is done on a purchase order basis for immediate resale commitments or stocking, and there are no long-term purchase commitments. In the event we were to lose an account, we would not expect any long-term reduction in our sales due to the broad end-user acceptance of our products. We would anticipate that in the event of a loss of any one or more distributors, that after an initial transition period, the sale of our products would resume at or near their historical levels. Furthermore, in the case of certain national distribution chains like Ferguson and other distributors, it is possible that there would continue to be purchasing activity from one or more regional or branch distribution customers. We sell our products within North America, primarily in the United States and Canada, and we also sell our products internationally, primarily in Europe through our facility located in Banbury, England. Our sales outside of North America represent approximately 12% of our total net sales, with most of the sales occurring in the United Kingdom and elsewhere in Europe. We do not have a material portion of our long-lived assets located outside of the United States, and due to its small size, the foreign operations do not carry any additional risk from being located outside of the United States.

Distribution of Sales

As mentioned previously, we sell our products primarily through independent outside sales organizations, including independent sales representatives, distributors, fabricating distributors, wholesalers, and OEMs. We have a limited internal sales function that sells our products to key accounts, including OEMs and distributors of bulk hose. We believe that within each geographic market in which the independent sales representative, distributor or wholesaler

is located that our outside sales organizations are the first or second most successful outside sales organization for the particular product line within that geographic area.

Competition

There are approximately ten manufacturers of flexible metal hose in the United States, and approximately that number in Europe, several in South America, and six to eight in Asia. The U. S. manufacturers include Titeflex Corporation, Parker Hannifin Corporation, Ward Manufacturing, Truflex, Microflex, U. S. Hose, Hose Master, and several smaller privately held companies. No one manufacturer, as a general rule, participates in more than two of the major market categories as outlined above with most concentrating in just one. We estimate that we hold a number one or number two share position in the two major market categories in which we participate. In the flexible gas piping market, the U.S. market is currently concentrated in the residential housing market, and based on the reports issued by the national trade groups on housing construction, the level of acceptance of flexible gas piping in the construction market, and the average usage of flexible gas piping in a residential building, we are able to estimate with a high level of accuracy the size of the total gas piping market, and based on our sales our position within that market. For other applications, industry trade groups collect and report on the size of the relevant market, and we can estimate our percentage of the relevant market based on our sales as compared to the market as a whole. The larger of our two markets, the construction industry, has seen a reduction in the number of housing starts in 2007. As discussed elsewhere, black iron pipe or copper tube was historically used by all builders of commercial and residential buildings until the advent of flexible gas piping and changes in the relevant building codes. Since that time, flexible gas piping has taken an increasing share of the total amount of fuel gas piping used in construction, until at present we estimate that flexible gas piping is slightly more than one-half of the market for the residential component, but significantly less for commercial. Within the flexible gas piping market, we compete against five other manufacturers of flexible metal hose, including Titeflex, Parker Hannifin, and Wardflex.

In the industrial market, due to the number of applications in which flexible metal hose may be used, and the number of companies engaged in the manufacture and sale of flexible metal hose, the market is very fragmented, and we estimate that no one company has a predominant market share of the business over other competitors. The general industrial markets within Europe are very mature and tend to offer opportunities which are interesting to us in niche markets or during periods in which a weak dollar increases the demand for our products on a competitive basis. Such has been the case for several years and has created new relationships for us. Currently, we are not heavily engaged in the manufacture of flexible metal hose for the aerospace or automotive markets, but we continue to review opportunities in all markets for our products to determine appropriate applications that will provide growth potential and high margins. In some cases, where the product offering is considered a commodity, price is the overriding competing factor. In other cases, a proprietary product offering or superior performance will be the major factors with pricing being secondary and in some cases, a non-factor. The majority of our sales are to distributors and wholesalers, and our relationships with these customers are on an arms-length basis in that neither we, nor the customers are so dependent on the other to yield any significant business advantage. From our perspective, we are able to maintain a steady demand for our products due to the broad acceptance of our products by end users, regardless of which distributor or wholesaler sells the product.

