

Omega Flex, Inc.  
Form 10-Q  
November 07, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **September 30, 2014**

**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** **23-1948942**  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

**451 Creamery Way, Exton, PA**  
(Address of principal executive offices)

**19341**  
(Zip Code)

**(610) 524-7272**

Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

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

Yes  No

**APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS**

**DURING THE PRECEDING FIVE YEARS.**

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

The number of shares of the registrant's common stock outstanding as of September 30, 2014 was 10,091,822.

**OMEGA FLEX, INC.**

**QUARTERLY REPORT ON FORM 10-Q  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014**

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

	<b>September 30, 2014 (unaudited)</b>	<b>December 31, 2013</b>
	(Dollars in thousands)	
<b>ASSETS</b>		
Current Assets	\$	\$
Cash and Cash Equivalents	16,123	8,257
Accounts Receivable - less allowances of \$785 and \$729, respectively	15,094	12,968
Inventories-Net	6,560	6,728
Deferred Taxes	791	871
Other Current Assets	996	1,359
Total Current Assets	39,564	30,183
Property and Equipment - Net	4,454	4,762
Goodwill	3,526	3,526
Other Long Term Assets	1,409	1,603
	\$	\$
Total Assets	48,953	40,074
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:	\$	\$
Accounts Payable	2,000	1,793
Accrued Compensation	3,043	3,114
Accrued Commissions and Sales Incentives	2,780	3,934
Taxes Payable	455	134
Other Liabilities	3,603	3,575

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Total Current Liabilities	11,881	12,550
Deferred Taxes	1,466	1,032
Other Long Term Liabilities	854	861
Total Liabilities	14,201	14,443
Shareholders' Equity:		
Omega Flex, Inc. Shareholders' Equity:		
Common Stock par value \$0.01 Share: authorized 20,000,000 Shares: 10,153,633 shares issued and 10,091,822 outstanding at September 30, 2014 and December 31, 2013, respectively	102	102
Treasury Stock	(1)	(1)
Paid-in Capital	10,808	10,808
Retained Earnings	24,055	14,929
Accumulated Other Comprehensive Loss	(425)	(329)
Total Omega Flex, Inc. Shareholders' Equity	34,539	25,509
Noncontrolling Interest	213	122
Total Shareholders' Equity	34,752	25,631
	\$	\$
Total Liabilities and Shareholders' Equity	48,953	40,074

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

**OMEGA FLEX, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(unaudited)**

	<b>For the three-months ended</b>		<b>For the nine-months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(Amounts in Thousands, except earnings per Common Share)</b>			
	\$	\$	\$	\$
Net Sales	23,837	19,988	60,298	55,262
Cost of Goods Sold	9,521	9,009	25,249	25,462
Gross Profit	14,316	10,979	35,049	29,800
Selling Expense	3,706	3,185	10,257	9,429
General and Administrative Expense	3,751	3,032	9,011	7,908
Engineering Expense	764	673	2,126	2,017
Operating Profit	6,095	4,089	13,655	10,446
Interest Income	9	3	21	3
Other Income (Expense)	(32)	64	(25)	(62)
Income Before Income Taxes	6,072	4,156	13,651	10,387
Income Tax Expense	2,002	1,420	4,430	3,518
Net Income	4,070	2,736	9,221	6,869
Less: Net Income attributable to the Noncontrolling Interest, Net of Tax	(35)	(27)	(95)	(43)
	\$	\$	\$	\$
Net Income attributable to Omega Flex, Inc.	4,035	2,709	9,126	6,826
	\$	\$	\$	\$
Basic and Diluted Earnings per Common Share	0.40	0.27	0.90	0.68



Basic and Diluted Weighted-Average Shares Outstanding	10,092	10,092	10,092	10,092
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See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

**OMEGA FLEX, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(unaudited)**

	<b>For the three-months ended September 30,</b>		<b>For the nine-months ended September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<b>(Amounts in Thousands)</b>		<b>(Amounts in Thousands)</b>	
	\$	\$	\$	\$
Net Income	4,070	2,736	9,221	6,869
Other Comprehensive Income (Loss), Net of Tax:				
Foreign Currency Translation Adjustment, net of Taxes	(193)	99	(100)	40
Other Comprehensive Income (Loss)	(193)	99	(100)	40
Comprehensive Income	3,877	2,835	9,121	6,909
Less: Comprehensive Income Attributable to the Noncontrolling Interest	(26)	(33)	(91)	(45)
	\$	\$	\$	\$
Total Other Comprehensive Income	3,851	2,802	9,030	6,864

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

## OMEGA FLEX, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

	<b>For the nine-months ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
	(Dollars in thousands)	
Cash Flows from Operating Activities:	\$	\$
Net Income	9,221	6,869
Adjustments to Reconcile Net Income to Net Cash Provided By Operating Activities:		
Non-Cash Compensation Expense	139	234
Depreciation and Amortization	379	393
Provision for Losses on Accounts Receivable, net of write-offs and recoveries	56	135
Changes in Assets and Liabilities:		
Accounts Receivable	(2,220)	(718)
Inventory	151	3
Other Assets	636	119
Accounts Payable	217	(668)
Accrued Compensation	(71)	1,854
Accrued Commissions and Sales Incentives	(1,156)	(558)
Other Liabilities	672	(758)
Net Cash Provided by Operating Activities	8,024	6,905
Cash Flows from Investing Activities:		
Capital Expenditures	(78)	(473)
Net Cash Used in Investing Activities	(78)	(473)
Cash Flows from Financing Activities:		
Principal Payments on Line of Credit	-	(324)
Net Cash Used in Financing Activities	-	(324)
Net Increase in Cash and Cash Equivalents	7,946	6,108
Translation effect on cash	(80)	(15)
Cash and Cash Equivalents    Beginning of Period	8,257	939
Cash and Cash Equivalents    End of Period	\$	\$

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16,123

7,032

Supplemental Disclosure of Cash Flow Information:

	\$	\$
Cash paid for Income Taxes	2,247	3,556
	\$	\$
Cash paid for Interest	-	1

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

**OMEGA FLEX, INC.**

**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. BASIS OF PRESENTATION AND DESCRIPTION OF BUSINESS**

**Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of Omega Flex, Inc. (Omega) and its subsidiaries (collectively the Company). The Company's unaudited condensed consolidated financial statements for the quarter ended September 30, 2014 have been prepared in accordance with accounting principles generally accepted in the United States (GAAP), and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although the company believes that the disclosures made are adequate to make the information not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's latest shareholders' annual report (Form 10-K). All material inter-company accounts and transactions have been eliminated in consolidation. It is Management's opinion that all adjustments necessary for a fair statement of the results for the interim periods have been made, and that all adjustments are of a normal recurring nature or a description is provided for any adjustments that are not of a normal recurring nature.

