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FLANDERS CORP
Form 10-Q
August 20, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2001
Commission File No. 0-27958

FLANDERS CORPORATION

(Exact name of registrant as specified in its charter)

North Carolina

13-3368271

(State or other jurisdiction of
incorporation or organization.)

(IRS Employer ID Number)

2399 26th Avenue North, St. Petersburg, Florida

33734

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (727) 822-4411

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

26,033,153 shares common stock, par value \$.001 per share
(Title of Class)

FLANDERS CORPORATION
FORM 10-Q
FOR QUARTER ENDED JUNE 30, 2001

PART I - FINANCIAL INFORMATION

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Item 1 -

Financial Statements

Consolidated Condensed Balance Sheets for June 30, 2001

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FLANDERS CORPORATION AND SUBSIDIARIES CONSOLIDATED CONDENSED BALANCE SHEETS

| ASSETS | June 30, 2001 | December 31, 2000 |
|---------------------------|------------------|----------------------|
| | (unaudited) | |
| Current assets | | |
| Cash and cash equivalents | \$ 453,307 | \$ 1,333,128 |

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| | | |
|---|---------------|---------------|
| Receivables: | | |
| Trade, net of allowance for doubtful accounts of \$1,461,726 at 6/30/2001 and \$1,777,973 at 12/31/2000 | 33,234,664 | 33,481,302 |
| Other | 538,555 | 514,202 |
| Inventories (Note B) | 31,069,744 | 28,299,766 |
| Deferred taxes | 3,020,545 | 3,020,545 |
| Other current assets | 5,940,880 | 6,094,903 |
| | ----- | ----- |
| Total current assets | 74,257,695 | 72,743,846 |
| | ----- | ----- |
| Related party receivables | 533,957 | 385,696 |
| Other assets | 2,555,956 | 2,985,180 |
| Intangible assets, net of accumulated amortization of \$3,242,795 at 6/30/2001 and \$2,812,300 at 12/31/2000 | 28,757,710 | 29,185,805 |
| Property and equipment, net of accumulated depreciation of \$30,320,107 at 6/30/2001 and \$26,451,929 at 12/31/2000 | 76,173,905 | 74,921,196 |
| | ----- | ----- |
| | \$182,279,223 | \$180,221,723 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| ----- | | |
| Current liabilities | | |
| Current maturities of long-term debt | \$ 1,285,040 | \$ 32,832,253 |
| Accounts payable | 18,290,255 | 20,267,236 |
| Accrued expenses and other current liabilities | 7,186,159 | 6,000,140 |
| | ----- | ----- |
| Total current liabilities | 26,761,454 | 59,099,629 |
| Long-term capital lease obligation | 3,294,481 | 3,403,664 |
| Long-term debt, less current maturities | 47,233,068 | 13,134,219 |
| Deferred income taxes | 6,432,927 | 6,432,927 |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Preferred stock, no par value, 10,000,000 shares authorized; none issued | - | - |
| Common stock, \$.001 par value; 50,000,000 shares authorized; issued and outstanding: 26,033,153 shares at 6/30/2001; 26,379,633 at 12/31/2000 | 26,033 | 26,380 |
| Additional paid-in capital | 90,331,524 | 90,898,258 |
| Notes receivable | (8,132,371) | (7,891,208) |
| Retained earnings | 16,332,107 | 15,117,854 |
| | ----- | ----- |
| Total stockholders' equity | 98,557,293 | 98,151,284 |
| | ----- | ----- |
| | \$182,279,223 | \$180,221,723 |
| | ===== | ===== |

See Notes to Consolidated Condensed Financial Statements.

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UNAUDITED CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS

| | Three Months Ended June 30, | | Six |
|--|--------------------------------|---------------|--------------|
| | 2001 | 2000 | 2001 |
| Net sales | \$ 49,916,418 | \$ 50,033,661 | \$ 97,006,19 |
| Cost of goods sold | 39,794,877 | 38,698,340 | 75,507,32 |
| | 10,121,541 | 11,335,321 | 21,498,86 |
| Gross profit | | | |
| Operating expenses | 8,684,879 | 9,263,304 | 18,199,41 |
| | 1,436,662 | 2,072,017 | 3,299,45 |
| Operating income from continuing operations | | | |
| Nonoperating expenses from continuing operations, net | (424,179) | (323,103) | (671,77 |
| | 1,012,483 | 1,748,914 | 2,627,67 |
| Earnings from continuing operations before income taxes | | | |
| Provision for income taxes | 465,993 | 789,565 | 1,201,07 |
| | 546,490 | 959,349 | 1,426,60 |
| Earnings from continuing operations | | | |
| Loss from operations of discontinued operations, net of tax benefit of \$68,06 and \$136,696 for the three months ended June 30, 2001 and 2000, respectively, and \$148,997 and \$371,493 for the six months ended June 30, 2001 and 2000, respectively | (90,950) | (204,924) | (212,35 |
| | \$ 455,540 | \$ 754,425 | \$ 1,214,25 |
| Net earnings | | | |
| Earnings per share from continuing operations | | | |
| Basic | \$ 0.02 | \$ 0.04 | \$ 0.0 |
| Diluted | \$ 0.02 | \$ 0.04 | \$ 0.0 |
| Loss per share from discontinued operations | | | |
| Basic | \$ (0.00) | \$ (0.01) | \$ (0.0 |
| Diluted | \$ (0.00) | \$ (0.01) | \$ (0.0 |
| Net earnings per share | | | |
| Basic | \$ 0.02 | \$ 0.03 | \$ 0.0 |
| Diluted | \$ 0.02 | \$ 0.03 | \$ 0.0 |
| Weighted average common and common equivalent shares outstanding: | | | |
| Basic | 26,033,153 | 25,261,880 | 26,039,01 |
| Diluted | 26,033,153 | 26,472,188 | 26,039,01 |