Backlog

Management does not believe that backlog figures are material to an understanding of our business because most products are shipped promptly after the receipt of orders.

Intellectual Property

We have a comprehensive portfolio of intellectual property, including approximately 149 patents issued in 31 countries around the world. The patents cover (a) the AutoFlare[®] fittings used by the flexible gas piping to join the piping to a junction or assembly, (b) pre-sleeved corrugated stainless steel tubing for use in underground applications, (c) an electrically conductive jacket for flexible gas piping that we sell under the trademark CounterStrike[®], and (d) a tubing containment system for our DoubleTrac[®] flexible underground petroleum piping. Our AutoFlare[®] fitting is the leading fitting for use with flexible gas piping because it offers a metal-to-metal seal between the fitting and the tubing, and because of its robustness and ease of use. The metal-to-metal contact provides for a longer lasting and more reliable seal than fittings which use gaskets or sealing compounds that can deteriorate over time. In applications involving fuel gases in a building, the ability to maintain the seal and prevent the leaking of such gases over long periods of time is valued by our customers. We also have received a patent for the composition of the polyethylene jacket used in our CounterStrike[®] flexible gas piping product, which has increased ability to dissipate electrical energy in the event of a nearby lightning strike. The tubing containment system of our DoubleTrac[®] flexible underground petroleum piping, which is also patented in the U.S. and in other countries, allows for the monitoring and collection of any liquids that may leak from the stainless steel containment layer. The expiration dates for the several patents covering our AutoFlare[®] fittings will expire between 2016 and 2020 and the Counterstrike[®] patent will expire 2025. We currently have several patent applications pending in the United States and internationally covering improvements to our AutoFlare[®] fittings and our CounterStrike[®] polyethylene jacket. Finally, and as mentioned above, our unique rotary process for manufacturing flexible metal hose has been developed over the last ten years, and constitutes a valuable trade secret. In a recently concluded case, a Pennsylvania court has issued a ruling that confirms our proprietary rotary manufacturing process does constitute a trade secret under Pennsylvania law, and is entitled to protection against unauthorized disclosure or misappropriation.

We are currently engaged in a case currently pending in the U.S. District Court in Massachusetts, in which we have sued a flexible gas pipe competitor for infringement on one or more of our U.S. patents covering our AutoFlare[®] fittings. The court has found that the defendants have infringed on our patent, and the case is scheduled for trial in May 2008 on the sole issue of the validity of our patent. See Item 3 Legal Proceedings for a more detailed description of the litigation.

Employees

As of December 31, 2007, we had 125 employees. Most of our employees are located in our main facility in Exton, Pennsylvania, which is currently our main manufacturing facility, and which contains our engineering, finance, human resources and most sales personnel. Our factory workforce in Exton, Pennsylvania is not represented by a collective bargaining agent. We also maintain an office in Middletown, Connecticut where six employees in management and sales are primarily assigned. A number of individual sales personnel are scattered across the United

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States. We also maintain a facility in Banbury, England. The operation in England has a total of twelve people. The sales personnel in England handle all sales and service for our products in Europe and select accounts in Asia and the Middle East.

Environmental

Our manufacturing processes do not require the use of significant quantities of hazardous substances or materials, and therefore we are able to operate our Exton facility as a small quantity generator under the Resource Conservation and Recovery Act, 42 U.S.C. §§ 321 *seq.* As a result, compliance with federal, state and local environmental laws do not pose a material burden on our business, and we are not required to expend any material amounts on capital expenditures for environmental control facilities for our manufacturing facility.

Internet Website

You may learn more about our company by visiting our website at www.omegaflex.com. Among other things, you can access our filings with the Securities and Exchange Commission. These filings include annual reports (Form 10-K), quarterly reports (Form 10-Q), and current reports (Form 8-K), as well as Section 16 reports filed by our officers and directors (Forms 3, 4 and 5). All of these reports will be available on the website as soon as reasonably practicable after we file the reports with the SEC. You may also view on our website the following important corporate governance documents:

Code of Business Ethics

Corporate Governance Guidelines

Charters for each of the Board committees

Policy on receiving complaints regarding account or internal control issues

Item 1B UNRESOLVED STAFF COMMENTS

We do not have any unresolved comments from the staff of the Securities and Exchange Commission.