**Description of Business**

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

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

## 2. SIGNIFICANT ACCOUNTING POLICIES

### Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and, the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition and related sales incentives, accounts receivable valuations, inventory valuations, goodwill valuation, product liability reserve and accounting for income taxes. Actual amounts could differ significantly from these estimates.

### Revenue Recognition

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

.

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

.

Delivery has occurred or services rendered.

.

The sales price to the customer is fixed or determinable.

.

Collection is reasonably assured.

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

Gross sales are reduced for all consideration paid to customers for which no identifiable benefit is received by the Company. This includes promotional incentives, which includes various programs including year-end rebates and discounts. The amounts of certain incentives are known with reasonable certainty at the time of sale, while others are projected based upon the most reliable information available at the reporting date.

Commissions, for which the Company receives an identifiable benefit, are accounted for as a sales expense.

### Accounts Receivable

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance for uncollectible amounts is based primarily on specific analysis of accounts in the receivable portfolio and historical write-off experience. While management believes the allowance to be adequate, if the financial condition of the Company's customers were to deteriorate, resulting in their inability to make payments, additional allowances may be required.





### **Inventory**

Inventories are valued at the lower of cost or market. Cost of inventories is determined by the first-in, first-out (FIFO) method. The Company generally considers inventory quantities beyond two-years usage, measured on a historical usage basis, to be excess inventory and reduces the gross carrying value of inventory accordingly.

### **Goodwill and Intangible Assets**

In accordance with Financial Accounting Standards Board (FASB) ASC Topic 350, Intangibles - Goodwill and Other, the Company performed an annual impairment test in accordance with this guidance as of December 31, 2013. This analysis did not indicate any impairment of goodwill. There are no circumstances that indicate that Goodwill might be impaired at September 30, 2014.

### **Product Liability Reserves**

Product liability reserves represent the estimated unpaid amounts under the Company's insurance policies with respect to existing claims. The Company uses the most current available data to estimate claims. As explained more fully under Note 5, Commitments and Contingencies, for various product liability claims covered under the Company's general liability insurance policies, the Company must pay certain defense costs within its deductible or self-insured retention limits, ranging primarily from \$25,000 to \$250,000 per claim, depending on the terms of the policy in the applicable policy year, up to an aggregate amount. The Company is vigorously defending against all known claims.

### **Fair Value of Financial and Nonfinancial Instruments**

The Company measures financial instruments in accordance with FASB ASC Topic 820, Fair Value Measurements and Disclosures. The accounting standard defines fair value, establishes a framework for measuring fair value under GAAP, and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard creates a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels as follows: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs that reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability. The Company relies on its actively traded share value - a level 1 input - in determining the fair value of the reporting unit in its annual impairment test as described in the FASB ASC Topic 350, Intangibles - Goodwill and Other.

### **Earnings per Common Share**

Basic earnings per share have been computed using the weighted-average number of common shares outstanding. For the periods presented, there are no dilutive securities. Consequently, basic and dilutive earnings per share are the same.

### **Currency Translation**

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at exchange rates prevailing on the balance sheet dates. The statements of income are translated into U.S. dollars at average exchange rates for the period. Adjustments resulting from the translation of financial statements are excluded from the determination of income and are accumulated in a separate component of shareholders' equity. Exchange gains and losses resulting from foreign currency transactions are included in operations (other income (expense)) in the period in which they occur.

### **Income Taxes**

The Company accounts for taxes in accordance with the FASB ASC Topic 740, Income Taxes. Under this method the Company records income tax expense and the related deferred taxes and tax benefits.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in income in the period in which the rate is enacted. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain. No valuation reserve was deemed necessary at September 30, 2014 or at December 31, 2013. Also, in accordance with FASB ASC Topic 740 (formerly FIN 48), the Company had reserves on the books for uncertainties in tax positions of \$104,000, and \$100,000 at September 30, 2014, and December 31, 2013, respectively. These reserves are reviewed each quarter.

### **Other Comprehensive Income (Loss)**

For the three and nine-months ended September 30, 2014 and 2013, respectively, the sole component of Other Comprehensive Income (Loss) was a foreign currency translation adjustment.

**New Accounting Pronouncements**

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for the Company in the first quarter of fiscal year 2017. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the consolidated financial statements.

ASU 2013-11, *Income Taxes (Topic 740): Presentation of Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force)*. Per this ASU, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The initial adoption of this guidance in 2014 did not have a material effect on the Company's financial statements.

**Concentrations**

The Company has one significant customer who represents more than 10% of the Company's Net Sales for the quarter and first nine months of 2014 and 2013, and more than 10% of the Company's Accounts Receivable balance at September 30, 2014 and December 31, 2013. Geographically, the Company has a significant amount of sales in the United States versus internationally. These concentrations are discussed in detail in the Company's December 31, 2013 Form 10-K, and there has been little change as of this quarterly report.

**3. INVENTORIES**

Inventories, net of reserves consisted of the following:

	<b>September 30, 2014</b>	<b>December 31, 2013</b>
	(dollars in thousands)	
	\$	\$
Finished Goods	4,749	4,839
Raw Materials	1,811	1,889
	\$	\$
Total Inventory	6,560	6,728



#### 4. LINE OF CREDIT

As of October 23, 2014, the Company agreed to new proposed terms provided by Santander Bank, formerly Sovereign Bank, NA ( Sovereign ) which would allow the Company to borrow on an unsecured \$15,000,000 line of credit for a period of five years with interest rates slightly more favorable to the Company than provided in the December 30, 2010 agreement, which is detailed below. The revised formal Revolving Line of Credit Note and Loan Agreement are currently being finalized.

On December 30, 2010, the Company agreed to a Revolving Line of Credit Note and Loan Agreement with Sovereign. The Company established a line of credit facility in the maximum amount of \$10,000,000, maturing on December 31, 2014, with funds available for working capital purposes and other cash needs. The loan is collateralized by all of the Company's tangible and intangible assets. The loan agreement provides for the payment of any borrowings under the agreement at an interest rate range of either LIBOR plus 1.75% to plus 2.75% (for borrowings with a fixed term of 30, 60, or 90 days), or, Prime less 0.50% to plus 0.50% (for borrowings with no fixed term other than the December 31, 2014 maturity date), depending upon the Company's then existing financial ratios.