See Notes to Consolidated Condensed Financial Statements

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FLANDERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY

| | Common Stock | Additional Paid-In Capital | Notes Receivable |
|--|-----------------|----------------------------------|---------------------|
| | ----- | ----- | ----- |
| Balance, January 1, 2000 | \$ 25,436 | \$ 91,798,188 | \$ (6,323,300) |
| Issuance of 2,300,000 shares of common stock upon exercise of options | 2,300 | 2,297,700 | (1,150,000) |
| Issuance of notes receivable | - | - | (357,300) |
| Interest on notes receivable secured by common shares | - | - | (60,590) |
| Cancellation of 150,000 shares related to unmet contingent conditions of acquisitions | (150) | 150 | - |
| Purchase and retirement of 1,206,000 shares of common stock | (1,206) | (3,197,780) | - |
| Net loss | - | - | - |
| | ----- | ----- | ----- |
| Balance, December 31, 2000 | 26,380 | 90,898,258 | (7,891,200) |
| Interest on notes receivable secured by common shares | - | - | (241,160) |
| Purchase and retirement of 354,000 shares of common stock, unaudited | (354) | (585,527) | - |
| Issuance of 7,520 shares of common stock upon exercise of options | 7 | 18,793 | - |
| Net earnings, unaudited | - | - | - |
| | ----- | ----- | ----- |
| Balance, June 30, 2001, unaudited | \$ 26,033 | \$ 90,331,524 | \$ (8,132,370) |
| | ===== | ===== | ===== |

See Notes to Consolidated Condensed Financial Statements

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FLANDERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Three Months Ended June 30, | | Si |
|---|--------------------------------|----------------|--------------|
| | ----- | ----- | ----- |
| | 2001 | 2000 | 2001 |
| | ----- | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | |
| Net cash provided (used) by continuing operations | \$ 409,972 | \$ (3,728,835) | \$ 2,355,000 |
| Net cash provided (used) by discontinued operations | (90,950) | 1,231,525 | (212,000) |

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| | | | |
|---|-------------|--------------|-----------|
| Net cash provided (used) by operating activities | 319,022 | (2,497,310) | 2,143, |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Purchase of property and equipment | (2,776,127) | (1,830,719) | (5,120, |
| Net payments (advances) on notes receivable | 747,529 | (120,266) | 208, |
| Net decrease (increase) in other assets | 46,698 | (73,772) | 32, |
| Net cash used in investing activities of continuing operations | (1,981,900) | (2,024,757) | (4,879, |
| Net cash used in investing activities of discontinued operations | - | (11,215) | - |
| Net cash used in investing activities | (1,981,900) | (2,035,972) | (4,879, |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Net proceeds from sale of bonds | - | - | - |
| Purchase and retirement of common stock | - | (125,000) | (585, |
| Net change in revolving credit agreement | (135,206) | 8,846,845 | 3,062, |
| Net principal payments on long-term borrowings | (263,577) | (4,260,285) | (620, |
| Net cash provided (used) by financing activities of continuing operations | (398,783) | 4,461,560 | 1,856, |
| Net cash used in financing activities of discontinued operations | - | (22,427) | - |
| Net cash provided (used) by financing activities | (398,783) | 4,439,133 | 1,856, |
| Net change in cash and cash equivalents | (2,061,661) | (94,149) | (879, |
| CASH AND CASH EQUIVALENTS | | | |
| Beginning of period | 2,514,968 | 4,209,193 | 1,333, |
| End of period | \$ 453,307 | \$ 4,115,044 | \$ 453, |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | | |
| Cash paid during the period for: | | | |
| Income taxes | \$ - | \$ - | \$ - |
| Interest | \$ 880,504 | \$ 554,184 | \$ 1,613, |

See Notes to Consolidated Condensed Financial Statements

Note A. Nature of Business and Interim Financial Statements

Nature of business:

We design, manufacture and sell air filters and related products. Our business

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is focused on providing complete environmental control systems for end uses ranging from controlling contaminants in residences and commercial office buildings through specialized manufacturing environments for semiconductors and specialized pharmaceuticals. We also design and manufacture much of our production equipment to automate processes to decrease labor costs associated with our standard products. We also produce glass-based air filter media for many of our products. The vast majority of our sales come from the sale of after-market replacement filters, since air filters are typically placed in equipment designed to last much longer than the filters.

We have only one segment, filtration products. We sell some products for end users outside of the United States through domestic specialty cleanroom contractors. These sales are accounted for as domestic sales. We also sell products through foreign distributors, primarily in Europe, and a wholly owned subsidiary, which sells to customers in the Far East. Sales through foreign distributors and our wholly owned foreign subsidiary total less than 5% of net sales. Assets held outside the United States are negligible.