Item 2 - PROPERTIES

Our main facility is located in Exton, Pennsylvania about one hour west of Philadelphia and contains about 83,000 square feet of manufacturing and office space. We lease our Exton facility from Exton Ranch, Inc., our wholly-owned subsidiary. We lease additional non-manufacturing space in Downingtown, Pennsylvania approximately 5 miles from the main plant. The majority of manufacturing of our flexible metal hose is done at the Exton facility. The corporate office of Omega Flex, Inc. in Middletown, Connecticut is rented. In the United Kingdom, we rent a facility in Banbury, which manufactures products and serves sales, warehousing and operational functions as well.

Item 3 - LEGAL PROCEEDINGS

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The Company is not presently involved in any litigation that it believes could materially and adversely affect its financial condition or results of operations, except as described in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations-under the sub-caption Commitments .

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We were involved in a putative class action litigation filed in the Clark County Circuit Court, in Arkansas, alleging that our corrugated stainless steel tubing product, TracPipe® and similar products manufactured by several other manufacturers (also named as defendants in the case) was defective against potential damage caused by nearby lightning strikes. On September 5, 2006, we entered into a Stipulation and Settlement Agreement with the Class Representatives and Class Counsel, to settle and resolve the allegations brought forth in the lawsuit. We and the other defendants deny all of the allegations in the lawsuit, and deny any wrongdoing or legal liability, but agreed to settle this matter to avoid further cost and the uncertainty and risk of the outcome of further litigation. A copy of the Settlement Agreement has been filed as an exhibit to the Current Report on Form 8-K that we filed with the Securities and Exchange Commission on September 6, 2006, and is available on our website at www.omegaflex.com. The court gave final approval to the Settlement Agreement on February 1, 2007. The remedial program provided under the Settlement Agreement is currently processing claims from class members as provided under the Settlement Agreement. The deadline for submitting such claims was September 5, 2007.

We are currently engaged in a patent infringement case in which we have sued a flexible gas pipe competitor for infringement on one or more of our U.S. patents covering our AutoFlare® fittings. We have alleged that the competitor has infringed on one or more of our patents covering the AutoFlare® fittings by including certain patented features in the competitor's fitting, including a locator sleeve that makes it easier to align the connection. The trial court has ruled that the competitor did infringe on one or more of our AutoFlare® patents, and that the AutoFlare® patents are valid. An appeals court reversed the trial court's ruling on validity of our patent, and the case is scheduled for trial in May 2008 on the sole issue of whether our patent is valid under U.S. patent law. If the patent is upheld as being valid, then the damages due to Omega Flex have been previously determined.

In another case that was pending in the Court of Common Pleas in Chester County, Pennsylvania, we sued a former employee and a flexible metal hose competitor to enjoin the disclosure of our trade secrets covering our proprietary rotary manufacturing process. In this case, a former long-term employee left our company to work for a competitor who is engaged in the flexible metal hose market. The former employee had been involved in the development and/or refinement of aspects of the rotary process manufacturing method, and had detailed knowledge of our trade secrets concerning this manufacturing method. We filed suit to enjoin any disclosure of our trade secrets by the former employee to his new employer, to enforce certain terms of an employment agreement previously signed by the former employee, and to obtain damages for any unauthorized disclosure or misappropriation of our trade secrets. The case went to trial in March 2006, and the court issued its decision in July 2006, ruling that our proprietary rotary process for manufacturing corrugated stainless steel tubing was a trade secret under Pennsylvania law, and was to be accorded protection against unauthorized disclosure or misappropriation. The defendants were permanently enjoined from disclosing the trade secrets, or using the trade secrets in their business. At trial, we did not bring a claim for monetary damages, and no monetary damages were awarded by the court.