At September 30, 2014, the Company's ratio would allow for the most favorable rate under the agreement's range, which would be a rate of 1.98% (LIBOR plus 1.75%). The Company is required to pay an annual commitment fee for the access to the funds, and is also obligated to pay a Line Fee ranging from 17.5 to 35.0 basis points of the average unused balance on a quarterly basis, depending again upon the Company's then existing financial ratios. The Company may terminate the line at any time during the four year term, as long as there are no amounts outstanding.

As of September 30, 2014, and December 31, 2013, the Company had no outstanding borrowings on its line of credit, and the Company was in compliance with all debt covenants.

#### 5. COMMITMENTS AND CONTINGENCIES

##### Commitments:

Under a number of indemnity agreements between the Company and each of its officers and directors, the Company has agreed to indemnify each of its officers and directors against any liability asserted against them in their capacity as an officer or director, or both. The Company's indemnity obligations under the indemnity agreements are subject to certain conditions and limitations set forth in each of the agreements. Under the terms of the Agreement, the Company is contingently liable for costs which may be incurred by the officers and directors in connection with claims arising by reason of these individuals' roles as officers and directors. The Company has obtained directors' and officers' insurance policies to fund certain of the Company's obligations under the indemnity agreements.

The Company has salary continuation agreements with one current employee, and one former employee who retired at the end of 2010. These agreements provide for monthly payments to each of the employees or their designated beneficiary upon the employee's retirement or death. The payment benefits range from \$1,000 per month to \$3,000 per month.

with the term of such payments limited to 15 years after the employee's retirement at age 65. The agreements also provide for survivorship benefits if the employee dies before attaining age 65, and severance payments if the employee is terminated without cause; the amount of which is dependent on the length of company service at the date of termination. The net present value of the retirement payments associated with these agreements is \$489,000 at September 30, 2014, of which \$477,000 is included in Other Long Term Liabilities, and the remaining current portion of \$12,000 is included in Other Liabilities, associated with the retired employee previously noted who is now receiving benefit payments. The December 31, 2013 liability of \$451,000, had \$439,000 reported in Other Long Term Liabilities, and a current portion of \$12,000 in Other Liabilities.

The Company has obtained and is the beneficiary of three whole life insurance policies with respect to the two employees discussed above, and one other employee policy. The cash surrender value of such policies (included in Other Long Term Assets) amounts to \$1,006,000 at September 30, 2014 and \$962,000 at December 31, 2013.

As disclosed in detail in the December 31, 2013 Form 10-K, the Company has several lease obligations in place that will be paid out over time. Most notably, the Company has a lease for its manufacturing facility in Banbury, England, and also leases one of its buildings in Exton, Pennsylvania. Both locations provide manufacturing, warehousing and distribution space.

**Contingencies:**

The Company's general liability insurance policies are subject to deductibles or retentions, ranging primarily from \$25,000 to \$250,000 per claim, (depending on the terms of the policy and the applicable policy year) up to an aggregate amount. The Company is insured on a first dollar basis for workers' compensation subject to statutory limits. In the ordinary and normal conduct of the Company's business, it is subject to periodic lawsuits, investigations and claims (collectively, the Claims). For several years, there has been an increase in the number of those Claims relating primarily to product liability. Although the pace of new Claims has slowed during 2014, many of the new Claims are associated with higher deductible or retention programs. The Company does not believe that the Claims have legal merit, and is therefore vigorously defending against those Claims. In 2013, the Company won two of the Claims at two separate trials, both of which were held in U.S. District Court; one in St. Louis, Missouri and the other in Bridgeport, Connecticut. In both cases, the jury unanimously found that the Company was not negligent in designing its TracPipe® product, and that the TracPipe® product was not defective or unreasonably dangerous. In 2010, the Company took its first Claim to trial in Pennsylvania, and the jury returned a verdict that the Company was not negligent in designing and selling the TracPipe product, but that under the unique law in Pennsylvania for strict liability, the product lacked any element necessary to make it safe for its intended use. The Company has appealed that portion of the verdict, and the Supreme Court of Pennsylvania heard oral arguments on that case with the focus on whether the product liability law in Pennsylvania should be revised. A decision is expected in 2014.

The Company has in place commercial general liability insurance policies that cover the Claims, as noted above, including those alleging damages as a result of product defects. Litigation is subject to many uncertainties and management is unable to predict the outcome of the pending suits and claims. The potential liability for a given claim could range from zero to a maximum of \$250,000, depending upon the insurance deductible or retention in place for the respective claim year. The aggregate maximum exposure for all current open Claims is estimated to not exceed approximately \$4,100,000, which represents the potential costs that may be incurred over time for the Claims within the applicable insurance policy deductibles or retentions. It is possible that the results of operations or liquidity of the Company, as well as the Company's ability to procure reasonably priced insurance, could be adversely affected by the pending litigation, potentially materially. The Company is currently unable to estimate the ultimate liability, if any, that may result from the pending litigation, or potential litigation from future claims or claims that have not yet come to our attention, and accordingly, the liability in the consolidated financial statements primarily represents an accrual for legal costs for services previously rendered and outstanding settlements for existing claims. The liabilities recorded on the Company's books at September 30, 2014 and December 31, 2013 were \$518,000 and \$686,000, respectively, and are included in Other Liabilities.

Finally, two putative class action cases have been filed against the Company; one in U.S. District Court for the Middle District of Florida titled *Hall v. Omega Flex, Inc.* and one in U.S. District Court for the Southern District of Ohio titled *Schoelwer v. Omega Flex, Inc.* In both cases, the lead plaintiffs claimed that they are exposed to an increased likelihood of harm if one of the plaintiffs' houses that contain TracPipe CSST is struck by lightning, that could damage the CSST causing a release of fuel gas in the house and causing a fire. However, none of the lead plaintiffs have suffered any actual harm. In January 2014, the judge in the *Hall* case granted the Company's motion to dismiss all of the plaintiff's claims due primarily to a lack of jurisdiction because there is no actual case or controversy posed by these claims. The plaintiff in *Schoelwer* voluntarily dismissed her claims in January 2014, but refiled the case in May 2014 alleging purely economic damages (i.e., no personal injury or property damage). The Company does not believe that the Schoelwer Claim has any legal merit, and is therefore vigorously defending that Claim.