Interim financial statements:

The interim consolidated condensed financial statements presented herein are unaudited and have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2000. The accompanying financial statements have not been examined by independent accountants in accordance with auditing standards generally accepted in the United States of America, but in the opinion of management such financial statements include all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly our financial position, results of operations, and cash flows. The results of operations and cash flows for the three months and six months ended June 30, 2001 may not be indicative of the results that may be expected for the year ending December 31, 2001.

Earnings per common share:

We have adopted FASB Statement No. 128 which requires the presentation of earnings per share by all entities that have outstanding common stock or potential common stock, such as options, warrants and convertible securities, that trade in a public market. Those entities that have only common stock outstanding are required to present basic earnings per-share amounts. Basic per-share amounts are computed by dividing net earnings (the numerator) by the weighted-average number of common shares outstanding (the denominator). All other entities are required to present basic and diluted per-share amounts. Diluted per-share amounts assume the conversion, exercise or issuance of all potential common stock instruments unless the effect is to reduce the loss or increase the income per common share from continuing operations.

Note B. Inventories

Our inventories consist of the following at June 30, 2001 and December 31, 2000:

| | 6/30/2001 | 12/31/2000 |
|------------------|---------------|---------------|
| | ----- | ----- |
| Finished goods | \$ 15,332,646 | \$ 12,423,309 |
| Work in progress | 3,059,276 | 2,440,136 |
| Raw materials | 14,063,532 | 14,822,031 |
| | ----- | ----- |

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| | | |
|-----------------|---------------|---------------|
| | 32,455,454 | 29,685,476 |
| Less allowances | 1,385,710 | 1,385,710 |
| | ----- | ----- |
| | \$ 31,069,744 | \$ 28,299,766 |
| | ===== | ===== |

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Note C. Stock Options and Warrants

The following table summarizes the activity related to our stock options and warrants for the three months ended June 30, 2001 and the year ended December 31, 2000:

| | Warrants | Stock Options | Exercise Price per Share | | Weighted Exercis per S |
|----------------------------------|----------|------------------|-----------------------------|---------------|------------------------------|
| | | | Warrants | Options | |
| Outstanding at January 1, 2000 | 612,239 | 7,013,220 | \$5.54 - 14.73 | \$1.00 - 9.50 | \$ 9.57 |
| Granted | - | 12,500 | - | 2.50 - 2.63 | - |
| Exercised | - | (2,300,000) | - | 1.00 | - |
| Canceled or expired | (72,239) | - | 5.54 - 8.16 | - | 6.07 |
| | ----- | ----- | | | |
| Outstanding at December 31, 2000 | 540,000 | 4,725,720 | 8.40 - 14.73 | 2.50 - 9.50 | 10.04 |
| Granted | - | 50,000 | - | 2.05 | - |
| Exercised | - | - | - | - | - |
| Canceled or expired | - | (2,137,420) | - | 2.50 - 9.50 | - |
| | ----- | ----- | | | |
| Outstanding at June 30, 2001 | 540,000 | 2,638,300 | \$8.40 - 14.73 | \$2.05 - 8.50 | \$10.04 |
| | ===== | ===== | | | |
| Exercisable at June 30, 2001 | 540,000 | 2,625,800 | \$8.40 - 14.73 | \$2.50 - 8.50 | \$10.04 |
| | ===== | ===== | | | |

The options and warrants expire at various dates ranging from January 2002 through December 2008.

Note D. Disclosures About Debt Agreements

On February 9, 2000, we completed the extension of our \$45,000,000 revolving credit facility with a bank. The credit facility consists of a \$30 million working capital facility and a \$15 million line of credit to support issuances of letters of credit. Outstanding balances on the working capital facility bear interest, at the option of the Company, at either (a) the "prime" rate of interest publicly announced by the bank, which was 6.75% at June 30, 2001, or (b) the "LIBOR" rate as reported by the Wall Street Journal, which was 3.7375% at June 30, 2001, plus an amount equal to 1.0% to 2.5%, depending on the ratio of total liabilities of the Company to its tangible net worth.

In connection with our lines of credit agreements and a note payable to a

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regional development authority and bank, we agreed to certain restrictive covenants which include, among other things, not paying dividends and maintenance of certain financial ratios at all times including a minimum current ratio, minimum tangible net worth, a maximum ratio of total liabilities to tangible net worth and a minimum fixed charge coverage ratio. At times during 2000 and 2001, including at December 31, 2000 and June 30, 2001, we were in violation of certain of these financial loan covenants. We have received waivers for these violations and signed an agreement to amend the credit agreement which modifies required financial ratios and other loan covenants. The amendment also reduces the amount available for issuing letters of credit to \$10 million.

As of June 30, 2001, the Company had used approximately \$29,477,000 of the working capital facility and had issued \$9,400,000 of letters of credit against the line of credit, leaving approximately \$0.5 million available for future borrowings and \$0.6 million available for future letters of credit. Unless this credit facility is renewed, it will expire in June 2002.

