

Edgar Filing: ROYAL APPLIANCE MANUFACTURING CO - Form 10-K

ROYAL APPLIANCE MANUFACTURING CO  
Form 10-K  
March 26, 2003

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the fiscal year ended DECEMBER 31, 2002

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 0-19431  
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ROYAL APPLIANCE MFG. CO.

-----  
(Exact name of registrant as specified in its charter)

OHIO

34-1350353

-----  
(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification)

7005 COCHRAN ROAD, GLENWILLOW, OHIO

44139

-----  
(Address of principal executive offices)

Zip Code

(440) 996-2000

-----  
(Registrant's telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Common Shares, Without Par Value

New York Stock Exchange

-----  
(Title of Each Class)

(Name of Each Exchange on which Registered)

Securities Registered Pursuant to Section 12(g) of the Act: None

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

Indicate, by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Sec. 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this

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Form 10-K or any amendment to this Form 10-K [ ].

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-1). Yes [ ] No [X].

The aggregate market value of the voting shares held by non-affiliates of the Registrant, as reported on the New York Stock Exchange, based upon the closing sale price of Registrant's Common Shares on March 21, 2003, was \$53,213,322. Common Shares held by each officer and director have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of outstanding shares of the Registrant's common shares as of March 21, 2003, was 12,861,052.

The Exhibit index appears on sequential page 55.

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### PART I

#### ITEM 1. BUSINESS

##### General

Royal Appliance Mfg. Co. ("Royal" or the "Company"), an Ohio corporation with its corporate offices in the Cleveland, Ohio metropolitan area, develops, assembles or sources and markets a full line of cleaning products for home and some for commercial use, primarily in North America under the Dirt Devil(R) and Royal(R) brand names. In 1984, the Company introduced the first in a line of Dirt Devil floorcare products, which the Company believes has become one of the largest selling lines of vacuum cleaners in the United States. The Company has used the Dirt Devil brand name recognition to gain acceptance for other Dirt Devil floorcare products. The Company continues to market certain metal vacuum cleaners for home and commercial use under the Royal brand name.

On December 16, 2002, the Company entered into a definitive agreement ("agreement") for its acquisition by Techtronic Industries ("TTI"). The agreement provides for Royal shareholders to receive \$7.37 per share in cash, for a total price of \$105 million. Under the terms of the agreement, Royal will be merged with a subsidiary of TTI which, following the completion of the merger, will operate as a wholly owned, indirect subsidiary of TTI. The transaction is expected to close on April 23, 2003. It is subject to, among other things, the approval by the shareholders of both TTI and Royal. The parties have received early termination of the Hart-Scot-Rodino waiting period.

During 2001, the Company's subsidiary, Privacy Technologies, Inc. ("Privacy Technologies(TM)") introduced the TeleZapper(TM) - a telephone attachment that helps block unwanted telemarketing calls and removes consumers' phone numbers from the telemarketers' computerized dialing lists.

In July 2002, the Company acquired the North American rights to the home, health and beauty line of products from Medisana AG, along with certain other assets for approximately \$800,000. Medisana home, health and beauty products were offered in North America for the past three years through their North American wholly-owned subsidiary Medisana USA.

The Company's business strategy is primarily focused on leveraging its distribution channels and its well-known Dirt Devil brand, where applicable, to

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new and innovative products both inside and outside the floorcare industry, primarily in North America. The Company's product offering consists of name brand consumer products in two business segments: Consumer Products - Floorcare and Consumer Products - Other. The Company's goal is to expand the number, visibility and volume of its products sold by retailers, as well as to increase the number of major retailers carrying its products. The Company also seeks to increase the sale of its products through independent floorcare dealers by offering dealer-exclusive product lines and cooperative promotional programs.

The Company's marketing strategy is essential to its success. The Company uses television, print, cooperative advertising and its Dirt Devil and Privacy Technologies websites to build and maintain brand awareness and consumer demand, as well as to gain shelf space for its product lines from major retailers.

### Business Segments

**Consumer Products - Floorcare:** The Company's Consumer Products - Floorcare business segment designs, assembles or sources, markets and distributes a full line of plastic and metal vacuum cleaners. The Company's Dirt Devil vacuum cleaners are intended for home use. The Company's metal vacuum cleaners are intended for home and commercial use.

This business segment's primary retail product lines are sold under the Dirt Devil name. The first Dirt Devil product, the Hand Vac, was introduced in 1984. The Dirt Devil line has since been expanded to include a full line of upright vacuum cleaners at various price points, both with bags and bagless, upright and hand held carpet and upholstery extractors, canister vacuum cleaners, and a full line of corded and cordless hand held vacuum cleaners.

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### ITEM 1. BUSINESS (CONTINUED)

#### Business Segments (continued)

The Company has produced durable metal vacuum cleaners since the early 1900's. Currently, the Company markets a full line of metal upright and plastic upright and canister vacuum cleaners under the Royal brand name for home and commercial use exclusively through its network of independent dealers. The Company also sells accessories, carpet and upholstery cleaning solutions, attachments, refurbished cleaners and replacement parts for each of its product lines.

In order to provide the retailers with distinct product alternatives, the Company offers different Dirt Devil products in a variety of styles and colors and with various features. Major retailers currently carrying some portion of the Dirt Devil product line include Best Buy, Canadian Tire, Home Depot, Kmart, Lowe's, Sam's Club, Sears, Target, and WalMart. The Company also sells its Dirt Devil products through independent dealers, who primarily sell the metal line of Royal vacuum cleaners.

**CONSUMER PRODUCTS - OTHER:** The Company's Consumer Products - Other segment primarily represents business conducted by Privacy Technologies, Inc., Product Launch Partners, Inc. and Medisana, Inc. This business segment designs, sources and distributes consumer products outside of the Company's traditional floorcare business. Currently, this segment is substantially comprised of the TeleZapper, which was introduced in the second half 2001 by Privacy Technologies, Inc. The TeleZapper is a telephone attachment that helps block unwanted telemarketing calls and removes consumers' phone numbers from telemarketers' computerized dialing lists. Major retailers currently offering the TeleZapper include Best

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Buy, CVS, Kmart, RadioShack, Target, Walgreens and WalMart.