In February of 2012, the Company was made aware of a fraud perpetrated by an outside party involving insurance related premiums that the Company had prepaid for umbrella coverage. The assets are currently secured by a governmental agency who investigated the case, held in a custodial account. As of May of 2014, utilizing the secured funds, the court has ordered restitution to all victims including Omega. It is not clear however at this point what amount will eventually be received by the Company. The value of the assets on the books amount to \$213,000 at September 30, 2014, and \$227,000 at December 31, 2013, and are included in Other Long Term Assets. It is possible that not all of those funds will be returned to the Company, or the Company may need to incur additional costs to procure collection. The Company is currently pursuing all avenues in an effort to bring closure to the event, reclaim the assets, and has since replaced the aforementioned insurance coverage.

## 6. STOCK BASED PLANS

### Phantom Stock Plan

**Plan Description.** On April 1, 2006, the Company adopted the Omega Flex, Inc. 2006 Phantom Stock Plan (the *Plan*). The Plan authorizes the grant of up to one million units of phantom stock to employees, officers or directors of the Company and of any of its subsidiaries. The phantom stock units ("Units") each represent a contractual right to payment of compensation in the future based on the market value of the Company's common stock.

The Units are not shares of the Company's common stock, and a recipient of the Units does not receive any of the following:

§

ownership interest in the Company

§

shareholder voting rights

§

other incidents of ownership to the Company's common stock

The Units are granted to participants upon the recommendation of the Company's CEO, and the approval of the Compensation Committee. Each of the Units that are granted to a participant will be initially valued by the Compensation Committee, and at a minimum, the Unit's value will be equal to the closing price of the Company's common stock on the grant date. The Units follow a vesting schedule, with a maximum vesting of 3 years after the grant date. Upon vesting, the Units represent a contractual right of payment for the value of the Unit. The Units will be paid on their maturity date, one year after all of the Units granted in a particular award have fully vested, unless an acceptable event occurs under the terms of the Plan prior to one year, which would allow for earlier payment. The amount to be paid to the participant on the maturity date is dependent on the type of Unit granted to the participant.

The Units may be *Full Value*, in which the value of each Unit at the maturity date, will equal the closing price of the Company's common stock as of the maturity date; or *Appreciation Only*, in which the value of each Unit at the maturity date will be equal to the closing price of the Company's common stock at the maturity date *minus* the closing price of the Company's common stock at the grant date.

On December 9, 2009, the Board of Directors authorized an amendment to the Plan to pay an amount equal to the value of any cash or stock dividend declared by the Company on its common stock to be accrued to the phantom stock units outstanding as of the record date of the common stock dividend. The dividend equivalent will be paid at the same time the underlying phantom stock units are paid to the participant.

In certain circumstances, the Units may be immediately vested upon the participant's death or disability. All Units granted to a participant are forfeited if the participant is terminated from his relationship with the Company or its subsidiary for *cause*, which is defined under the Plan. If a participant's employment or relationship with the Company is terminated for reasons other than for *cause*, then any vested Units will be paid to the participant upon termination. However, Units granted to certain specified employees as defined in Section 409A of the





Internal Revenue Code will be paid approximately 181 days after termination.

**Grants of Phantom Stock Units.** As of December 31, 2013, the Company had 17,193 unvested units outstanding, all of which were granted at *Full Value*. On February 19, 2014, the Company granted an additional 10,460 *Full Value* Units with a fair value of \$17.72 per unit on grant date, using historical volatility. In March 2014, the Company paid \$199,000 for the 8,100 fully vested and matured units that were granted on March 3, 2010, including their respective earned dividend values. As of September 30, 2014, the Company had 19,156 unvested units outstanding.

The Company uses the Black-Scholes option pricing model as its method for determining fair value of the Units. The Company uses the straight-line method of attributing the value of the stock-based compensation expense relating to the Units. The compensation expense (including adjustment of the liability to its fair value) from the Units is recognized over the vesting period of each grant or award.

The FASB ASC Topic 718, Stock Compensation, requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates in order to derive the Company's best estimate of awards ultimately to vest.

Forfeitures represent only the unvested portion of a surrendered Unit and are typically estimated based on historical experience. Based on an analysis of the Company's historical data, which has limited experience related to any stock-based plan forfeitures, the Company applied a 0% forfeiture rate to Plan Units outstanding in determining its Plan Unit compensation expense as of September 30, 2014.

The total Phantom Stock related liability as of September 30, 2014 was \$439,000 of which \$167,000 is included in other liabilities, as it is expected to be paid in March 2015, and the balance of \$272,000 is included in other long term liabilities.

In accordance with FASB ASC Topic 718, Stock Compensation, the Company recorded compensation expense of approximately \$139,000 and \$234,000 related to the Phantom Stock Plan for the nine months ended September 30, 2014 and 2013, respectively.

The following table summarizes information about the Company's nonvested phantom stock Units at September 30, 2014:

	<b>Units</b>	<b>Weighted Average Grant Date Fair Value</b>
Number of Phantom Stock Unit Awards:		
Nonvested at December 31, 2013	17,193	\$12.89
Granted	10,460	\$17.72
Vested	(8,497)	\$12.57
Forfeited	---	---
Canceled	---	---
Nonvested at September 30, 2014	19,156	\$15.67
Phantom Stock Unit Awards Expected to Vest	19,156	\$15.67

The total unrecognized compensation costs calculated at September 30, 2014 are \$244,000 which will be recognized through February of 2017. The Company will recognize the related expense over the weighted average period of 1.48 years.

## **7. NONCONTROLLING INTERESTS**

The Company owns 100% of all subsidiaries, except for a small portion of one, which is owned by a Noncontrolling Interest. At December 31, 2013, Total Shareholders' Equity was \$25,631,000, and the Noncontrolling Interest was \$122,000. For the nine month period ended September 30, 2014, the Noncontrolling Interest's portion of Net Income was approximately \$95,000, and their portion of Other Comprehensive Income was a loss of \$4,000. At September 30, 2014, Total Shareholders' Equity was \$34,752,000, of which the Noncontrolling Interest held a value of \$213,000.

