FLANDERS CORP
Form 10-Q
August 20, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2002
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 [X] NO [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock: As of August 13, 2002, the issuer had 26,033,153 shares common stock, par value $.001 per share, outstanding.

FLANDERS CORPORATION
FORM 10-Q
FOR QUARTER ENDED June 30, 2002

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FLANDERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

	June 30,	December 31,

ASSETS	2002	2001
	(unaudited)	
Current assets		
Cash and cash equivalents	$ 3,119,165	$ 3,877,785
Receivables:		
Trade, less allowance for doubtful accounts: 6/30/2002 $1,827,984; 12/31/2001 $1,531,650	33,652,730	29,995,949
Other	593,230	483,941
Inventories (Note B)	33,468,763	31,391,365
Deferred taxes	1,994,964	1,994,964
Other current assets	4,358,120	4,633,848
Total current assets	77,186,972	72,377,852
Related party receivables	482,650	549,350
Other assets	2,652,985	2,715,855
Intangible assets, less accumulated amortization of $3,670,891	28,332,207	28,332,307
Property and equipment, less accumulated depreciation: 6/30/2002 $ 36,906,808; 12/31/2001 $33,515,344	74,678,285	76,279,734
	$183,333,099	$180,255,098

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current maturities of long-term debt and capital leases	$ 32,124,454	$ 32,599,894
Accounts payable	18,075,342	15,726,086
Accrued expenses	9,367,392	9,449,073
Total current liabilities	59,567,188	57,775,053
Long-term capital lease obligations, less current maturities	3,047,458	3,173,502
Long-term debt, less current maturities	15,716,955	16,271,430
Long-term liabilities, other	1,280,983	1,089,983
Deferred taxes	4,989,362	5,065,762
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	26,033	26,033
Additional paid-in capital	90,331,524	90,331,524
Notes receivable	(8,519,326)	(8,325,978)
Accumulated other comprehensive loss	(768,590)	(653,990)
Retained earnings	17,661,512	15,501,779
	98,731,153	96,879,368
	$183,333,099	$180,255,098

See Notes to Consolidated Condensed Financial Statements

FLANDERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(unaudited)

	Three Months Ended June 30,		Six M[onths Ended] J[une 30,]
	2002	2001	2002
Net sales	$ 44,767,256	$ 49,916,418	$ 87,221,44
Cost of goods sold	33,266,881	39,794,877	66,540,26
Gross profit	11,500,375	10,121,541	20,681,17
Operating expenses	7,576,158	8,684,879	14,559,28
Operating income from continuing operations	3,924,217	1,436,662	6,121,89
Nonoperating expenses from continuing operations, net	(1,481,453)	(424,179)	(2,422,33
Earnings from continuing operations before income taxes	2,442,764	1,012,483	3,699,55
Provision for income taxes	981,531	465,993	1,539,82
Earnings from continuing operations	1,461,233	546,490	2,159,73
Loss from operations of discontinued subsidiary, (including tax benefit of $68,062 and $136,696 for the three months and six months ended June 30, 2001)	-	(90,950)	-
Net earnings	$ 1,461,233	$ 455,540	$ 2,159,73
Earnings per share from continuing operations			
Basic	$ 0.06	$ 0.02	$ 0.0
Diluted	$ 0.06	$ 0.02	$ 0.0
Loss per share from discontinued operations			
Basic	$ -	$ (0.00)	$ -
Diluted	$ -	$ (0.00)	$ -
Net earnings per share			
Basic	$ 0.06	$ 0.02	$ 0.0

Diluted	$ 0.06	$ 0.02	$ 0.0
Weighted average common shares outstanding			
Basic	26,033,153	26,033,153	26,033,15
Diluted	26,033,153	26,033,153	26,035,07