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Note E. Litigation

The Company is involved in a dispute with a former workers' compensation administrator and stop-loss insurer for some of the Company's subsidiaries. The administrator has alleged that they are owed insurance premiums, claims reimbursement and administrative fees. The Company has counter-sued, claiming that the administrator was negligent in its duties as administrator of our claims, that it made payments on our behalf which were specifically disallowed, that they refused to follow instructions given to them by us, that they failed to meet minimal acceptable standards for administering claims, and that such failures constituted a material dereliction of their responsibilities as administrator, as well as other claims related to malfeasance and negligence. The amount and probability of any payment or settlement is unknown at this time. Among the issues being considered is the matter of currently unresolved workers' compensation claims whose estimate of potential loss may change as a result of this litigation. While management believes it has reserved an adequate amount for settlement of these claims, there is no guarantee that the Company's actual liability will not exceed its current estimate. Accordingly, these matters, if resolved in a manner different from management's estimate, could have a material adverse effect on the operating results or cash flows in any one future accounting period.

From time to time, the Company is a party as plaintiff or defendant to various legal proceedings related to our normal business operations. In the opinion of management, although the outcome of any legal proceeding cannot be predicted with certainty, the ultimate liability of the Company in connection with its legal proceedings will not have a material adverse effect on the Company's financial position, but could be material to the results of operations in any one future accounting period.

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

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of Operations

The following discussions should be read in conjunction with our Consolidated Condensed Financial Statements and the notes thereto presented in "Item 1 - Financial Statements." The information set forth in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" includes forward-looking statements that involve risks and uncertainties. Many factors, including those discussed below under "Factors That May Affect Future Results" could cause actual results to differ materially from those contained in the forward-looking statements below.

Overview

Flanders is a full-range air filtration product company engaged in designing, manufacturing and marketing high performance, mid-range and standard-grade air filtration products and certain related products and services. Our focus has evolved from expansion through acquisition to increasing the quality and efficiency of our high-volume replacement filtration products, and using these benefits to compete more effectively in the marketplace. We also design and manufacture much of our own production equipment and also produce glass-based media for many of our air filtration products. Historical results of operations do not reflect any future operating efficiencies and improvements from integrating and consolidating the acquired businesses into our operations. As a result, historical results of operations for the periods presented should be evaluated specifically against these objectives. There can be no guarantee that we will be able to achieve these objectives and gains in efficiency.

Results of Operations for the Three Months Ended June 30, 2001 Compared to June 30, 2000

The following table summarizes our results of operations as a percentage of net sales for the three months ended June 30, 2001 and 2000.

| | Three Months Ended June 30, | | | |
|---|--------------------------------|--------|-----------|--------|
| | 2001 | | 2000 | |
| | (000's omitted) | | | |
| Net sales | \$ 49,916 | 100.0% | \$ 50,034 | 100.0% |
| Gross profit | 10,122 | 20.3 | 11,335 | 22.7 |
| Operating expenses | 8,685 | 17.4 | 9,263 | 18.5 |
| Operating income from continuing operations | 1,437 | 2.9 | 2,072 | 4.1 |
| Provision for income taxes | 466 | 0.9 | 790 | 1.6 |
| Earnings from continuing operations | 546 | 1.1 | 959 | 1.9 |
| Loss from discontinued operations | (91) | (0.2) | (205) | (0.4) |
| Net earnings | 456 | 0.9 | 754 | 1.5 |

Net sales: Net sales for the second quarter of 2001 decreased by \$118,000, or 0.2%, to \$49,916,000 from \$50,034,000 for the second quarter of 2000. This represents the attraction of additional core business and the capture of additional market share from competitors in a contracting market, balanced by the elimination of our unprofitable tubing insulation product line in May 2001.

Gross Profit: Gross profit for the second quarter of 2001 decreased by \$1,213,000, or 10.7%, to \$10,122,000, which represented 20.3% of net sales, from \$11,335,000, which represented 22.7% of net sales, for the second quarter of 2000. The decrease in gross profit was principally attributable to:

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- * Increased price competition for several major retail accounts.
- * Increased inbound freight costs for raw materials associated with fuel price increases and fuel surcharges.

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Operating expenses: Operating expenses for the second quarter of 2001 decreased by \$578,000, or 6.2%, to \$8,685,000, representing 17.4% of net sales, from \$9,263,000, representing 18.5% of net sales, for the second quarter of 2000. The decrease in operating expenses was caused by our ongoing programs to reduce overhead by eliminating redundant personnel and functions at our subsidiaries.

Loss from discontinued operations: In December 1999, we adopted a formal plan to close Airseal West, a wholly-owned subsidiary, and sell its various assets and product lines to unrelated third parties. Closure of all production associated with the discontinued assets was completed during this quarter. The assets to be sold consist primarily of inventories, designs and other intellectual properties. Operating losses from Airseal West were approximately \$91,000 and \$205,000, net of income tax benefit, for the second quarter of 2001 and 2000, respectively.

Provision for income taxes: Our income tax provision for the second quarter of 2001 and 2000 consisted of a blended state and federal tax rate, excluding the effect of nondeductible expenses consisting primarily of amortization of goodwill of approximately \$900,000 per year, of approximately 40%.