NET SALES BY BUSINESS SEGMENT: The following table sets forth the amounts and percentages of the Company's net sales for the three years ended December 31, 2002 for the Company's two business segments.

(000's omitted)	2002	%	2001	%	2000
	-----	-----	-----	-----	-----
Consumer Products - Floorcare	\$ 353,427	90.7%	\$ 399,388	94.8%	\$ 401,
Consumer Products - Other	36,299	9.3%	21,923	5.2%	
	-----	-----	-----	-----	-----
	\$ 389,726	100.0%	\$ 421,311	100.0%	\$ 401,
	=====	=====	=====	=====	=====

For further information on business segments, see Note 13 of the Notes to the Consolidated Financial Statements.

### NEW PRODUCTS

The Company introduces new products and enhances its existing products on a regular basis for both the retail and dealer markets. In order to support its product development efforts, the Company engages in research and development activities, particularly with respect to new product engineering. The Company's engineering and product development expenditures were approximately \$6.8 million, \$7.9 million, and \$6.8 million in 2002, 2001 and 2000, respectively.

The Company has license and R&D agreements with third parties. Additionally, the Company has licensing agreements with third parties, which license the Dirt Devil brand name for certain other cleaning products in North America and for use of the Dirt Devil brand name in other countries.

The Company has also created Product Launch Partners, Inc. in 2002. Product Launch Partners, Inc. was established as a vehicle for inventors and start-up consumer product companies to joint venture with the Company on new product launch opportunities. As of the date of this report, no new products have been commercialized through Product Launch Partners, Inc.

In addition to internally developing products, the Company may purchase product tooling, license product designs and patents, and outsource product assembly for products to be marketed under the Dirt Devil and Royal brand names or through Privacy Technologies.

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### ITEM 1. BUSINESS (CONTINUED)

#### MARKETING AND CUSTOMERS

The Company markets its Dirt Devil and TeleZapper products primarily through major retailers, including mass market retailers (e.g. WalMart, Target and Kmart), electronic chains (e.g. Best Buy and RadioShack), warehouse clubs

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(e.g. Sam's Club and B.J.'s Wholesale Club), home improvement centers (e.g. Home Depot and Lowe's), and drug store chains (e.g. CVS and Walgreens). During 2002, WalMart (including Sam's Club), Kmart and Target accounted for approximately 27.5%, 15.1%, and 15.0%, respectively, of the Company's net sales, compared to approximately 31.1%, 14.3%, and 14.1%, respectively, of the Company's net sales in 2001. These were the only customers who accounted for 10% or more of the Company's net sales during such periods. During 2002 and 2001, the Company's net sales in the aggregate to its five largest customers were 67.6% and 68.1%, respectively, of total net sales. The loss of any of these customers or loss of their shelf space could have a significant impact on the Company's operations. The Company anticipates that the significant percentage of the Company's net sales attributable to a limited number of major retail customers will continue. The Company believes that its relations with its customers are good. The Company sells most of its products to retailers through its internal sales staff. Recently, several major retailers have experienced significant financial difficulties and some, including Kmart, have filed for protection from creditors under applicable bankruptcy laws. As of December 31, 2002, the net exposure related to Kmart's pre-bankruptcy balance as well as other customer balances for which management believes collection is doubtful was included in the calculation of allowance for doubtful accounts. The Company sells its products to certain customers that are in bankruptcy proceedings.

Since Dirt Devil and TeleZapper products are targeted to sell to the mass market, the Company believes that brand name recognition is critical to the success of these products. The Company provides advertising and promotional support for its Dirt Devil and TeleZapper products through television and cooperative advertising with retailers and believes that these promotional activities, as well as those of its major customers, affect brand name awareness and sales. The Company's cooperative advertising program is established based upon planning ads and promotions with its mass market retail customers. Some of the Company's advertising and promotional activities are tied to holidays and also to specific promotional activities of retailers, and historically have been higher during the Christmas shopping season. The Company's advertising and promotional expenditures are not proportional to anticipated sales. In addition, the Company has generated a small portion of its sales from consumer direct orders, primarily for accessories and new product launches, through the Company's toll-free number, websites and from direct response television infomercials.

The Company devotes considerable attention to the design and appearance of its products and their packaging in order to enhance their appeal to consumers and to stand out among other brands on retailers' shelves. In order to increase the presence of its Dirt Devil products in major retail outlets, the Company provides retailers with distinct product alternatives by offering its Dirt Devil product lines in a variety of styles and colors and with various features.

The Company also strives to meet the logistic and product merchandising needs of its retailers. The Company endeavors to have sufficient quantities of products in stock in order to process and fill orders in a timely manner. Since orders are typically shipped within 10 days of the receipt of a purchase order, the Company does not have a significant order backlog. The Company permits cancellation of orders up to 72 hours prior to shipment.

The Company's line of metal vacuum cleaners is currently sold exclusively through a network of independent vacuum cleaner dealers. As part of its effort to support its independent dealer network, the Company has attempted to meet independent dealers' needs for distinctive product offerings not available to mass merchants. The Company's metal product lines are targeted at consumers and commercial customers who are interested in purchasing more durable and higher quality vacuum cleaners. The Company focuses its promotional activities with its independent dealers on cooperative advertising.

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Many of the Company's independent dealers also provide warranty service for Royal and Dirt Devil products. This allows the consumer to have prompt access to local service outlets and is an important component of the Company's efforts to be responsive to consumers. The Company's products are generally sold with a one to six-year limited warranty.

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### ITEM 1. BUSINESS (CONTINUED)

#### MARKETING AND CUSTOMERS (CONTINUED)

The Company has generally accepted over-the-counter product returns from its retail customers reflecting the retailers' customer return policies.

Each of the Company's products has a toll-free number printed on it that consumers may use to contact a Company customer service representative. Through its customer service computer system, the Company can provide a prompt response to consumer inquiries concerning the availability of its products and service dealers in the consumer's vicinity.