See Notes to Consolidated Condensed Financial Statements

FLANDERS CORPORATION AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock	Additional Paid-In Capital	Notes Receivable	Accum- ulated Other Compre- hensive Loss	Reta Earn
Balance, January 1, 2001	$ 26,380	$ 90,898,258	$ (7,891,208)	$ -	$ 15,
Interest on notes receivable secured by common shares	-	-	(434,770)	-	
Purchase and retirement of 354,000 shares of common stock	(354)	(585,527)	-	-	
Issuance of 7,520 shares of common stock upon exercise of options	7	18,793	-	-	
Comprehensive income (loss)					
Net earnings	-	-	-	-	
Transition adjustment				(579,273)	
Net loss on cash flow hedges				(74,717)	
Total comprehensive loss					
Balance, December 31, 2001	26,033	90,331,524	(8,325,978)	(653,990)	15,
Interest on notes receivable secured by common shares (unaudited)	-	-	(193,348)	-	
Comprehensive income (loss)					
Net earnings (unaudited)	-	-	-	-	2,
Net loss on cash flow hedges (unaudited)				(114,600)	
Total comprehensive income (unaudited)					
Balance, June 30, 2002 (unaudited)	$ 26,033	$ 90,331,524	$ (8,519,326)	$ (768,590)	$ 17,

See Notes to Consolidated Condensed Financial Statements

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

	Three Months Ended June 30,		Six M J
	2002	2001	2002
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash provided by continuing operations	$ 1,929,791	$ 409,972	$ 2,452,31
Net cash used in discontinued operations	-	(90,950)	-
Net cash provided by operating activities	1,929,791	319,022	2,452,31
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment	(1,225,620)	(2,776,127)	(2,106,56
Net proceeds from notes receivable	30,617	747,529	66,70
Net (increase) decrease in other assets	9,900	46,698	(15,11
Net cash used in investing activities of continuing operations	(1,185,103)	(1,981,900)	(2,054,97
CASH FLOWS FROM FINANCING ACTIVITIES			
Purchase and retirement of common stock	-	-	-
Net proceeds (payments) from revolving credit agreement	(209,127)	(135,206)	(492,81
Principal payments on long-term borrowings	(380,676)	(263,577)	(663,14
Net cash provided by (used in) financing activities	(589,803)	(398,783)	(1,155,95
Net increase (decrease) in cash and cash equivalents	154,885	(2,061,661)	(758,62
CASH AND CASH EQUIVALENTS			
Beginning of period	2,964,280	2,514,968	3,877,78
End of period	$ 3,119,165	$ 453,307	$ 3,119,16
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Cash paid during the period for:			
Income taxes	$ 83,193	$ -	$ 83,19

Interest	$ 1,372,911	$ 880,504	$ 2,814,72
SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES			
After tax impact of increase in interest rate swap liability	$ 203,397	$ -	$ 114,60

See Notes to Consolidated Condensed Financial Statements

FLANDERS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note A. Nature of Business and Interim Financial Statements

Nature of business:

The Company designs, manufactures and sells air filters and related products. It is focused on providing complete environmental control systems for end users ranging from controlling contaminants in residences and commercial office buildings through specialized manufacturing environments for semiconductors and pharmaceuticals. The Company also designs and manufactures much of its own production equipment to automate processes to decrease labor costs associated with its standard products. The Company also produces glass-based air filter media for many of its products. The vast majority of the Company's current revenues 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.

The Company sells some products for end users outside of the United States through domestic specialty cleanroom contractors. These sales are accounted for as domestic sales. The Company also sells 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 the Company's 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, 2001. In the opinion of management the interim 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 and six months ended June 30, 2002 may not be indicative of the results that may be expected for the year ending December 31, 2002.

Goodwill:

As of January 1, 2002, the Company adopted Statement of Financial Accounting Standard No. 142, "Goodwill and Other Intangible Assets" (SFAS 142). SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Thus, effective January 1, 2002, the Company has ceased amortization of goodwill, including goodwill recorded in past business combinations. The Company does not have any intangible assets with indefinite lives other than goodwill.

In connection with the transitional goodwill impairment evaluation, SFAS 142 required the Company to perform an assessment of whether there was an indication that goodwill was impaired as of January 1, 2002. To accomplish this the Company was required to identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company, as of June 30, 2002, determined the fair value of each reporting unit and compared it to the reporting unit's carrying amount. If a reporting unit's carrying amount exceeds its fair value, then the reporting unit's goodwill may be impaired and the Company must perform the second step of the transitional impairment test. As of June 30, 2002, the Company determined that the fair value of each reporting unit with goodwill exceeded the carrying amount, and hence there was no impairment.