Results of Operations for the Six Months Ended June 30, 2001 Compared to June 30, 2000

The following table summarizes our results of operations as a percentage of net sales for the six months ended June 30, 2001 and 2000.

| | Three Months Ended June 30, | | | |
|---|--------------------------------|--------|-----------|--------|
| | 2001 | | 2000 | |
| | (000's omitted) | | | |
| Net sales | \$ 97,006 | 100.0% | \$ 94,133 | 100.0% |
| Gross profit | 21,499 | 22.2 | 24,085 | 25.6 |
| Operating expenses | 18,199 | 18.8 | 18,565 | 19.7 |
| Operating income from continuing operations | 3,299 | 3.4 | 5,520 | 5.9 |
| Provision for income taxes | 1,201 | 1.2 | 2,207 | 2.3 |
| Earnings from continuing operations | 1,427 | 1.5 | 2,860 | 3.0 |
| Loss from discontinued operations | (212) | (0.2) | 557 | 0.6 |
| Net earnings | 1,214 | 1.3 | 2,303 | 2.4 |

Net sales: Net sales for the first half of 2001 increased by \$2,873,000, or 3.1%, to \$97,006,000 from \$94,133,000 for the first half of 2000. This increase represents the attraction of additional core business and the capture of

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additional market share from competitors in a contracting market, partially balanced by the elimination of our tubing insulation product line in June 2001.

Gross Profit: Gross profit for the first half of 2001 decreased by \$2,586,000, or 10.7%, to \$21,499,000, which represented 22.2% of net sales, from \$24,085,000, which represented 25.6% of net sales, for the first half of 2000. The decrease in gross profit was principally attributable to:

- * Expanded facilities in Tijuana, which were brought partially online during the quarter, experienced additional expenses associated with completing expansions, reorganizing production schedules, hiring and training additional laborers, and other inefficiencies typical of expanded manufacturing operations, including duplicate staffing at our San Diego and Nevada facilities. Results for the first quarter of 2001 do not include any benefit from the associated reductions in force, which were completed in March and April 2001.
- * Increased price competition for several major retail accounts.

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- * Increased inbound freight costs for raw materials associated with fuel price increases and fuel surcharges.

Operating expenses: Operating expenses for the first half of 2001 decreased by \$366,000, or 2.0%, to \$18,199,000, representing 18.8% of net sales, from \$18,565,000, representing 19.7% of net sales, for the first half of 2000. The increase in operating expenses was caused primarily by our ongoing programs to reduce overhead by eliminating redundant personnel and functions at our subsidiaries.

Loss from discontinued operations: In December 1999, we adopted a formal plan to close Airseal West, a wholly-owned subsidiary, and sell its various assets and product lines to unrelated third parties. Closure of all production associated with the discontinued assets was completed during this quarter. The assets to be sold consist primarily of inventories, designs and other intellectual properties. Operating losses from Airseal West were approximately \$212,000 and \$557,000, net of income tax benefit, for the first half of 2001 and 2000, respectively.

Provision for income taxes: Our income tax provision for the first half of 2001 and 2000 consisted of a blended state and federal tax rate, excluding the effect of nondeductible expenses consisting primarily of amortization of goodwill of approximately \$900,000 per year, of approximately 40%.

Liquidity and Capital Resources

Our working capital was \$47,497,000 at June 30, 2001, compared to \$13,644,000 at December 31, 2000. This includes cash and cash equivalents of \$453,000, at June 30, 2001 and \$1,333,000 at December 31, 2000. The major cause of the difference in working capital was changing the classification of our revolving credit facility from short-term to long-term debt based upon the receipt of various loan covenant waivers. Using comparable classifications, working capital was \$18,009,000 at June 30, 2001.

Our trade receivables decreased \$246,000, or 0.7%, to \$33,235,000 at June 30, 2001, from \$33,481,000 at December 31, 2000. Days sales outstanding, the ratio

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of receivables to average daily sales during the prior three months was 61 days at June 30, 2001, compared to 62 days at December 31, 2000. These ratios for days sales outstanding typically vary between 60 and 70 days, depending on timing differences in shipments and payments received.

Our continuing operations provided \$410,000 of cash during the second quarter of 2001 compared to using \$3,729,000 during the second quarter of 2000. Historically, our business is seasonal, with our second and third quarters having higher sales than our first and fourth quarters. We attempt to moderate swings in labor requirements and product shortages due to this seasonal variance by increasing inventories in the first quarter and first part of the second quarter. Larger inventories reduce the likelihood of stock shortages during our busy season and help smooth out our labor requirements. We anticipate that current excess inventory will be sold during our busy season and will return to historical norms by the end of the third quarter of 2001. In general, we expect operations to consume cash, or generate substantially less cash than earnings before taxes, depreciation and amortization, during our first and second quarters because of increases in inventory and trade accounts receivable. Our financing activities from continuing operations consumed \$399,000 of cash during the second quarter of 2001, primarily consisting of net payments on debt. Our investing activities from continuing operations consumed \$1,982,000 of cash during the second quarter of 2001, primarily used to purchase property and equipment.

On February 9, 2000, we completed the extension of our \$45,000,000 revolving credit facility with a bank. The credit facility consists of a \$30 million working capital facility and a \$15 million line of credit to support issuances of letters of credit. Outstanding balances on the working capital facility bear interest, at the option of the Company, at either (a) the "prime" rate of interest publicly announced by the bank, which was 6.75% at June 30, 2001, or (b) the "LIBOR" rate as reported by the Wall Street Journal, which was 3.7375% at June 30, 2001, plus an amount equal to 1.0% to 2.5%, depending on the ratio of total liabilities of the Company to its tangible net worth.