## **8. SHAREHOLDERS' EQUITY**

As of September 30, 2014 and December 31, 2013, the Company had authorized 20,000,000 common stock shares with par value of \$0.01 per share. At both dates, the number of shares issued was 10,153,633, and the total number of outstanding shares was 10,091,822, with the 61,811 variance representing shares held in Treasury.

On April 4, 2014, the Company's Board of Directors authorized an extension of its stock repurchase program without expiration, up to a maximum amount of \$1,000,000. The original program established in December of 2007 authorized the purchase of up to \$5,000,000 of its common stock. The purchases may be made from time-to-time in the open market or in privately negotiated transactions, depending on market and business conditions. The Board retained the right to cancel, extend, or expand the share buyback program, at any time and from time-to-time. Since inception, the Company has purchased a total of 61,811 shares for approximately \$932,000, or approximately \$15 per share. The Company did not make any stock repurchases during the first nine months of 2014, or during the year ended December 31, 2013.

## **9.**

## **SUBSEQUENT EVENTS**

The Company evaluated all events or transactions that occurred through the date of this filing. During this period, the Company did not have any material subsequent events that impacted its condensed consolidated financial statements.

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

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

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

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

**OVERVIEW**

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 managed 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, with a comprehensive portfolio of intellectual property and patents issued in various countries around the world. The Company's primary product, 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 trademarks AutoSnap<sup>®</sup> and AutoFlare<sup>®</sup>, TracPipe<sup>®</sup> and TracPipe<sup>®</sup> CounterStrike<sup>®</sup> flexible gas piping allows users to substantially cut the time required to install gas piping, as compared to traditional methods. The Company's products are manufactured at the Company's Exton, Pennsylvania facilities and in Banbury, Oxfordshire in the United Kingdom. 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**

The Cash balance was \$16,123,000 at September 30, 2014, compared to \$8,257,000 at December 31, 2013, increasing \$7,866,000 (95.3%) during the nine months. The Company had Net Income attributable to Omega Flex, Inc. of \$9,126,000 through the first nine months of the year, but as typical during the first portion of the year, also paid some major obligations, such as incentive compensation, promotional incentives and taxes, which offset a portion of the cash generation from operations.

The Accounts Receivable balance was \$15,094,000 at September 30, 2014, compared to \$12,968,000 at December 31, 2013, therefore increasing \$2,126,000 (16.4%) during the period. Sales for the third quarter of 2014 were approximately 9% higher than sales in the fourth quarter of 2013, which therefore created an increase in the Accounts Receivable balance, and the remaining change between periods is principally due to timing.

Accrued Commissions and Sales Incentives decreased \$1,154,000 (29.3%), being \$2,780,000 at September 30, 2014, compared to \$3,934,000 at December 31, 2013. The decrease mostly pertained to the payment of annual sales incentive programs earned in 2013 and paid during the first quarter of 2014, offset partially by the recording of the new 2014 program obligations. Historically, annual programs represent a significant portion of the overall sales incentive payment structure, and therefore the balance at the end of a year is typically more significant than during any other quarter end. Additionally, sales incentives have been lower in 2014 than in the prior year largely due to some customers inability to reach required growth tiers which enable them to earn higher payouts.

**RESULTS OF OPERATIONS****Three-months ended September 30, 2014 vs. September 30, 2013**

The Company reported comparative results from operations for the three-months ended September 30, 2014 and 2013 as follows:

		<b><u>Three-months ended September 30,</u></b>			
		(in thousands)			
		<b>2014</b>	<b>2014</b>	<b>2013</b>	<b>2013</b>
		<b>(\$000)</b>		<b>(\$000)</b>	
Net Sales	\$		100.0%	\$	100.0%
		23,837		19,988	
Gross Profit	\$		60.1%	\$	54.9%
		14,316		10,979	
Operating Profit	\$		25.6%	\$	20.5%
		6,095		4,089	

**Net Sales.** The Company's 2014 third quarter sales increased \$3,849,000 (19.3%) over the same period in 2013, ending at \$23,837,000 for the three months ended September 30, 2014, compared to \$19,988,000 for the same three months in 2013.



The 19.3% increase in Net Sales for the quarter was largely driven by a rise in unit volume, reflecting a solid rebound in the construction environment from the sluggish first quarter of the year that was stifled by the harsh weather conditions seen across a large portion of the United States. Net Sales for the period have also benefited from modest price improvements, such as a decrease in promotional incentives.

**Gross Profit.** The Company's gross profit margins have improved between the two periods, being 60.1% and 54.9% for the three-months ended September 30, 2014 and 2013, respectively. The favorable change resulted from a combination of items, including the pricing improvements noted above, and the Company's ability to find various efficiencies in cost of sales.

**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 \$3,706,000 and \$3,185,000 for the three-months ended September 30, 2014 and 2013, respectively, representing an increase of \$521,000. Commissions and freight each increased largely in conjunction with the increase in sales, and advertising was also higher during the quarter. Sales expense as a percent of net sales has however decreased, being 15.6% for the three-months ended September 30, 2014, compared to 15.9% for the three-months ended September 30, 2013.

**General and Administrative Expenses.** General and administrative expenses consist primarily of employee salaries, benefits for administrative, executive and finance personnel, legal and accounting, insurance, and corporate general and administrative services. General and administrative expenses were \$3,751,000 and \$3,032,000 for the three-months ended September 30, 2014 and 2013, respectively, increasing \$719,000 or 23.7% between periods. There was a \$573,000 increase in staffing related expenses, mostly incentive compensation earned in association with the strong profits generated during the quarter. Additionally, the Company recognized an increase in legal and insurance related expenses primarily associated with product liability claims and coverage. As a percentage of sales, general and administrative expenses increased to 15.7% for the three months ended September 30, 2014 from 15.2% for the three months ended September 30, 2013.

**Engineering Expense.** Engineering expenses consist of development expenses associated with the development of new products, and costs related to enhancements of existing products and manufacturing processes. Engineering expenses increased \$91,000 for the quarter. They were \$764,000 and \$673,000 for the three months ended September 30, 2014 and 2013, respectively. Engineering expenses as a percentage of sales were 3.2% and 3.4% for the three months ended September 30, 2014, and 2013, respectively, showing a slight improvement.

**Operating Profit.** Reflecting all of the factors mentioned above, Operating Profits increased by \$2,006,000, or 49.1% over last year. The Company had a profit of \$6,095,000 in the three-month period ended September 30, 2014, versus a profit of \$4,089,000 in the three-months ended September 30, 2013.