FLANDERS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note A. Nature of Business and Interim Financial Statements - continued

The following table reconciles the Company's net earnings for the six months ended June 30, 2002 and 2001 adjusted to exclude goodwill amortization pursuant to SFAS 142 to amounts previously reported:

	Three Months Ended June 30,		Six M J
	2002	2001	2002
Net earnings			
Reported net earnings	$ 1,461,233	$ 455,540	$ 2,159,73
Add back: Goodwill amortization	-	215,248	-
Adjusted net earnings	$ 1,461,233	$ 670,788	$ 2,159,73
Earnings per share - basic			
Reported net earnings	$ 0.06	$ 0.02	$ 0.0
Goodwill amortization	-	0.01	-
Adjusted net earnings	$ 0.06	$ 0.03	$ 0.0
Earnings per share - diluted			

Reported net earnings	$ 0.06	$ 0.02	$ 0.0
Goodwill amortization	-	0.01	-
Adjusted net earnings	$ 0.06	$ 0.03	$ 0.0

Other comprehensive income (loss):

Other comprehensive income (loss) is defined as the change in equity during a period, from transactions and other events not included in net earnings, excluding changes resulting from investments by owners (e.g., supplement stock offerings) and distributions to owners (e.g., dividends).

As of June 30, 2002, accumulated comprehensive income (loss) consisted of the following:

Balance at December 31, 2001	$ (653,990)
Net change during the period related to cash flow hedges	(114,600)
Balance at June 30, 2002	$ (768,590)

Accounts receivable:

The majority of the Company's accounts receivable are due from large retail, wholesale, construction and other companies. Credit is extended based on evaluation of the customers' financial condition. Accounts receivable terms are within normal time frames for the respective industries. The Company maintains allowances for doubtful accounts for estimated losses, which are reviewed regularly by management. The estimated losses are based on the aging of accounts receivable balances and historical write-off experience, net of recoveries. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Note A. Nature of Business and Interim Financial Statements - continued

Derivative financial instruments:

The Company has two interest rate swap agreements to hedge against the potential impact on earnings from increases in market interest rates of two variable rate bonds. Under the interest rate swap agreements, the Company receives or makes payments on a monthly basis, based on the differential between 5.14% and a tax exempt interest rate as determined by a remarketing agent. These interest rate swap agreements are accounted for as a cash flow hedge in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133) as amended by SFAS 138, "Accounting for Certain Derivative Instruments and

Hedging Activities -- an Amendment to FASB Statement No. 133." The tax effected fair market value of the interest rate swap of $768,590 at June 30, 2002 is included in other comprehensive loss. The interest rate swap contracts expire in 2013 and 2015.

Note B. Inventories

Our inventories consist of the following at June 30, 2002 and December 31, 2001:

	6/30/2002	12/31/2001
Finished goods	$ 16,661,523	$ 14,530,664
Work in progress	3,986,286	3,287,288
Raw materials	13,540,785	14,723,048
	34,188,594	32,541,000
Less allowances	719,831	1,149,635
	$ 33,468,763	$ 31,391,365

Note C. Stock Options and Warrants

The following table summarizes the activity related to all Company stock options and warrants for the six months ended June 30, 2002 and the year ended December 31, 2001:

			Exercise Price per Share		Weighted Exercis per S
	Warrants	Stock Options	Warrants	Options	Warrants
Outstanding at January 1, 2001	540,000	4,725,720	$ 8.40 - 14.73	$ 2.50 - 9.50	$ 10.04
Granted	-	2,110,000	-	1.88 - 7.50	-
Exercised	-	(7,520)	-	2.50	-
Canceled or expired	-	(2,129,900)	-	2.50 - 9.50	-
Outstanding at December 31, 2001	540,000	4,698,300	8.40 - 14.73	1.88 - 8.50	10.04
Granted	-	230,000	-	1.44 - 2.36	-
Exercised	-	-	-	-	-
Canceled or expired	(140,000)	(379,300)	-	1.74 - 8.50	14.73
Outstanding at June 30, 2002	400,000	4,549,000	$ 8.40	$ 1.44 - 7.50	$ 8.40
Exercisable at June 30, 2002	400,000	4,369,000	$ 8.40	$ 1.88 - 7.50	$ 8.40

The warrants and options expire at various dates ranging from June 2003 through December 2008.