In connection with our lines of credit agreements and a note payable to a regional development authority and bank, we agreed to certain restrictive covenants which include, among other things, not paying dividends and maintenance

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of certain financial ratios at all times including a minimum current ratio, minimum tangible net worth, a maximum ratio of total liabilities to tangible net worth and a minimum fixed charge coverage ratio. At times during 2000 and 2001, including at December 31, 2000 and June 30, 2001, we were in violation of certain of these financial loan covenants. We have received waivers for these violations and signed an agreement to amend the credit agreement which modifies required financial ratios and other loan covenants. The amendment also reduces the amount available for issuing letters of credit to \$10 million.

As of June 30, 2001, the Company had used approximately \$29,477,000 of the working capital facility and had issued \$9,400,000 of letters of credit against the line of credit, leaving approximately \$0.5 million available for future borrowings and \$0.6 million available for future letters of credit. Unless this credit facility is renewed, it will expire in June 2002.

Continuing expansion may require substantial capital investment for the

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manufacture of filtration products. Although we have been able to arrange debt facilities or equity financing to date, there can be no assurance that sufficient debt financing or equity will continue to be available in the future, or that it will be available on acceptable terms. Failure to obtain sufficient capital could materially adversely impact our growth strategy.

In 1998, the Board of Directors authorized the repurchase of up to two million shares of our common stock, which repurchase was completed in September 2000. On September 22, 2000, the Board of Directors authorized the repurchase of up to an additional two million shares of common stock. As of August 20, 2001, approximately 575,000 shares had been repurchased under this authorization. These shares may be acquired in the open market or through negotiated transactions. These repurchases may be made from time to time, depending on market conditions, share price and other factors. These repurchases are to be used primarily to satisfy our obligations under stock option and purchase plans or any other authorized incentive plans, or for issuance pursuant to future equity financing.

Outlook

During the first half of 2001, we began force reductions to eliminate approximately 350 redundant positions and regain efficiency at several of our manufacturing plants, primarily due to our reorganization of the west coast. This force reduction is expected to save approximately \$8 million annually, with being phased in beginning in the second quarter of 2001. In addition, all employees have taken a ten percent reduction in wages, beginning in August.

We are currently introducing new products for the retail marketplace, primarily our Airia indoor air cleaners and wholehouse residential air cleaning systems. In contrast to our standard retail filters, the bulk of which sell for unit prices between \$0.50 and \$10, these new products will sell for substantially more (between \$200 and \$5,000, with replacement packs ranging from \$3/mo. to \$15/mo). These are new products which are substantially different in features, appearance and performance from competing products, and we have no actual market data on how successful they will be, and hence have no way of estimating their impact on the financial results of the Company. Any sales of these units in significant quantities will require additional financial resources, either through equity or financing, to meet working capital requirements for production and sale of these products.

We believe there is currently a gradually increasing public awareness of the issues surrounding indoor air quality and that this trend will continue for the next several years. We also believe there is an increase in public concern regarding the effects of indoor air quality on employee productivity, as well as an increase in interest by standards-making bodies in creating specifications and techniques for detecting, defining and solving indoor air quality problems.

Our most common products, in terms of both unit and dollar volume, are residential throw-away spun glass filters, which usually sell for prices under \$1.00. Any increase in consumer concern regarding air pollution, airborne pollens, allergens, and other residential airborne contaminants could result in replacement of some of these products with higher value products. Our higher value products include our NaturalAire higher-efficiency filters for residential use, with associated sales prices typically over \$5.00 each. Any such trend would have a beneficial effect on our business. If our residential air cleaners are successful, we believe replacement filter sales, and the

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increased awareness of indoor air quality engendered by the simple presence of the air cleaners, will help to create and/or accelerate this trend.

Currently, the largest domestic market for air filtration products is for mid-range ASHRAE-rated products and HVAC systems, typically used in commercial and industrial buildings. To date, our penetration of this market has been relatively small. We believe our ability to offer a "one stop" supply of air filtration products to HVAC distributors and wholesalers may increase our share of this market. We also believe that our recently developed modular air handlers and environmental tobacco smoke systems will enable us to expand sales to these customers. We intend our new products to serve as high profile entrants with distributors and manufacturers' representatives, who can then be motivated to carry our complete product line.

This Outlook section, and other portions of this document, include certain "forward-looking statements" within the meaning of that term in Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, including, among others, those statements preceded by, following or including the words "believe," "expect," "intend," "anticipate" or similar expressions. These forward-looking statements are based largely on the current expectations of management and are subject to a number of assumptions, risks and uncertainties. Our actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating such forward-looking statements include those discussed below under the heading "Factors That May Affect Future Results" as well as:

- * the shortage of reliable market data regarding the air filtration market,
- * changes in external competitive market factors or in our internal budgeting process which might impact trends in our results of operations,
- * anticipated working capital or other cash requirements,
- * changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the market,
- * product obsolescence due to the development of new technologies, and
- * various competitive factors that may prevent us from competing successfully in the marketplace.

In light of these risks and uncertainties, there can be no assurance that the events contemplated by the forward-looking statements contained in this Form 10-Q will in fact occur.