**Interest Income (Expense).** Interest income is recorded on cash investments, and interest expense is recorded at times when the Company has debt amounts outstanding on its line of credit. The interest income was nominal for the third quarter of 2014 and 2013.

**Other Income (Expense).** Other Income (Expense) primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our U.K. subsidiary. For the current quarter, the Company recognized expense of \$32,000, but in 2013, the Company recorded income of \$64,000.

**Income Tax Expense.** Income Tax Expense was \$2,002,000 for the third quarter of 2014, compared to \$1,420,000 for the same period in 2013. The \$582,000 increase was primarily due to higher income before taxes. The Company's effective tax rate in 2014 approximates the 2013 rate and does not differ materially from expected statutory rates.

### **Nine-months ended September 30, 2014 vs. September 30, 2013**

The Company reported comparative results from operations for the nine-months ended September 30, 2014 and 2013 as follows:

		<b><u>Nine-months ended September 30,</u></b>			
		(in thousands)			
	<b>2014</b>	<b>2014</b>	<b>2013</b>	<b>2013</b>	
	<b>(\$000)</b>		<b>(\$000)</b>		
Net Sales	\$	100.0%	\$	100.0%	
Gross Profit	\$	58.1%	\$	53.9%	
Operating Profit	\$	22.7%	\$	18.9%	
	13,655		10,446		

**Net Sales.** The Company's sales for the first nine months of 2014 increased \$5,036,000 (9.1%) over the same period in 2013, ending at \$60,298,000 and \$55,262,000 in 2014 and 2013, respectively.

The 9.1% increase in Net Sales reflects a steady progression of improvement over the year, as the first quarter saw growth of 1.3%, and through the first six months Net Sales had increased by 3.4% over 2013. As previously noted, the construction environment was hampered by the harsh weather conditions during the first quarter, but has since picked up. The increase in sales is a combination of price enhancements, including a decrease in promotional incentives, and a rise in unit volume.

**Gross Profit.** The Company's gross profit margins have increased between the two periods, being 58.1% and 53.9% for the nine-months ended September 30, 2014 and 2013, respectively. The improvement resulted from a combination of items, including the pricing changes noted above, and the Company's ability to find various efficiencies in cost of sales.





**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 \$10,257,000 and \$9,429,000 for the nine-months ended September 30, 2014 and 2013, respectively, representing an increase of \$828,000. Although no particular item was the main contributor or represented a significant increase on its own, there were a few components that were higher than others and make up the bulk of the difference. Advertising costs increased due to various campaigns, and staffing related expenses also rose. In addition, Commissions and freight increased compared to last year, largely in relation with the increase in sales. Sales expense as a percent of Net Sales was mostly flat, being 17.0% for the nine-months ended September 30, 2014, and 17.1% for the nine-months ended September 30, 2013.

**General and Administrative Expenses.** General and administrative expenses consist primarily of employee salaries, benefits for administrative, executive and finance personnel, legal and accounting, insurance, and corporate general and administrative services. General and administrative expenses were \$9,011,000 and \$7,908,000 for the nine-months ended September 30, 2014 and 2013, respectively, increasing \$1,103,000 between periods. The majority of the change pertained to an increase in staffing related expenses of \$997,000, mostly incentive compensation earned in associated with the strong profits generated during the year. As a percentage of sales, general and administrative expenses increased to 14.9% for the nine-months ended September 30, 2014 from 14.3% for the nine-months ended September 30, 2013.

**Engineering Expense.** Engineering expenses consist of development expenses associated with the development of new products, and costs related to enhancements of existing products and manufacturing processes. Engineering expenses have increased slightly between periods, as they were \$2,126,000 and \$2,017,000 for the nine-months ended September 30, 2014 and 2013, respectively. Engineering expenses as a percentage of sales were 3.5% for the nine-months ended September 30, 2014 and 3.7% for the nine-months ended September 30, 2013.

**Operating Profit.** Reflecting all of the factors mentioned above, Operating Profits were up \$3,209,000 or 30.7%, ending with a profit of \$13,655,000 for the first nine months of 2014, compared to \$10,446,000 in 2013.

**Interest Income (Expense).** Interest income is recorded on cash investments, and interest expense is recorded at times when the Company has debt amounts outstanding on its line of credit. There was a nominal amount of interest income recorded during the first nine months of 2014 and 2013.

**Other Income (Expense).** Other Income (Expense) primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our U.K. subsidiary. For the nine month period, there was expense of \$25,000 in 2014, and \$62,000 in 2013, both largely the result of a weakened British Pound.

**Income Tax Expense.** Income Tax Expense was \$4,430,000 for the first nine months of 2014, compared to \$3,518,000 for the same period in 2013, increasing by \$912,000, largely in correlation with the change in income before taxes. The Company's effective tax rate in 2014

approximates the 2013 rate and does not differ materially from expected statutory rates.

### **CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES**

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

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the dates of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition and related sales incentives, accounts receivable valuations, inventory valuations, goodwill valuation, product liability reserve and accounting for income taxes. Actual amounts could differ significantly from these estimates.

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

#### **Revenue Recognition**

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

.

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

.

Delivery has occurred or services rendered.

.

The sales price to the customer is fixed or determinable.

.

Collection is reasonably assured.

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

Gross sales are reduced for all consideration paid to customers for which no identifiable benefit is received by the Company. This includes promotional incentives, which includes various programs including year-end rebates and discounts. The amounts of certain incentives are known with reasonable certainty at the time of sale, while others are projected based upon the most reliable information available at the reporting date.

Commissions, for which the Company receives an identifiable benefit, are accounted for as a sales expense.



### **Accounts Receivable**

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance for uncollectible amounts is based primarily on specific analysis of accounts in the receivable portfolio and historical write-off experience. While management believes the allowance to be adequate, if the financial condition of the Company's customers were to deteriorate, resulting in their inability to make payments, additional allowances may be required.

### **Inventory**

Inventories are valued at the lower of cost or market. Cost of inventories is determined by the first-in, first-out (FIFO) method. The Company generally considers inventory quantities beyond two-years usage, measured on a historical usage basis, to be excess inventory and reduces the gross carrying value of inventory accordingly.

### **Goodwill**

In accordance with FASB ASC Topic 350, Intangibles - Goodwill and Other, the Company performs an annual impairment test in accordance with this guidance at the end of each year, or when a triggering event is noted that may indicate impairment. This was last tested at December 31, 2013, and the analysis did not indicate any impairment of goodwill. There are no circumstances that indicate that Goodwill might be impaired at September 30, 2014.