#### COMPETITION

The Company's Consumer Products - Floorcare business segment's most significant competitors are Hoover, Eureka and Bissell in the upright vacuum and carpet shampooer markets and Black & Decker and Euro Pro in the hand-held market. Many of these competitors and several others are subsidiaries or divisions of companies that are more diversified and have greater financial resources than the Company. The Company believes that the domestic vacuum cleaner industry is a mature industry with modest annual growth in many of its products but with a decline in certain other products. Competition is dependent upon price, quality, extension of product lines, and advertising and promotion expenditures. Additionally, competition is influenced by innovation in the design of replacement models and by marketing and approaches to distribution. The Company experiences extensive competition, including price pressure and increased advertising by its competitors, in all product lines within the Consumer Products - Floorcare segment. These trends are expected to continue into 2003.

#### TRADEMARKS AND PATENTS

The Company holds numerous trademarks registered in the United States and foreign countries for various products. The Company has registered trademarks in the United States and a number of foreign countries for the Dirt Devil, Royal, TeleZapper, and other names and logos, which are used in connection with the sale of its vacuum cleaners, consumer electronics and other products and accessory parts. The Company considers both the Dirt Devil and TeleZapper trademarks to be of considerable value and critical to its business. No challenges to its rights to the Dirt Devil trademark have arisen and the Company has no reason to believe that any such challenges will arise in the future. Recently, a lawsuit was filed against the Company asserting trademark infringement by the Company through the use of the TeleZapper trademark. See Item 3: Legal Proceedings for further details.

On December 11, 2002, the Company announced that it had entered into a cross license agreement with Matsushita Home Appliances ("Panasonic") with respect to certain patents and related intellectual property rights. Panasonic has received a license to continue to manufacture and market bagless upright vacuum cleaner products under the Royal bagless upright patent portfolio. Royal received a license to continue to manufacture and market vacuum cleansers under

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patents for certain Panasonic technology. The agreement will result in ongoing positive cash payments to Royal beginning in the fourth quarter of 2002. The Company has also entered into a license agreement with The Hoover Company. See Item 3 - Legal Proceedings for further details.

The Company holds or licenses the use of numerous domestic and international patents, including design patents and processes. The Company may also license its trademarks and patents. The Company believes that its product lines in the Consumer Products - Floorcare segment are generally not dependent upon any single patent or group of patents. Within the Consumer Products - Other segment, the primary product line, the TeleZapper, is dependent upon a limited number of patents for that product.

### SEASONALITY

The Company believes that a significant percentage of certain of its products are given as gifts and therefore, sell in larger volumes during the Christmas and other holiday shopping seasons. Because of the Company's continued dependency on its major customers, the timing of purchases by these major customers and the timing of new product introductions cause quarterly fluctuations in the Company's net sales. As a consequence, results in prior quarters are not necessarily indicative of future results of operations.

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### ITEM 1. BUSINESS (CONTINUED)

#### PRODUCTION

The production of the majority of the Company's products has been outsourced to global third party contract manufacturers. The company continues to assemble certain products in the Cleveland, Ohio metropolitan area. Unlike many of its competitors, the Company does not manufacture component parts for its products. Component parts for the Company's products are manufactured by suppliers, frequently using molds and tooling owned by the Company and built to its specifications. Since the Company's production operations are currently limited to final assembly, it believes that its fixed costs are lower than many of its competitors. The Company also believes that this approach and the use of third party contract manufacturers has provided increased flexibility in the introduction and modification of products.

The Company's engineering department is primarily responsible for the design and testing of its products. The Company has computer-aided design systems to assist its engineers in developing new products and modifying existing products. The Company also retains outside design firms to assist its engineers in designing new products. In addition to internally developing products, the Company may purchase tooling, license intellectual property, or otherwise sell products produced by others to the Company's specifications which may be marketed under the Dirt Devil and Royal brand names or through Privacy Technologies.

A majority of the raw materials purchased by the Company are component parts, such as motors, bags, cords, and plastic parts, which are available from multiple suppliers. The amount of time required by suppliers to fill orders released by the Company varies from 1 to 3 months for sourced finished goods, and days to several weeks for component parts. The Company does not believe that it is dependent on any single source for any significant portion of its raw material or component purchases. The Company believes that it has good relationships with its suppliers and contract manufacturers and has not experienced any significant raw material or component shortages.

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### EMPLOYEES

As of December 31, 2002, the Company employed approximately 550 full-time employees, a reduction of approximately 120 from December 31, 2001. In addition, the Company generally utilizes temporary personnel during the period when the Company is responding to its peak selling season. During 2002, the peak temporary personnel level reached approximately 300. The Company's employees are not represented by any labor union. The Company considers its relations with its employees to be good.

The Company has in effect a severance compensation plan that provides for a severance payment to full-time employees, based on years of employment, if within thirty-six months after a change-in-control of the Company (as is anticipated to occur if the Techtronic Industries merger is approved by shareholders) their employment is terminated for any reason other than death, permanent disability, voluntary retirement or for cause. Executives who receive payments pursuant to change-in-control and other employment arrangements will not receive duplicative severance payments under the severance compensation plan.

### GOVERNMENTAL REGULATION

The Company's facilities are subject to numerous federal, state and local laws and regulations designed to protect the environment from waste, emissions, and from hazardous substances. The Company is also subject to the Federal Occupational Safety and Health Act and other laws and regulations affecting the safety and health of employees in its facilities. The Company is not a party to any investigation or litigation by the Environmental Protection Agency or any state environment agency. The Company believes that it is in compliance, in all material respects, with applicable environmental and occupational safety regulations.

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### ITEM 2. PROPERTIES

On December 31, 2002, the Company and its subsidiaries owned or leased the material properties listed on the following table:

LOCATION AND ADDRESS -----	APPROXIMATE SQUARE FOOTAGE		LEASE EXPIRATIONS (EXCLUDING RENEWALS) -----	FUNCTION -----
	OWNED -----	LEASED -----		
7005 Cochran Road Glenwillow, Ohio	--	458,000	07/15	Distribution Center Headquarters
1340 East 289th Street Wickliffe, Ohio (1)	106,000	--	11/11	Warehouse
8120 Tyler Blvd. Mentor, Ohio	300,000	--	N/A	Assembly, Shipping and Refurb Operati
3951 East Earlstone Ontario, CA	--	140,400	06/06	Distribution Center



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- (1) This leased property is reflected as owned because it contains a bargain purchase option of \$1. For further description, see Note 4 of Notes to Consolidated Financial Statements.