Factors That May Affect Future Results

Failure to Manage Future Growth Could Adversely Impact Our Business Due to the Strain on Our Management, Financial and Other Resources

If our business continues to grow, the additional growth will place burdens on management to manage such growth while maintaining profitability. We have no guarantee that we will be able to do so. Due to our recent acquisitions and expansions, our net sales increased by approximately 405% from 1995 through 2000, (a compound annual growth rate of 32%). We may not continue to expand at this rate. Our ability to compete effectively and manage future growth depends on our ability to:

- * recruit, train and manage our work force, particularly in the areas of corporate management, accounting, research and development and operations,
- * manage production and inventory levels to meet product demand,
- * manage and improve production quality,
- * expand both the range of customers and the geographic scope of our customer base, and
- * improve financial and management controls, reporting systems and procedures.

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Any failure to manage growth effectively could have a material adverse effect on our business, financial condition and results of operations.

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Any Delay in Procuring Financing for New Products or Failure to Adequately Ramp-Up Production Capacity to Meet Demand Could Adversely Impact Our Business Due to Strain on Financial Resources.

During 2001 we are introducing new products which, if successfully mass-marketed, will require large amounts of additional financing and/or capital. This financing may need to be available on short notice. Any failure to obtain such financing, or delay in financing, could cause the failure of the new products due to inability to deliver on time, and could adversely impact relationships with current major accounts. In addition, delays in an untried supply chain, new production chains, and other delays common to the launch of a new product line could also adversely impact the success of the products, as well as current relationships with major accounts.

Our Plan to Centralize Overhead Functions May Not Produce the Anticipated Benefits to Our Operating Results

We are currently implementing plans to centralize and eliminate duplication of efforts between our subsidiaries in the following areas:

- * purchasing,
- * production planning,
- * shipping coordination,
- * marketing,
- * accounting,
- * personnel management,
- * risk management, and
- * benefit plan administration.

We have no assurance that cutting overhead in this fashion will have the anticipated benefits to our operating results. Additionally, we have no assurance that these reorganizations will not significantly disrupt the operations of the affected subsidiaries.

The preceding discussion should be read in conjunction with our annual report on Form 10-K, which also includes additional "Factors That May Affect Future Results" which are still applicable during the current period. Because of the foregoing factors, as well as other variables affecting our operating results, past financial performance should not be considered a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, including changes in foreign currency exchange rates and interest rate risks. Market risk is the potential loss arising from adverse change in market rates and prices, such as foreign currency exchange and interest rates. For us, these exposures are primarily related to the sale of product to foreign customers and changes in interest rates.

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The fair value of our total debt at June 30, 2001 was approximately \$51,813,000. We have entered into an interest rate swap agreement related to \$8,500,000 of this amount, related to two outstanding Industrial Revenue Bonds. These swap agreements are hedges which have the effect of fixing the interest rate of these two IRB's at 5.14% per annum. Market risk for the remaining \$43,313,000 was estimated as the potential decrease (increase) in future earnings and cash flows resulting from a hypothetical 10% increase (decrease) in our estimated weighted average borrowing rate at June 30, 2001. Although most of the interest on our debt is indexed to a market rate, there would be no material effect on the future earnings or cash flows related to our total debt for such a hypothetical change.

Our financial position is not materially affected by fluctuations in currencies against the U.S. dollar, since assets held outside the United States are negligible. Our sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels of local currency prices, as the preponderance of our foreign sales occur over short periods of time or are demarcated in U.S. dollars.

We do not have any derivatives or other financial instruments for trading or speculative purposes.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

We are involved in a dispute with a former benefit plan administrator (U.S. District Court, Middle District of Florida, Tampa Division, Case No. CIV 1971-T-17-F, Liberty Mutual v. Flanders Corporation et al). Liberty Mutual was the Workers' Compensation administrator and stop-loss insurer for some of the Company's subsidiaries. They have alleged that they are owed insurance premiums, claims reimbursement and administrative fees. We have counter-sued, claiming that Liberty Mutual was negligent in its duties as administrator of our claims, that it made payments on our behalf which were specifically disallowed, that they refused to follow instructions given to them by us, that they failed to meet minimal acceptable standards for administering claims, and that such failures constituted a material dereliction of their responsibilities as administrator, as well as other claims related to malfeasance and negligence. The amount and probability of any settlement or award related to this litigation is unknown at this time. Among the issues being considered is the matter of currently unresolved workers' compensation claims whose estimate of potential loss may change as a result of this litigation. While management believes it has reserved an adequate amount for settlement of these claims, there is no guarantee that the Company's actual liability will not exceed its current estimate. Accordingly, these matters, if resolved in a manner different from management's estimate, could have a material adverse effect on the operating results or cash flows in any one future accounting period.

Additionally, from time to time, we are a party to various legal proceedings incidental to our business. None of these proceedings are material to our business, operations or financial condition.

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In the opinion of management, although the outcome of any legal proceeding cannot be predicted with certainty, the ultimate liability of the Company in connection with its legal proceedings will not have a material adverse effect on the Company's financial position, but could be material to the results of operations in any one future accounting period.

Item 2. Changes in Securities and the Use of Proceeds - None.

Item 3. Defaults Upon Senior Securities - None.

Item 4. Submission of Matters to a Vote of Security Holders - None.