Item 4 - SUBMISSION OF MATTER TO A VOTE OF THE SECURITY HOLDERS

No matters were submitted to the security holders of the Company for a vote during the fourth quarter of 2007.

PART II

Item 5 - MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Common Stock

Our common stock is listed on the NASDAQ Global Market, under the symbol OFLX. The number of shareholders of record as of March 30, 2008, based on inquiries of the registrant's transfer agent, was 809. For this purpose, shareholders whose shares are held by brokers on behalf of such shareholders (shares held in street name) are not separately counted or included in that total.

The following table sets forth, for the periods indicated, the high and low closing sale prices for our common stock as reported by the NASDAQ Global Market.

PRICE RANGE

| | <u>2007</u> | | <u>2006</u> | |
|----------------|--------------------|-------------------|--------------------|-------------------|
| | <u>high</u> | <u>low</u> | <u>high</u> | <u>low</u> |
| First Quarter | \$23.32 | \$20.23 | \$19.40 | \$15.05 |
| Second Quarter | \$22.64 | \$18.91 | \$20.05 | \$16.15 |
| Third Quarter | \$19.66 | \$14.75 | \$25.43 | \$19.00 |
| Fourth Quarter | \$18.00 | \$12.94 | \$23.30 | \$18.27 |

We do not have any other securities, other than common stock, listed on a stock exchange or are publicly traded.

Dividends

We have declared two special dividends on our common stock between the period of 2006 and 2007.

On December 11, 2006, the Board of Directors authorized a special dividend of \$0.40 per share to all shareholders of record as of January 2, 2007, and payable as soon as practicable. The payment in the amount of \$4,061 was subsequently paid on January 16, 2007.

On December 11, 2007, the Board authorized a special dividend of \$0.70 per share to all Shareholders of record as of January 3, 2008, and subsequently paid on January 16, 2008 in the amount of \$7,092.

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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.

The Company adopted the Omega Flex, Inc. 2006 Phantom Stock Plan during 2006 as described in Note 13. There are no plans to institute any other such plan at this time.

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Item 7 - 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 Annual Report on Form 10-K 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-K. 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

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, 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® and CounterStrike® flexible gas piping allows users to substantially cut the time required to install the gas piping, as compared to traditional methods. Most of the Company's products are manufactured at the Company's Exton, Pennsylvania facility with a minor amount of manufacturing performed in the UK. 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

(All dollars in thousands)

During 2007, the Company's cash balance has decreased \$4,281 from \$17,424 at December 31, 2006 to \$13,143 at December 31, 2007. Some of the major transactions that affected our cash balance were a \$4,061 special dividend payment made on January 16, 2007, and a payment of \$6,000 on March 7, 2007 pursuant to the Settlement Agreement outlined in Note 11 of the year-end Form 10-K. Those payments were partially offset by cash generated from earnings for the year.

Accrued Legal Settlement and Related Costs have decreased \$5,184 with a detailed description provided in Note 11, Commitments and Contingencies.

As discussed in Note 7, Shareholders' Equity, in December of 2007 the Company declared a dividend, which amounted to \$7,092. In addition, the Company paid a \$4,061 dividend on January 16, 2007, which was declared in 2006.

RESULTS OF OPERATIONS

(All dollars in thousands)

Three-months ended December 31, 2007 vs. December 31, 2006

The Company reported comparative results from continuing operations for the three-month period ended December 31, 2007 and 2006 as follows:

| | <u>Three-months ended December 31,</u> | | | |
|-------------------|---|--------------------|-----------------------|--------------------|
| | (in thousands) | | | |
| | <u>2007</u> | <u>2007</u> | <u>2006</u> | <u>2006</u> |
| | <u>(\$000)</u> | <u>%</u> | <u>(\$000)</u> | <u>%</u> |
| Net Sales | \$19,711 | 100.0% | \$19,068 | 100.0% |
| Gross Profit | \$11,657 | 59.1% | \$ 9,873 | 51.8% |
| Operating Profits | \$ 5,621 | 28.5% | \$ 4,315 | 22.6% |

The Company's sales increased \$643 (3.4%) from \$19,068 in the three-month period ended December 31, 2006 as compared to \$19,711 in the three-month period December 31, 2007. The increase in revenue for the three-months reflects continued penetration in the non-residential construction market and price increases realized during the quarter. Those factors were partially offset by continued weakness in the residential construction industry. Overall volume for the quarter was down 8.7%.