### **Product Liability Reserves**

Product liability reserves represent the estimated unpaid amounts under the Company's insurance policies with respect to existing claims. The Company uses the most current available data to estimate claims. As explained more fully under Note 5, Commitments and Contingencies, for various product liability claims covered under the Company's general liability insurance policies, the Company must pay certain defense costs within its deductible or self-insured retention limits, ranging primarily from \$25,000 to \$250,000 per claim, depending on the terms of the policy in the applicable policy year, up to an aggregate amount. The Company is vigorously defending against all known claims.

### **Fair Value of Financial and Nonfinancial Instruments**

The Company measures financial instruments in accordance with Financial Accounting Standards Board (FASB) ASC Topic 820, Fair Value Measurements and Disclosures. The accounting standard defines fair value, establishes a framework for measuring fair value under GAAP, and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure

fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard creates a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels as follows: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs that reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability. The Company relies on its actively traded share value a level 1 input in determining the fair value of the reporting unit in its annual impairment test as described in the FASB ASC Topic 350, Intangibles - Goodwill and Other.

### **Earnings per Common Share**

Basic earnings per share have been computed using the weighted-average number of common shares outstanding. For the periods presented, there are no dilutive securities. Consequently, basic and dilutive earnings per share are the same.

### **Currency Translation**

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at exchange rates prevailing on the balance sheet dates. The Statements of Income are translated into U.S. dollars at average exchange rates for the period. Adjustments resulting from the translation of financial statements are excluded from the determination of income and are accumulated in a separate component of shareholders' equity. Exchange gains and losses resulting from foreign currency transactions are included in operations (other income (expense)) in the period in which they occur.

### **Income Taxes**

The Company accounts for taxes in accordance with the FASB ASC Topic 740, Income Taxes. Under this method the Company records income tax expense and the related deferred taxes and tax benefits.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in income in the period in which the rate is enacted. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain. No valuation reserve was deemed necessary at September 30, 2014 or at December 31, 2013. Also, in accordance with FASB ASC Topic 740 (formerly FIN 48), the Company had reserves on the books for uncertainties in tax positions of \$104,000, and \$100,000 at September 30, 2014, and December 31, 2013, respectively. These reserves are reviewed each quarter.

### **Other Comprehensive Income (Loss)**

For the nine-months ended September 30, 2014 and 2013, respectively, the sole component of Other Comprehensive Income (Loss) was a foreign currency translation adjustment.

### **New Accounting Pronouncements**

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, requiring an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. Early adoption is not permitted. The updated standard becomes effective for the Company in the first quarter of fiscal year 2017. The Company has not yet selected a transition method and is currently evaluating the effect that the updated standard will have on the consolidated financial statements.

ASU 2013-11, *Income Taxes (Topic 740): Presentation of Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force)*. Per this ASU, an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The initial adoption of this guidance in 2014 did not have a material effect on the Company's financial statements.

### **LIQUIDITY AND CAPITAL RESOURCES**

Historically, the Company's primary cash needs have been related to working capital items, which the Company has largely funded through cash generated from operations.

As of September 30, 2014, the Company had a cash balance of \$16,123,000. Additionally, the Company has a \$10,000,000 line of credit available with Sovereign, as discussed in detail in Note 4, which had no borrowings outstanding upon it at September 30, 2014. At December 31, 2013, the Company had cash of \$8,257,000, and also had no borrowings against the line of credit at that time.

### **Operating Activities**

Cash provided by operating activities is net income adjusted for certain non-cash items and changes in certain assets and liabilities, such as those included in working capital.

For the first nine months of 2014, the Company's cash provided from operating activities was \$8,024,000, compared to \$6,905,000 of cash provided during the first nine months of 2013, thus increasing by \$1,119,000 between periods. It is worthy to note that the cash activity during 2013 had two unusual events that were significant, and partially offsetting. The Company paid approximately \$1,300,000 during the first quarter of 2013 related to the settlement in England, as discussed in Note 11 of the Company's December 31, 2013 Form 10-K, which depleted cash. Inversely, most of the incentive compensation earned during 2012 was paid in December of the same year, whereas it is usually paid during the first quarter of the following year, and therefore had the effect of increasing cash generation during 2013 by slightly over \$2,000,000. Excluding those two isolated events from 2013, cash generation during 2014 was even stronger than the prior year than originally described above.

As a general trend, the Company tends to deplete cash early in the year, as significant payments are typically made for accrued promotional incentives, incentive compensation, and taxes. Cash has then historically shown a tendency to be restored and accumulated during the latter portion of the year.

### **Investing Activities**

Cash used in investing activities for the first nine months of 2014 and 2013 was \$78,000 and \$473,000, respectively, all related to capital expenditures for both periods. During 2013, the Company added machinery and leasehold improvements to the new facility in Exton which required a greater outlay of cash than in the current year.

We believe our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend upon many factors including our rate of revenue growth, the timing and extent of any expansion efforts, and the potential for investments in, or the acquisition of any complementary products, businesses or supplementary facilities for additional capacity. There are currently no known material commitments for capital expenditures.

### **Financing Activities**

The Company paid \$324,000 during the first quarter of 2013 to pay off the entire outstanding balance on the line of credit that existed at December 31, 2012. The Company had no borrowings on its line of credit during 2013 or 2014, and therefore did not have any outstanding balances on the line at either September 30, 2014 or December 31, 2013.

As of October 23, 2014, the Company agreed to new proposed terms provided by Santander Bank, formerly Sovereign Bank, NA ( Sovereign ) which would allow the Company to borrow on an unsecured \$15,000,000 line of credit for a period of five years with interest rates



slightly more favorable to the Company than provided in the existing December 30, 2010 agreement, which is detailed in Note 4, under Line of Credit . The revised formal Revolving Line of Credit Note and Loan Agreement are currently being finalized.

### **CONTINGENT LIABILITIES AND GUARANTEES**

See Note 5 to the Company s condensed consolidated financial statements.

### **OFF-BALANCE SHEET ARRANGEMENTS**

Refer to Item 7 of the Company s 2013 year-end Form 10-K under the caption Off-Balance Sheet Obligations or Arrangements .