Item 5. Other Information - None

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

| Exhibit No. | Description |
|-------------|---|
| 3.1 | Articles of Incorporation for Flanders Corporation, filed with the Form 8-A dated March 8, 1996, incorporated herein by reference. |
| 3.2 | Bylaws of Flanders Corporation, filed with the Form 8-A dated March 8, 1996, incorporated herein by reference. |
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| 10.1 | Indemnification Agreement between Flanders Corporation, Steven K. Clark, Robert Amerson and Thomas Allan, filed with the Form 10-K dated December 31, 1995, and incorporated herein by reference. |
| 10.2 | Stock Purchase Agreement between Flanders Corporation and the Shareholders of Eco-Air Products, Inc. dated May 7, 1998, filed with the Form 8-K dated June 30, 1998, and incorporated herein by reference. |
| 10.3 | Amendment dated May 20, 1998 to Stock Purchase Agreement by and between the Registrant and the Shareholders of Eco-Air Products, Inc. dated May 7, 1998, filed with the Form 8-K dated June 30, 1998, and incorporated herein by reference. |
| 10.4 | Promissory Note from Precisionaire, Inc. to SunTrust Bank, Tampa Bay, in the amount of \$2,134,524 dated August 28, 1997, filed with the Form S-1 dated September 15, 1997 (Reg No. 333-33635), and incorporated herein by reference. |
| 10.5 | Assumption Agreement between POF Realty, Precisionaire, Inc., Polk County Industrial Development Authority and SunTrust Bank, dated August 1, 1997, filed with the Form S-1 dated September 15, 1997 (Reg No. 333-33635), and incorporated herein by reference. |
| 10.6 | Mortgage Deed and Security Agreement between Precisionaire, Inc. and Sun Trust Bank, Tampa Bay dated August 28, 1997, filed with the Form S-1 dated September 15, 1997 (Reg No. 333-33635), and incorporated herein by reference. |

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- 10.7 Credit Agreement between Flanders Corporation, SunTrust Bank, Tampa Bay and Zions First National Bank, dated November 10, 1997, filed with the Form 10-K dated December 31, 1997, and incorporated herein by reference.
- 10.8 Loan Agreement between Will-Kankakee Regional Development Authority and Flanders Corporation dated December 15, 1997, filed with the Form 10-K dated December 31, 1997, and incorporated herein by reference.
- 10.9 Letter of Credit Agreement between Flanders Corporation and SunTrust Bank, Tampa Bay, dated April 1, 1998, filed with the Form 10-Q dated March 31, 1998, and incorporated herein by reference.
- 10.10 Credit Agreement between Flanders Corporation, SunTrust Equitable Securities Corporation and SunTrust Bank, dated February 9, 2000, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.11 Loan Agreement between Flanders Corporation and the Johnston County Industrial Facilities and Pollution Control Financing Authority, dated April 1, 1998, filed with the Form 10-Q dated March 31, 1998, and incorporated herein by reference.
- 10.12 Loan Agreement between Flanders Corporation and the Johnston County Industrial Facilities and Pollution Control Financing Authority, dated March 1, 2000, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.13 Flanders Corporation 1996 Director Option Plan, filed with the Form 10-K dated December 31, 1995, and incorporated herein by reference.
- 10.14 Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with the Form 10-K dated December 31, 1995, and incorporated herein by reference.
- 10.15 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with the Form S-1 dated October 21, 1996 (Reg. No. 333-14655), and incorporated herein by reference.
- 10.16 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with the Form 10-K dated December 31, 1997, and incorporated herein by reference.

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- 10.17 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.18 Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc. and Robert R. Amerson, filed with the Form 10-K dated December 31, 1995, and incorporated herein by reference.
- 10.19 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Robert R. Amerson, filed with the Form

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S-1 dated October 21, 1996 (Reg. No. 333-14655), and incorporated herein by reference.

- 10.20 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Robert R. Amerson, filed with the Form 10-K dated December 31, 1997, and incorporated herein by reference.
- 10.21 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Robert R. Amerson, filed with Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.22 Stock Option Agreement between Flanders Corporation and Robert R. Amerson dated February 22, 1996, filed with the Form S-8 dated July 21, 1997, and incorporated herein by reference.
- 10.23 Amendment to Stock Option Agreement between Flanders Corporation and Robert R. Amerson dated December 22, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.24 Stock Option Agreement between Flanders Corporation and Robert R. Amerson dated June 3, 1996, filed with the Form S-8 dated July 21, 1997, and incorporated herein by reference.
- 10.25 Stock Option Agreement between Flanders Corporation and Steven K. Clark dated February 22, 1996, filed with the Form S-8 dated July 21, 1997, and incorporated herein by reference.
- 10.26 Amendment to Stock Option Agreement between Flanders Corporation and Steven K. Clark dated December 22, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.27 Stock Option Agreement between Flanders Corporation and Steven K. Clark dated June 3, 1996, filed with the Form S-8 dated July 21, 1997, and incorporated herein by reference.
- 10.28 Note Agreement between Steven K. Clark and Flanders Corporation, dated April 24, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.29 Note Agreement between Robert R. Amerson and Flanders Corporation, dated April 24, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.

(b) Reports on Form 8-K - None

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated this 20th day of August, 2001.

FLANDERS CORPORATION

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By: /s/ Robert R. Amerson
Robert R. Amerson
President, Chief Executive Officer and Director

By: /s/ Steven K. Clark
Steven K. Clark
Chief Operating Officer, Vice President/Chief
Financial Officer, Principal Accounting Officer
and Director

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