### ITEM 3. LEGAL PROCEEDINGS

The Hoover Company (Hoover) filed a lawsuit in federal court, in the Northern District of Ohio (case #1:00cv 0347), against the Company on February 4, 2000, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserted that the Company's Dirt Devil Easy Steamer infringed three utility patents and two design patents held by Hoover, and also that the Easy Steamer design infringed the trade dress of Hoover's carpet extractor products. The Court had dismissed charges of infringement against Royal regarding one of the three utility patents, and found that the Dirt Devil Easy Steamer infringed one claim of a second utility patent. The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:01cv 2775), against The Hoover Company (Hoover) on December 10, 2001, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserted that Hoover infringed certain patents relating to bagless technology held by the Company. On October 17, 2002, the Company and Hoover reached a settlement of all patent-related litigation described above. Hoover has granted rights to the Company with regard to its existing carpet extractor patents. The Company has granted rights to Hoover with regard to its existing bagless upright vacuum cleaner patents. The settlement includes net cash payments to the Company and resulted in a gain of \$3,371,000 which was included in the caption "Litigation Settlement" on the Consolidated Statement of Operations.

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 0338), against Bissell Homecare, Inc. (Bissell) on February 22, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that Bissell infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

Bissell Homecare, Inc. (Bissell) filed a lawsuit in federal court, in Michigan (case #02cv71079), against the Company on March 20, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that the Company's Dirt Devil Easy Steamer and Platinum Force Extractor products infringe certain design and utility patents held by Bissell. Bissell seeks damages, injunction on future production, and legal fees. On June 19, 2002, the Court transferred the case (now #1:02cv 1358) to the Northern District of Ohio. The Company is vigorously defending the suit and believes it is without merit. If Bissell were to prevail on all its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 1127), against White Consolidated, Ltd. (Eureka) on June 14, 2002, under the patent, trademark and unfair competition laws of the United States. The Complaint asserts that Eureka infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

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### ITEM 3. LEGAL PROCEEDINGS (CONTINUED)

The Company filed a lawsuit in federal court, in the Northern District of

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Ohio against Euro-Pro Corporation and Sanyo North America Corporation (together referred to as "Defendants") on November 15, 2002, under the patent, trademark and unfair competition laws of the United States. The complaint asserts that Defendants infringe certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production and legal fees.

Phone Zap, LLC ("Phone Zap") filed a lawsuit in United States District Court, District of Columbia, against the Company and its subsidiary, Privacy Technologies, Inc. on January 6, 2003, under the patent, trademark and unfair competition laws of the United States. The complaint asserts trademark infringement by the Company through the use of the Company's TeleZapper(R) trademark. The Company is vigorously defending the suit and believes it is without merit. If Phone Zap were to prevail on all its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company is involved in various other claims and litigation arising in the normal course of business. The Company has product liability and general liability insurance policies in amounts management believes to be reasonable. There can be no assurance, however, that such insurance will be adequate to cover all potential product or other liability claims against the Company. In the opinion of management, the ultimate resolution of these actions will not materially affect the consolidated financial position, results of operations, or cash flows of the Company.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

### PART II

#### ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY AND RELATED SHAREHOLDER MATTERS

The Company's common shares are quoted on the New York Stock Exchange (NYSE) under the symbol "RAM". The following table sets forth, for the periods indicated, the high and low closing price for the Company's Common Shares as reported by the New York Stock Exchange.

	Year Ended December 31,			
	2002		2001	
	High	Low	High	Low
Quarters:				
First	\$5.70	\$4.65	\$4.75	\$3.85
Second	\$7.13	\$5.40	\$6.10	\$3.15
Third	\$6.40	\$3.90	\$6.61	\$3.57
Fourth	\$7.27	\$3.55	\$5.55	\$4.00

The Company has not declared or paid any cash dividends and currently intends not to pay any cash dividends in 2003. The Board of Directors intends to retain earnings, if any, to support the operations and growth of the business. The Company's current credit agreement permits the payment of cash dividends and additional stock repurchases based on a defined formula up to \$18,369 as of December 31, 2002.

On March 21, 2003, there were approximately 800 shareholders of record of the Company's Common Shares, as reported by National City Corporation, the Company's Registrar and Transfer Agent, which maintains its corporate offices at

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National City Center, Cleveland, Ohio 44101-0756.

On December 16, 2002, the Company entered into a definitive agreement ("agreement") for its acquisition by Techtronic Industries ("TTI"). The agreement provides for Royal shareholders to receive \$7.37 per share in cash, for a total price of \$105 million. Under the terms of the agreement, Royal will be merged with a subsidiary of TTI which, following the completion of the merger, will operate as a wholly owned, indirect subsidiary of TTI. The transaction is expected to close on April 23, 2003. It is subject to, among other things, the approval by the shareholders of both TTI and Royal. The parties have received early termination of the Hart-Scot-Rodino waiting period.

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### ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table sets forth selected consolidated financial data of the Company. The selected Consolidated Statements of Operations and Consolidated Balance Sheet data for each of the five years during the period ended December 31, 2002, are derived from the audited Consolidated Financial Statements of the Company. Prior period amounts have been reclassified to conform to the 2002 presentation. The data presented below should be read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere herein.

	Year Ended December 31,				
	2002	2001	2000	1999	1998
Consolidated Statements of Operations: <span style="float: right;">(Dollars in thousands, except per share amounts)</span>					
Net sales	\$389,726	\$421,311	\$401,515	\$401,295	\$295,100
Cost of sales	301,692	325,746	315,849	304,452	285,100
	-----	-----	-----	-----	-----
Gross margin	88,034	95,565	85,666	96,843	10,000
Selling, general and administrative expenses	74,684	77,587	72,986	71,160	71,160
Charge for tooling obsolescence	-	-	-	2,621	-
	-----	-----	-----	-----	-----
Income from operations	13,350	17,978	12,680	23,062	-
Interest expense	1,545	2,688	3,805	1,730	-
Litigation settlement	(3,371)	-	-	-	-
Receivable securitization expense	547	993	1,559	1,281	-
Other (Income) expense, net	(280)	(85)	(148)	(241)	-
	-----	-----	-----	-----	-----
Income before taxes	14,909	14,382	7,464	20,292	-
Income tax expense	5,344	5,058	1,525	7,610	-
	-----	-----	-----	-----	-----
Net income	\$ 9,565	\$ 9,324	\$ 5,939	\$ 12,682	\$ -
	=====	=====	=====	=====	=====
Basic Earnings per Share					
Weighted average number of common shares outstanding (in thousands)	12,983	13,731	15,083	18,155	18,155
Earnings per share	\$ .74	\$ .68	\$ .39	\$ .70	\$ .70