FLANDERS CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

Note D. 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 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 the Company's behalf which were specifically disallowed, that they refused to follow instructions given to them by the Company, 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. In addition, the Company is requesting reimbursement for excessive administrative fees paid but not allowed under the terms of the policy. 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 the future.

From time to time, the Company is a party as plaintiff or defendant to various legal proceedings related to 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.

Item 2. Management's Discussion and Analysis of Financial Condition and Results 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," our audited financial statements, and the related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our report on Form 10-K for the year ended December 31, 2001. 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 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 produce glass-based media for many of our air filtration products.

Critical Accounting Policies

The following discussion and analysis is based upon our consolidated condensed financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the periods reported, and assets and liabilities at the relevant balance sheet dates. Note A of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2001 describes the significant accounting policies used in preparation of the Consolidated Condensed Financial Statements. Estimates are used when accounting for certain items such as revenues, allowances for returns, early payment discounts, customer discounts, doubtful accounts, employee compensation programs, depreciation and amortization periods, taxes, inventory values, insurance programs, and valuations of investments, goodwill, other intangible assets and long-lived assets. We base our estimates on historical experience, where applicable, and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from our estimates under different assumptions or conditions.

We believe that the following critical accounting policies reflect our more significant judgments and estimates used in preparation of our consolidated financial statements. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payments due to us. We base our estimates on the aging of our accounts receivable balances and our historical write-off experience, net of recoveries. If the financial condition of one or more of our customers were to deteriorate, additional allowances may be required. We value our inventories at the lower of cost or market. We write down inventory balances for estimated obsolescence or unmarketable inventory equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, if there are changes in customer buying patterns, or if new technology or products are developed that compete with our existing inventory, additional inventory write-downs may be required. Our insurance costs are developed by management evaluation of the likelihood and probable amount of potential claims based on historical experience and evaluation of each claim. Changes in the key assumptions may occur in the future, which would result in changes to related insurance costs. We also have recorded goodwill and intangible assets related to previous acquisitions. We assess impairments associated with these assets when we determine that the undiscounted expected future cash flows decline below their carrying value. Poor operating performance of the business activities related to goodwill, other intangible assets, or long-lived assets could result in future cash flows of these assets declining below carrying values, which could require a writedown of the carrying value of these assets, which would adversely affect operating results.

Results of Operations for Three Months Ended June 30, 2002
Compared to June 30, 2001

The following table summarizes our results of operations as a percentage of net sales for the three months ended June 30, 2002 and 2001.

	Three Months Ended June 30,			
	2002		2001	
	$ (000's omitted)			
Net sales	$ 44,767	100.0%	$ 49,916	100.0%
Gross profit	11,500	25.7	10,122	20.3
Operating expenses	7,576	16.9	8,685	17.4
Operating income from continuing operations	3,924	8.8	1,437	2.9
Provision for income taxes	982	2.2	466	0.9
Earnings from continuing operations	1,461	3.3	546	1.1
Loss from discontinued operations	-	-	(91)	(0.2)
Net earnings	1,461	3.3	456	0.9

Net sales: Net sales for the second quarter of 2002 decreased by $5,149,000, or 10.3%, to $44,767,000 from $49,916,000 for the second quarter of 2001. This decrease in net sales was due to the continuation of an unexpectedly soft market that began in the fourth quarter of 2001, primarily related to our West Coast operations, where sales were down dramatically.

Gross Profit: Gross profit for the second quarter of 2002 increased by $1,378,000, or 13.6%, to $11,500,000, which represented 25.7% of net sales, from $10,122,000, which represented 20.3% of net sales, for the second quarter of 2001. The increase in gross profit percentage was principally attributable to price increases, the elimination of unprofitable accounts, and increases in operating efficiency in manufacturing operations, including labor force reductions.