The Company's gross profit margins increased from 51.8% in the three-month period ended December 31, 2006 to 59.1% in the three-month period ended December 31, 2007. The increase in margin is the result of a decrease in the cost of the Company's primary raw materials during the quarter, in particular stainless steel combined with strategic price increases previously noted.

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, and freight. Selling expense was in line with the prior year at \$3,021 and \$3,039 for the three months ended December 31, 2006 and 2007, respectively. Sales expense as a percentage of sales decreased from 15.8% for the three-months ended December 31, 2006 to 15.4% for the three-months ended December 31, 2007.

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 \$1,883 and \$2,220 for the three months ended December 31, 2006 and 2007, respectively. The \$337 increase in expenses is mostly attributable to an increase in staffing related expenses, and consulting fees. For the preceding reasons, general and administrative expense, as a percentage of sales, increased from 9.9% for the three months ended December 31, 2006 to 11.3% for the three months ended December 31, 2007.

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Legal Settlement and Related Costs. Legal charges related to the Arkansas litigation in the final three months of 2006 and 2007, were \$175 and \$31, respectively. Further details are provided in Note 11, Commitments and Contingencies. The majority of the costs associated with this litigation are behind the Company.

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 \$479 and \$746 for the three months ended December 31, 2006 and 2007 respectively. The \$267 increase in engineering expenses is mostly due to an increase in new product development costs and partially due to increases in consulting and engineering staffing. Accordingly, engineering expenses as a percentage of sales grew to 3.8% for the three months ended December 31, 2007 from 2.5% for the three months ended December 31, 2006.

Reflecting all of the factors mentioned above, Operating Profit margins increased \$1,306 from a profit of \$4,315 in the three-month period ended December 31, 2006 to a profit of \$5,621 in the three-month period ended December 31, 2007. The increase in Operating Profit was primarily as a result of the negative effect of the legal settlement of the class action litigation on the fourth quarter 2006 operating results.

Interest Income-Net. Interest income-net includes interest income on the note receivable from Mestek and interest income on our interest-bearing investments.

Other Income-Net. Other Income-net primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our U.K. subsidiary.

Income Tax Expense. The Company's effective tax rate in 2007 approximates the 2006 rate and does not differ materially from expected statutory rates.

Twelve-months ended December 31, 2007 vs. December 31, 2006

The Company reported comparative results from continuing operations for the twelve-month period ended December 31, 2007 and 2006 as follows:

Twelve-months ended December 31,

(in thousands)

| | <u>2007</u> | <u>2007</u> | <u>2006</u> | <u>2006</u> |
|-------------------|-----------------------|--------------------|-----------------------|--------------------|
| | <u>(\$000)</u> | <u>%</u> | <u>(\$000)</u> | <u>%</u> |
| Net Sales | \$74,510 | 100.0% | \$73,574 | 100.0% |
| Gross Profit | \$36,054 | 48.4% | \$38,158 | 51.9% |
| Operating Profits | \$13,212 | 17.7% | \$7,444 | 10.1% |

The Company's sales increased from \$73,574 in the twelve-month period ended December 31, 2006 as compared to \$74,510 in the twelve-month period ended December 31, 2007. Sales reflect growth in the non-residential construction and international markets coupled with strategic price

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increases. These increases were however, dampened by a decrease in sales in the residential construction industry. Overall volume for the twelve months was down 7.5%.