### **Item 3. Quantitative And Qualitative Information About Market Risks**

The Company does not engage in the purchase or trading of market risk sensitive instruments. The Company does not presently have any positions with respect to hedge transactions such as forward contracts relating to currency fluctuations. No market risk sensitive instruments are held for speculative or trading purposes.

### **Item 4 Controls And Procedures**

(a)

Evaluation of Disclosure Controls and Procedures.

At the end of the fiscal third quarter of 2014, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The Company s disclosure controls and procedures are designed to ensure that the Company records, processes, summarizes and reports in a timely manner the information required to be disclosed in the periodic reports filed by the Company with the Securities and Exchange Commission. The Company s management, including the chief executive officer and chief financial officer, have conducted an evaluation of the effectiveness of the design and operation of the Company s Disclosure Controls and Procedures as defined in the Rule 13a-15(e) of Securities Exchange Act of 1934. Based on that evaluation, the chief executive officer and chief financial officer have concluded that, as of the date of this report, the Company s disclosure controls and procedures are effective to provide reasonable assurance of achieving the purposes described in Rule 13a-15(e), and no changes are required at this time.

(b)

Changes in Internal Controls.

There was no change in the Company s internal control over financial reporting (as defined in rule 13a-15(f) of the Securities Exchange Act of 1934) identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934 that occurred during the three-month period covered by this Report on Form 10-Q that has materially affected or is reasonably likely to materially affect the Company s internal control over financial reporting subsequent to the date the chief executive officer and chief financial officer completed their evaluation.



## **PART II - OTHER INFORMATION**

### **Item 1 Legal Proceedings**

The Company's general liability insurance policies are subject to deductibles or retentions, ranging primarily from \$25,000 to \$250,000 per claim, (depending on the terms of the policy and the applicable policy year) up to an aggregate amount. The Company is insured on a first dollar basis for workers' compensation subject to statutory limits. In the ordinary and normal conduct of the Company's business, it is subject to periodic lawsuits, investigations and claims (collectively, the Claims). For several years, there has been an increase in the number of those Claims relating primarily to product liability. Although the pace of new Claims has slowed during 2014, many of the new Claims are associated with higher deductible or retention programs. The Company does not believe that the Claims have legal merit, and is therefore vigorously defending against those Claims. In 2013, the Company won two of the Claims at two separate trials, both of which were held in U.S. District Court; one in St. Louis, Missouri and the other in Bridgeport, Connecticut. In both cases, the jury unanimously found that the Company was not negligent in designing its TracPipe® product, and that the TracPipe® product was not defective or unreasonably dangerous. In 2010, the Company took its first Claim to trial in Pennsylvania, and the jury returned a verdict that the Company was not negligent in designing and selling the TracPipe product, but that under the unique law in Pennsylvania for strict liability, the product lacked any element necessary to make it safe for its intended use. The Company has appealed that portion of the verdict, and the Supreme Court of Pennsylvania heard oral arguments on that case with the focus on whether the product liability law in Pennsylvania should be revised. A decision is expected in 2014.

The Company has in place commercial general liability insurance policies that cover the Claims, as noted above, including those alleging damages as a result of product defects. Litigation is subject to many uncertainties and management is unable to predict the outcome of the pending suits and claims. The potential liability for a given claim could range from zero to a maximum of \$250,000, depending upon the insurance deductible or retention in place for the respective claim year. The aggregate maximum exposure for all current open Claims is estimated to not exceed approximately \$4,100,000, which represents the potential costs that may be incurred over time for the Claims within the applicable insurance policy deductibles or retentions. It is possible that the results of operations or liquidity of the Company, as well as the Company's ability to procure reasonably priced insurance, could be adversely affected by the pending litigation, potentially materially. The Company is currently unable to estimate the ultimate liability, if any, that may result from the pending litigation, or potential litigation from future claims or claims that have not yet come to our attention, and accordingly, the liability in the consolidated financial statements primarily represents an accrual for legal costs for services previously rendered and outstanding settlements for existing claims. The liabilities recorded on the Company's books at September 30, 2014 and December 31, 2013 were \$518,000 and \$686,000, respectively, and are included in Other Liabilities.

Finally, two putative class action cases have been filed against the Company; one in U.S. District Court for the Middle District of Florida titled *Hall v. Omega Flex, Inc.* and one in U.S. District Court for the Southern District of Ohio titled *Schoelwer v. Omega Flex, Inc.* In both

cases, the lead plaintiffs claimed that they are exposed to an increased likelihood of harm if one of the plaintiffs houses that contain TracPipe CSST is struck by lightning, that could damage the CSST causing a release of fuel gas in the house and causing a fire. However, none of the lead plaintiffs have suffered any actual harm. In January 2014, the judge in the *Hall* case granted the Company's motion to dismiss all of the plaintiff's claims due primarily to a lack of jurisdiction because there is no actual case or controversy posed by these claims. The plaintiff in *Schoelwer* voluntarily dismissed her claims in January 2014, but refiled the case in May 2014 alleging purely economic damages (i.e., no personal injury or property damage). The Company does not believe that the Schoelwer Claim has any legal merit, and is therefore vigorously defending that Claim.

In February of 2012, the Company was made aware of a fraud perpetrated by an outside party involving insurance related premiums that the Company had prepaid for umbrella coverage. The assets are currently secured by a governmental agency who investigated the case, held in a custodial account. As of May of 2014, utilizing the secured funds, the court has ordered restitution to all victims including Omega. It is not clear however at this point what amount will eventually be received by the Company. The value of the assets on the books amount to \$213,000 at September 30, 2014, and \$227,000 at December 31, 2013, and are included in Other Long Term Assets. It is possible that not all of those funds will be returned to the Company, or the Company may need to incur additional costs to procure collection. The Company is currently pursuing all avenues in an effort to bring closure to the event, reclaim the assets, and has since replaced the aforementioned insurance coverage.

#### **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 third quarter of 2014.

#### **Item 6 - Exhibits**

##### **Exhibit**

##### **No.**

##### **Description**

31.1

Certification of Chief Executive Officer of Omega Flex, Inc. pursuant to Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.

31.2

Certification of Chief Financial Officer of Omega Flex, Inc. pursuant to 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended.

32.1

Certification of Chief Executive Officer and Chief Financial Officer of Omega Flex, Inc., pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

OMEGA FLEX, INC.  
(Registrant)

Date: November 7, 2014

By: /S/ Paul J. Kane  
Paul J. Kane  
Vice President Finance  
and Chief Financial Officer