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Diluted Earnings per Share					
Weighted average number of common shares and potential common shares outstanding (in thousands)					
	13,877	14,297	15,574	18,371	
Earnings per share	\$ .69	\$ .65	\$ .38	\$ .69	\$
Consolidated Balance Sheet Data (at end of period)					
Working capital	\$ 43,238	\$ 32,566	\$ 39,885	\$ 38,950	\$
Total assets	141,169	140,444	138,552	151,892	1
Long-term debt	29,828	33,978	48,537	34,704	
Shareholders' equity	45,886	38,622	31,053	44,669	

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

#### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of its financial position and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Management believes that the critical accounting policies and areas that require the most significant judgments and estimates to be used in the preparation of the consolidated financial statements are revenue recognition including customer based programs and incentives, allowance for doubtful accounts, useful lives of tooling and other long lived assets and accrued warranty and customer returns.

**Revenue Recognition** - The Company's revenue recognition policy is to record sales upon shipment from the Company's distribution centers. Although a majority of customers are shipped "FOB shipping point", the Company has a select number of customers who use EDI for invoicing and are shipped "FOB destination". Customers that have "FOB destination" terms are primarily the Company's large retail customers. The Company's three distribution centers are strategically located within a relatively close proximity to these large retail customers' distribution centers. As a result, and in response to definitive just-in-time delivery parameters mandated by the retailers' product placement programs, shipments from the Company in transit and not received by the customer at year-end are de minimis.

All sales are final upon shipment of product to the customer. The Company records estimated reductions to net sales for customer programs and incentive offerings including pricing arrangements, promotions and other volume based incentives. If market conditions were to soften, the Company may take actions to increase customer incentives, possibly resulting in a reduction of net sales and gross margins at the time the incentive is offered.

The Company includes royalty income from various license agreements in net sales. For the years ended December 31, 2002, 2001 and 2000, royalty income totaled \$3,687,000, \$340,000 and \$497,000, respectively.

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Allowance for Doubtful Accounts - The Company maintains an allowance for trade accounts receivable for which collection on specific customer accounts is doubtful. In determining collectibility, management reviews available customer financial statement information, credit rating reports as well as other external documents and public filings. When it is deemed probable that a specific customer account is uncollectible, that balance is included in the reserve calculation. Actual results could differ from these estimates under different assumptions.

Useful Lives of Tooling - The Company capitalizes the cost of tooling used in the production of its products by third party suppliers and global contract manufacturers. The tooling is depreciated on a straight-line basis over 2-3 years, based on the nature of the product and the estimated product life cycle. The useful lives are reviewed on a quarterly basis by management and useful lives may be shortened if needed. In determining whether or not shortening of useful lives is required, management reviews sell-through data at retail, forecast demands and the timeframe of new product introductions.

Accrued Warranty and Customer Returns - The Company's return policy is to replace, repair or issue credit for product under warranty. Returns received during the current period are expensed as received and a reserve is maintained for future returns from current shipments. Management calculates the reserve utilizing historical return rates by product family. These rates are reviewed and adjusted periodically. Management utilizes judgment for estimating return rates of new products and adjusts those estimates as actual results become available.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

(In thousands, except per share amounts)

The following table sets forth, for the years indicated, the percentages of net sales of certain items in the Consolidated Statements of Operations and the percentage change in such items as compared to the indicated prior year.

	Year Ended December 31,			Year to Year Increases (Decreases)	
	2002	2001	2000	2002 vs. 2001	2001 vs. 2000
Net sales	100.0%	100.0%	100.0%	(7.5)%	
Cost of sales	77.4	77.3	78.7	(7.4)	
Gross margin	22.6	22.7	21.3	(7.9)	
Selling, general and administrative expenses	19.2	18.4	18.2	(3.7)	
Income from operations	3.4	4.3	3.1	(25.7)	
Interest expense	0.4	0.6	0.9	(42.5)	
Litigation settlement	(0.9)			-	

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Receivable securitization	0.1	0.3	0.4	(44.9)
Other (income) expense, net	-	-	-	229.4
	-----	-----	-----	-----
Income before income taxes	3.8%	3.4%	1.8%	3.7%
	=====	=====	=====	=====

### 2002 VS. 2001

Net sales for 2002 were \$389,726, a decrease of 7.5% from 2001. The decrease in sales for 2002 was primarily attributable to lower selling prices on the Company's floor care products, including but not limited to its upright and hand held vacuums and its upright and hand-held extractors, partially offset by increased sales of the TeleZapper, royalty income related to license agreements for the TeleZapper and bagless technology of approximately \$3,100, and an increase in unit sales of lower priced uprights. Overall, sales to the top 5 customers for 2002 (all of which are major retailers) accounted for approximately 67.6% of net sales as compared to approximately 68.1% in 2001. The Company believes that its dependence on sales to its largest customers will continue. Recently, several major retailers have experienced significant financial difficulties and some, including Kmart, have filed for protection from creditors under applicable bankruptcy laws. As of December 31, 2002, the net exposure related to Kmart's pre-bankruptcy balance as well as other customer balances for which management believes collection is doubtful was included in the calculation of allowance for doubtful accounts. The Company sells its products to certain customers that are in bankruptcy proceedings.

Gross margin, as a percent of sales, decreased from 22.7% in 2001 to 22.6% in 2002. The gross margin percentage was negatively affected in 2002 by the continued competitive pressure resulting in lower selling prices and margins on the Company's floor care products. The decrease in gross margins was offset by the increase in margins related to the TeleZapper, lower product costs, an adjustment to net sales of \$1,400 for certain sales programs, as well as lower returns on the Company's floor care products.

Selling, general and administrative expenses for 2002 were \$74,684, a decrease of \$2,903 or 3.7%. As a percentage of sales, selling, general and administrative expenses increased from 18.4% to 19.2%. The dollar decrease is primarily attributable to a decrease in advertising and promotion costs of approximately \$3,250, reduction of the allowance for doubtful accounts of \$1,250 and a reduction in engineering and product development expenditures of \$1,075, partially offset by increases in professional fees of approximately \$1,425 due to litigation, an increase of approximately \$500 in depreciation expense on the Company's information technology systems and an increase of approximately \$550 in compensation expense associated with phantom stock plans.