Operating expenses: Operating expenses for the second quarter of 2002 decreased by $1,109,000, or 12.8%, to $7,576,000, representing 16.9% of net sales, from $8,685,000, representing 17.4% of net sales, for the second quarter of 2001. The decrease in operating expenses was caused by a decrease in sales-related expenses associated with decreased revenues, a decrease of approximately $215,000 of amortization of goodwill expenses caused by the Company's adoption of SFAS 142 effective January 1, 2002, and reductions in administrative staffing and other cost containment efforts.

Provision for income taxes: Our income tax provision for the second quarter of 2002 and 2001 consisted of a blended state and federal tax rate, excluding nondeductible expenses such as amortization of goodwill of approximately $215,000 during the second quarter of 2001, of approximately 40% of earnings from continuing operations before income taxes.

Results of Operations for Six Months Ended June 30, 2002
Compared to June 30, 2001

The following table summarizes our results of operations as a percentage of net sales for the six months ended June 30, 2002 and 2001.

	Six Months Ended June 30,			
	2002		2001	
	$ (000's omitted)			
Net sales	$ 87,221	100.0%	$ 97,006	100.0%
Gross profit	20,681	23.7	21,499	22.2
Operating expenses	14,559	16.7	18,199	18.8
Operating income from continuing operations	6,122	7.0	3,299	3.4
Provision for income taxes	1,540	1.8	1,201	1.2
Earnings from continuing operations	2,160	2.5	1,427	1.5
Loss from discontinued operations	-	-	(212)	(0.2)
Net earnings	2,160	2.5	1,214	1.3

Net sales: Net sales for the first half of 2002 decreased by $9,785,000, or 10.1%, to $87,221,000 from $97,006,000 for the first half of 2001. This decrease in net sales was due to the continuation of an unexpectedly soft market that began in the fourth quarter of 2001.

Gross Profit: Gross profit for the first half of 2002 decreased by $818,000, or 3.8%, to $20,681,000, which represented 23.7% of net sales, from $21,499,000, which represented 22.2% of net sales, for the first half of 2001. The increase in gross profit percentage was principally attributable to price increases, the elimination of unprofitable accounts, and increases in operating efficiency in manufacturing operations, including labor force reductions.

Operating expenses: Operating expenses for the first half of 2002 decreased by $3,640,000, or 20.0%, to $14,559,000, representing 16.7% of net sales, from $18,199,000, representing 18.8% of net sales, for the first half of 2001. The decrease in operating expenses was caused by a decrease in sales-related expenses associated with decreased revenues, a decrease of approximately $430,000 of amortization of goodwill expenses caused by the Company's adoption of SFAS 142 effective January 1, 2002, and reductions in administrative staffing and other cost containment efforts.

Provision for income taxes: Our income tax provision for the first half of 2002 and 2001 consisted of a blended state and federal tax rate, excluding nondeductible expenses such as amortization of goodwill of approximately $430,000 during the first half of 2001, of approximately 40% of earnings from continuing operations before income taxes.

Liquidity and Capital Resources

Our working capital was approximately $17,620,000 at June 30, 2002, compared to approximately $14,603,000 at December 31, 2001. This includes cash and cash equivalents of $3,119,000, at June 30, 2002 and $3,878,000 at December 31, 2001.

Our trade receivables increased $3,657,000, or 12.2%, to $33,653,000 at June 30, 2002, from $29,996,000 at December 31, 2001. Days sales outstanding, the ratio of receivables to average daily sales during the prior three months was 68 days at June 30, 2002 and 64 days at December 31, 2001. 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 generated $1,930,000 and $319,000 of cash during the second quarters of 2002 and 2001,

respectively. 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. 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 used $590,000 of cash during the second quarter of 2002, primarily consisting of payments on debt. Our investing activities consumed $1,185,000 of cash during the second quarter of 2002, primarily used to purchase property and equipment.