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The Company's gross profit margins have decreased from 51.9% in the twelve-month period ended December 31, 2006 to 48.4% in the twelve-month period ended December 31, 2007, indicative of increases to the cost of the Company's primary raw materials, particularly stainless steel.

Selling Expenses. Selling expense was \$11,493 and \$11,976 for the twelve-months ended December 31, 2006 and 2007, respectively. The \$483 increase in selling expenses is mostly due to increases in various marketing programs, but also attributable to increased staffing and related costs. Sales expense as a percentage of sales increased to 16.1% for the twelve-months ended December 31, 2007 as compared to 15.6% for the twelve-months ended December 31, 2006.

General and Administrative Expenses. General and administrative expenses increased from \$6,833 in 2006 to \$7,657 for the twelve-months ended December 31, 2007. The \$824 increase was mostly attributable to staffing related expenses and consulting. As a percentage of sales, general and administrative costs increased from 9.3% for the twelve-months ended December 31, 2006 to 10.3% for the twelve-months ended December 31, 2007.

Legal Settlement and Related Costs. Legal charges related to the Arkansas litigation in the twelve months of 2006 and 2007, were \$10,499 and \$516, respectively. Further details are provided in Note 11, Commitments and Contingencies. The Company believes the majority of the litigation costs associated with this case is behind us.

Engineering Expense. Engineering expenses were \$1,889 and \$2,693 for the twelve-months ended December 31, 2006 and 2007 respectively. The \$804 increase in engineering expenses is largely due to expenditures associated with the certification and qualification of new products and to a lesser extent increased staffing and related costs. Engineering expenses as a percentage of sales were 2.6% for the twelve-months ended December 31, 2006 and 3.6% for the twelve-months ended December 31, 2007.

Reflecting all of the factors mentioned above, Operating Profit margins increased \$5,768 from \$7,444 in the twelve-month period ended December 31, 2006 to \$13,212 in the twelve-month period ended December 31, 2007. The increase in Operating Profit was primarily as a result of the negative effect of the legal settlement of the class action litigation on the 2006 operating results.

Interest Income-Net. Interest income-net includes interest income on the note receivable from Mestek and interest income on our interest-bearing investments. In the first quarter of 2006 the Company paid interest associated with the mortgage on our manufacturing facility; however, as disclosed in the December 31, 2006 10-K, that mortgage was paid off on April 27, 2006.

Other Income-Net. Other Income-net primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our U.K. subsidiary.

Income Tax Expense. The Company's effective tax rate in 2007 approximates the 2006 rate and does not differ materially from expected statutory rates.

COMMITMENTS AND CONTINGENCIES

Commitments:

On September 5, 2006 the Company entered into a Stipulation and Settlement Agreement with the Class Representatives and Class Counsel, to settle and resolve the allegations brought forth in the lawsuit titled *Lovelis, et al. v. Titeflex Corp., Inc., et al.* in the Arkansas Circuit Court, Clark County. All of the other defendants in the case also signed the Settlement Agreement. The lawsuit related to allegations that the Company's CSST products posed an unreasonable risk of fire due to lightning strikes. Both the Company and the other defendants denied these allegations, and denied any wrongdoing or legal liability, but agreed to settle this matter to avoid further cost and the uncertainty and risk of the outcome of further litigation.

The court gave final approval to the Settlement Agreement on February 1, 2007 and dismissed the case. The remedial program provided under the Settlement Agreement processed claims from class members through the deadline of September 5, 2007.

Under the Settlement Agreement, the Company has agreed to pay the value of each payment voucher redeemed by a class member for the installation of a lightning protection system or bonding and grounding of the Company's CSST product. The amount of the voucher is dependent on the geographical area in the United States where the building is located and the size of the heated or air-conditioned area of the building, as set forth in the Settlement Agreement. The Company also agreed to pay a fixed amount of administrative expenses in providing notice to the class, and establishing and operating a claim system under which class members may obtain information, submit claims, and have claims processed. Finally, the Company agreed to pay attorneys' fees to the Class Counsel to resolve this matter.

The Company cannot determine the exact