Interest expense for 2002 was \$1,545, a decrease of 42.5% from 2001. The decrease in interest expense resulted from a lower effective borrowing rate combined with lower levels of variable rate borrowings.

During 2002, the Company settled litigation with a competitor resulting in a one-time gain of \$3,371. See Note 5 to the Consolidated Financial Statements for further details.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (CONTINUED)

#### 2002 VS. 2001 (CONTINUED)

Receivable securitization expense was \$547, a decrease of 44.9% from 2001. This expense reflects the cost of the Company's trade accounts receivable securitization program. The decrease is a result of lower discount rates, which is based on commercial paper rates plus program fees. See Note 3 to the Consolidated Financial Statements for further details.

Other (income) expense, net principally reflects the income statement impact of changes in foreign currency rates on the Company's Canadian dollar transactions and early pay discounts on accounts payable transactions.

Due to the factors discussed above, the Company had income before income taxes for 2002 of \$14,909 as compared to \$14,382 in 2001. The components of the Company's effective income tax rate of 35.8% and 35.2% for 2002 and 2001, respectively, are described in Note 6 of the Company's Consolidated Financial Statements.

#### 2001 VS. 2000

Net sales for 2001 were \$421,311, an increase of 4.9% from 2000. The increase in sales for 2001 was attributable to the shipments of the TeleZapper, which was introduced during the third quarter of 2001. These sales increases were partially offset by lower sales of certain product lines within the Consumer Products - Floorcare segment including Dirt Devil canisters and stick vacuums. Overall sales to the top 5 customers for 2001 (all of which are major retailers) accounted for approximately 68.1% of net sales as compared with approximately 66.1% in 2000.

Gross margin, as a percent of net sales, increased from 21.3% for 2000 to 22.7% in 2001. The gross margin percentage was positively affected in 2001 primarily by shipments of the TeleZapper. The increase was partially offset by competitive pressure resulting in lower selling prices and margins on various floorcare products.

Selling, general and administrative expenses for 2001 were \$77,587, an increase of 6.3% from 2000. Selling, general and administrative expenses increased as a percentage of net sales from 18.2% in 2000 to 18.4% in 2001. The dollar increase is primarily attributable to employee compensation and related benefits of approximately \$2,600, higher professional fees associated with litigation of approximately \$300 (see Note 5 of the Company's Consolidated Financial Statements), bad debt expense of approximately \$1,900 primarily associated with the bankruptcy filing by Kmart, and expenses associated with upgrades to the Company's information technology systems such as training, equipment lease expense, software maintenance and depreciation expense of approximately \$1,600. These increases were partially offset by a reduction of advertising expenses of approximately \$3,100.

Interest expense for 2001 was \$2,688, a decrease of 29.4% from 2000. The decrease in interest expense resulted from a lower effective borrowing rate combined with lower levels of variable rate borrowings to finance working capital, share repurchases, and capital expenditures.

Receivable securitization expense was \$993, a decrease of 36.3% from 2000. The decrease during 2001 was a result of lower discount rates.

Due to the factors discussed above, the Company had income before income taxes for 2001 of \$14,382 as compared to income before income taxes for 2000 of \$7,464. The components of the Company's effective income tax expense rate of

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35.2% and 20.4% for 2001 and 2000, respectively, are described in Note 6 of the Company's Consolidated Financial Statements.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (CONTINUED)

#### LIQUIDITY AND CAPITAL RESOURCES

The Company has used cash generated from operations to fund its working capital needs, repay bank debt, fund capital expenditures and share repurchases. Working capital was \$43,238 at December 31, 2002, an increase of 32.8% over the December 31, 2001 level. Current assets, exclusive of cash increased by \$2,634 reflecting in part a \$4,729 increase of accounts receivable, partially offset by a \$2,499 decrease of inventories. The increase in accounts receivable was primarily due to the timing of sales to its largest customers. Current liabilities decreased by \$1,182 reflecting a \$2,760 decrease in trade accounts payable, which was consistent with the planned decrease in inventories, a \$1,340 decrease of accrued salaries, benefits, and payroll taxes, a \$802 decrease in accrued other, partially offset by a \$3,152 increase of accrued income taxes attributable to the timing of tax payments on fourth quarter earnings, and a \$1,204 increase in accrued advertising and promotion.

In 2002, the Company utilized \$6,400 of cash for capital expenditures, including approximately \$4,700 for tooling related to various products in the Consumer Products - Floorcare segment, and approximately \$800 for computer equipment and software.

At December 31, 2002, the Company had a collateralized revolving credit facility with availability of up to \$70,000, including letters of credit, and a maturity date of April 1, 2005. Under the agreement, pricing options of the bank's base lending rate and LIBOR rate are based on a defined formula. In addition, the Company pays a commitment fee based on a defined formula on the unused portion of the facility. The revolving credit facility contains covenants which require, among other things, the achievement of minimum net worth levels and the maintenance of certain financial ratios. The Company was in compliance with all applicable covenants as of December 31, 2002. The revolving credit facility is collateralized by the assets of the Company. As long as the Company remains in compliance with all covenants, the revolving credit facility permits share repurchases and dividends based on a defined formula up to \$18,369 as of December 31, 2002. The Company's effective interest rate was 4.99%, 7.34% and 9.28% for 2002, 2001 and 2000 respectively. Letters of credit and standby letters of credit outstanding at December 31, 2002 total \$812.

The Company utilizes a \$35,000 revolving trade accounts receivable securitization program to sell without recourse, through a wholly-owned subsidiary, certain trade accounts receivable. Pursuant to the terms of the securitization program, the Company transfers certain trade accounts receivable, on a revolving basis, to a wholly owned, bankruptcy-remote subsidiary of the Company, Royal Appliance Receivables, Inc. ("RAR"), which is consolidated for financial reporting purposes. In turn, RAR sells an undivided interest on a revolving basis, of up to \$35,000 in its accounts receivable to a special purpose bank sponsored commercial paper conduit. The Company retains an interest in the pool of trade receivables transferred to RAR which are not sold to the commercial paper conduit. These receivables represent ineligible receivables, which include but are not limited to receivables that are past due, concentrations over limits with specific customers and certain reserve amounts.