We currently have a $30 million working capital credit facility from two banks, which expires August 30, 2002. As of June 30, 2002, we had used approximately $29.3 million of the $30 million working capital facility. The working capital credit facility bears interest at LIBOR, which was 2.25% at June 30, 2002, plus 3.5%. At times during 2000 and 2001, including at December 31, 2001, the Company was in violation of certain of financial loan covenants. The working capital credit facility is collateralized by the pledge of all common stock of the subsidiaries owned by the Company and other assets of the Company.

In connection with the working capital credit facility and notes payable to a regional development authority and bank, the Company has agreed to certain restrictive covenants which include, among other things, not paying dividends, not repurchasing its stock, 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. Unless this credit facility is renewed, it will expire in August 2002. Failure to negotiate an extension to this credit facility, enter into a replacement facility, or obtain additional equity will materially adversely impact our business and operations.

Future operations and planned expansion may require substantial capital investment for the manufacture of filtration products. Although we have been able to arrange debt facilities or equity financing needed 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 through open market or negotiated transactions. Further repurchases under this program are restricted under our current line of credit agreement. As of August 16, 2002, approximately 575,000 shares had been repurchased in the open market under this authorization.

Outlook

We recently announced that we had adapted our biocontainment products for use as part of a system for hardening government buildings, commercial office complexes and public venues against airborne bioweapons such as anthrax and smallpox. There is currently interest in these products, but we do not know whether this interest will be sustained for a long period of time, or whether this interest will actually produce significant sales of these products. Any significant trend towards requiring hardening of these types of facilities against airborne bioweapons could have a significant impact on our business.

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 to $15 per month). These are new products which are substantially different in features, appearance and performance from competing products. 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 debt financing, to meet working capital requirements for production and sale of these products.

Sales of air filtration products for semiconductor facilities, historically a major market, are expected to be slow through the rest of 2002, with most analysts pushing recovery for this sector out to at least 2003. The current weak economy is also expected to have a dampening effect on sales of air filtration products across all product lines and end-user categories. As long as the current weakness in the economy continues, in individual market segments or the marketplace as a whole, our results will be negatively affected.

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

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

Due to acquisitions and expansions, our net sales increased by approximately 400% from 1995 through 2001, (a compound annual growth rate of 25%). We have not continued to expand at this rate during 2002. Future growth could place a strain on our management and financial capabilities. 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.

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

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 2002 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, mass manufacturing difficulties with new products, 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 changes in market rates and prices, such as foreign currency exchange and interest rates. For Flanders, these exposures are primarily related to the sale of product to foreign customers and changes in interest rates. We do not have any derivatives or other financial instruments for trading or speculative purposes.

The fair value of the Company's total long-term debt, including capital leases, at June 30, 2002 was approximately $50,889,000. Market risk was estimated as the potential decrease (increase) in future earnings and cash flows resulting from a hypothetical 10% increase (decrease) in the Company's estimated weighted average borrowing rate at June 30, 2002. Although most of the interest on the Company's debt is indexed to a market rate, there would be no material effect on the future earnings or cash flows related to the Company's total debt for such a hypothetical change.

We have only a limited involvement with derivative financial instruments. We have two interest rate swap agreements to hedge against the potential impact on earnings from increases in market interest rates of two variable rate bonds. Under the interest rate swap agreements, we receive or make payments on a monthly basis, based on the differential

between 5.14% and a tax exempt interest rate as determined by a remarketing agent. These agreements are accounted for as a cash flow hedge in accordance with SFAS 133 and SFAS 138. Gains or losses related to ineffectiveness of the cash flow hedge are included in net income during the appropriate period related to hedge ineffectiveness. The tax effected fair market value of the interest rate swap of $769,000 is included in other comprehensive income. The interest rate swap contracts expire in 2013 and 2015.

The Company's financial position is not materially affected by fluctuations in currencies against the U.S. dollar, since assets held outside the United States are negligible. Risks due to changes in foreign currency exchange rates are negligible, as the preponderance of our foreign sales occur over short periods of time or are demarcated in U.S. dollars.

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 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. In addition, we are requesting reimbursement of excessive administrative fees paid but not allowed under the terms of the policy. 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.

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

(b) Reports on Form 8-K - None

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 16th day of August, 2002.

FLANDERS CORPORATION

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