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The Company believes that the risk of loss associated with the unsold trade accounts receivable is minimal because of the high credit quality of the receivables that are included in the pool. During 2002 and 2001, the Company sold approximately \$142,000 and \$153,000, respectively, in total new securitization transactions. The loss recorded on these sales was \$547, \$993 and \$1,559 in 2002, 2001 and 2000, respectively, and has been classified as receivable securitization expense in the accompanying Consolidated Statements of Operations. The Company accounts for the portion of the receivables not sold as trade receivables on the Consolidated Balance Sheets. The Company continues to service the accounts receivable without being compensated by the bank sponsored commercial paper conduit. The Company has recorded a servicing liability, based on its estimate of adequate compensation for the services that are being performed, of \$56 and \$62 as of December 31, 2002 and 2001, respectively. The servicing liability is included within accrued liabilities - other on the Consolidated Balance Sheets.

As of December 31, 2002, RAR sold \$22,600 of undivided interests in accounts receivable. The proceeds from those sales were reflected as a reduction of accounts receivable on the Consolidated Balance Sheets and as operating cash flows in the Consolidated Statements of Cash Flows. The sale proceeds were used to pay down the Company's revolving credit facility. Additionally, the securitization program contains covenants that the Company was in compliance with as of December 31, 2002.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (CONTINUED)

#### LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

In February 2000, the Company's Board of Directors authorized a common share repurchase program that enabled the Company to purchase, in the open market and through negotiated transactions, up to an additional 4,250 of its outstanding common shares. The Company completed the program repurchasing 3,289 shares for an aggregate purchase price of \$20,065 in February 2001. In April 2001, the Company's Board of Directors authorized another common share repurchase program that enabled the Company to purchase, in the open market and through negotiated transactions, up to an additional 3,400 of its outstanding common shares. The Company repurchased approximately 1,322 shares for an aggregate purchase price of \$6,900 under the program that expired in December 2002.

On December 16, 2002, the Company entered into a definitive agreement ("agreement") for its acquisition by Techtronic Industries ("TTI"). The agreement provides for Royal shareholders to receive \$7.37 per share in cash, for a total price of \$105 million. Under the terms of the agreement, Royal will be merged with a subsidiary of TTI which, following the completion of the merger, will operate as a wholly owned, indirect subsidiary of TTI. The transaction is expected to close on April 23, 2003. It is subject to, among other things, the approval by the shareholders of both TTI and Royal. The parties have received early termination of the Hart-Scot-Rodino waiting period.

The following tables present total contractual obligations and other commercial commitments of the Company as of December 31, 2002:

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Contractual Obligations	Total	Payments Due by Year	
		2003	2004 - 2007
Long-Term Debt - Revolver	\$ 28,000	\$ -	\$ 28,000
Capital Lease Obligations	2,826	315	1,262
Operating Leases	26,473	3,422	9,428
Total Contractual Cash Obligations	\$ 57,299 =====	\$ 3,737 =====	\$ 38,690 =====

Other Commercial Commitments	Total Amounts Committed	Amount of Commitment Expirat	
		2003	2004 - 2007
Standby Letters of Credit	\$ 812	\$ 500	\$ -
Other Commercial Commitments	4,025	4,025	-
Total Commercial Commitments	\$ 4,837 =====	\$ 4,525 =====	\$ - =====

The Company believes that cash generated by operations along with its revolving credit facilities will be sufficient to provide for the Company's anticipated working capital and capital expenditure requirements for the next twelve months.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (CONTINUED)

QUARTERLY OPERATING RESULTS (UNAUDITED)

The following table presents certain unaudited consolidated quarterly operating information for the Company and includes all adjustments that the Company considers necessary for a fair presentation of such information for the interim periods.

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	Three Months Ended						
	Dec. 31, 2002 ----	Sept. 30, 2002 ----	June 30, 2002 ----	March 31, 2002 ----	Dec. 31, 2001 ----	Sept. 30, 2001 ----	June 30, 2001 ----
Net sales	\$ 117,467	\$ 91,705	\$ 89,390	\$ 91,164	\$ 127,236	\$ 111,503	\$ 79,164
Gross margin	32,256	21,086	16,344	18,348	32,663	26,461	15,164
Net income (loss)	7,675	3,134	(1,329)	85	3,773	4,085	(1,329)
Net income (loss) per share-diluted (a)	\$ 0.56	\$ 0.23	\$ (0.10)	\$ 0.01	\$ 0.27	\$ 0.29	\$ (0.10)

(a) The sum of 2002 and 2001 quarterly net income (loss) per common share does not equal annual net income per common share due to the change in the weighted average number of common shares outstanding due to share repurchases.

SEASONALITY

The Company believes that a significant percentage of certain of its products are given as gifts and therefore sell in larger volumes during the Christmas and other holiday shopping seasons. Because of the Company's continued dependency on its major customers, the timing of purchases by these major customers and the timing of new product introductions causes quarterly fluctuations in the Company's net sales. As a consequence, results in prior quarters are not necessarily indicative of future results of operations.

COMPETITION

The Company's Consumer Products - Floorcare business segment's most significant competitors are Hoover, Eureka and Bissell in the upright vacuum and carpet shampooer markets and, Black & Decker and Euro Pro in the hand-held market. Many of these competitors and several others are subsidiaries or divisions of companies that are more diversified and have greater financial resources than the Company. The Company believes that the domestic vacuum cleaner industry is a mature industry with modest annual growth in many of its products but with a decline in certain other products. Competition is dependent upon price, quality, extension of product lines, and advertising and promotion expenditures. Additionally, competition is influenced by innovation in the design of replacement models and by marketing and approaches to distribution. The Company experiences extensive competition, including price pressure and increased advertising by its competitors, in all product lines within the Consumer Products - Floorcare segment. These trends are expected to continue into 2003.

INFLATION

The Company does not believe that inflation by itself has had a material effect on the Company's results of operations. However, as the Company experiences price increases from its suppliers, which may include increases due to inflation, retail pressures may prevent the Company from increasing its prices.

ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and

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Other Intangible Assets", effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests. Other intangibles continue to be amortized over their useful lives and will be assessed for impairment under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The adoption of SFAS No. 142 did not impact the, results of operations, financial position or liquidity of the Company.

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (CONTINUED)

#### ACCOUNTING STANDARDS (CONTINUED)

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143 requires companies to record the fair value of a liability for an asset retirement obligation in the period in which it was incurred. The amount recorded as a liability will be capitalized by increasing the carrying amount of the related long-lived asset, which is then depreciated over its useful life. SFAS No. 143 became effective for the Company on January 1, 2003. The Company does not expect the adoption of SFAS No. 143 to have a material impact on its results of operations, financial position or liquidity.

In October 2001, the FASB issued SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement superseded FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations". The Company adopted the provisions of this statement effective January 1, 2002, at which time it had no affect on its results of operations, financial position or liquidity.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", effective for exit or disposal activities initiated after December 31, 2002. This Statement nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue No. 94-3, a liability for exit costs was recognized at the date of the entity's commitment to an exit plan. This Statement also establishes that fair value is the objective for initial measurement of the liability. The Company does not expect the adoption of this Statement to have a material impact on its results of operations, financial position or liquidity.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires certain guarantees to be recorded at fair value. The initial recognition and measurement provisions of FIN 45 are applicable, on a prospective basis, to guarantees issued or modified after December 31, 2002. FIN 45 also requires a guarantor to make new disclosures regarding guarantees. The disclosure requirements are effective for financial statements ending after December 15, 2002. The Company

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does not expect the disclosure to have a significant impact on its financials.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FAS 123, Accounting For Stock-Based Compensation", effective for financial statements for fiscal years ending after December 15, 2002. This Statement amends FAS No. 123, and provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. This Statement also amends FAS No. 123 and requires disclosure about the effects on reported net income with respect to the stock-based employee compensation. Lastly, this Statement amends APB Opinion No. 28, and requires disclosure about the effects of stock-based employee compensation in interim financial information. See Note 8 in the Notes to Consolidated Financial Statements for further details

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### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION (CONTINUED)

#### FORWARD LOOKING STATEMENTS

Forward-looking statements in this report are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. Potential risks and uncertainties include, but are not limited to: approval of the merger agreement by the shareholders of both Techtronic Industries and the Company, the financial strength of the retail industry particularly in the major mass retail channel; the impact of Kmart's recent bankruptcy filing on Royal's future sales and earnings; the competitive pricing and aggressive product development environment within the floor care industry; the impact of private-label programs by mass retailers; the cost and effectiveness of planned advertising, marketing and promotional campaigns; the success at retail and the continued acceptance by consumers of the Company's new products, the dependence upon the Company's ability to continue to successfully develop and introduce innovative products; the uncertainty of the Company's global supply chain and suppliers to continuously supply sourced finished goods and component parts; and general business and economic conditions.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company sells a small portion of its products in various global markets, primarily Canada. As a result, the Company's cash flow and earnings are exposed to fluctuations in foreign currency exchange rates relating to receipts from customers and payments to service providers in foreign currencies. As a general policy, the Company has from time to time hedged certain foreign currency commitments of future payments and receipts by purchasing foreign currency-forward contracts. As of December 31, 2002, there were no such contracts outstanding. The majority of the Company's receipts and expenditures are contracted in U.S. dollars, and the Company does not consider the market risk exposure relating to currency exchange to be material at this time.

If interest rates were to change by .25% on the Company's variable rate debt, the impact on interest expense would be approximately \$70.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and Board of Directors of  
Royal Appliance Mfg. Co.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Royal Appliance Mfg. Co. and its Subsidiaries (the "Company") at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Cleveland, Ohio  
February 12, 2003

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(DOLLARS IN THOUSANDS)

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December 31,  
2002

ASSETS

Current assets:

Cash and cash equivalents	\$ 10,277
Trade accounts receivable, less allowance for doubtful accounts of \$1,500 and \$3,000 at December 31, 2002 and 2001, respectively	37,448
Other receivables	3,407
Inventories	48,308
Deferred income taxes	4,096
Prepaid expenses and other	2,353
	-----
Total current assets	105,889
	-----

Property, plant and equipment, at cost:

Land	1,541
Buildings	7,777
Molds, tooling, and equipment	45,594
Furniture, office and computer equipment, and software	15,856
Assets under capital leases	3,171
Leasehold improvements and other	6,537
	-----

Less accumulated depreciation and amortization	80,476 (49,489)
	-----

30,987

Computer software and tooling deposits

1,668

Other

2,625

Total assets

\$ 141,169

=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Trade accounts payable	\$ 24,673
Accrued liabilities:	
Advertising and promotion	12,400
Salaries, benefits, and payroll taxes	5,918
Warranty and customer returns	9,300
Income taxes	4,522
Other	5,677
Current portions of capital lease obligations	161
	-----

Total current liabilities

62,651

-----

Revolving credit agreement

28,000

Capitalized lease obligations, less current portion

1,828

Total long-term debt

29,828

-----

Deferred income taxes

2,804

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Total liabilities	95,283
	-----
Commitments and contingencies (Note 4 and 5)	-
Shareholders' equity:	
Serial preferred shares; authorized - 1,000,000 shares; none issued and outstanding	-
Common shares, at stated value; authorized - 101,000,000 shares; issued 25,963,852 and 25,829,452 at December 31, 2002 and 2001, respectively	216
Additional paid-in capital	46,400
Note receivable for shares sold	(543)
Retained earnings	80,054
	-----
	126,127
Less treasury shares, at cost (13,102,800 and 12,365,700 shares at December 31, 2002 and 2001, respectively)	(80,241)
	-----
Total shareholders' equity	45,886
	-----
Total liabilities and shareholders' equity	\$ 141,169
	=====

The accompanying notes are an integral part of these financial statements.

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2002	2001	2000
	-----	-----	-----
Net sales	\$ 389,726	\$ 421,311	\$ 401,515
Cost of sales	301,692	325,746	315,849
	-----	-----	-----
Gross margin	88,034	95,565	85,666
Selling, general and administrative expenses	74,684	77,587	72,986
	-----	-----	-----
Income from operations	13,350	17,978	12,680
Interest expense	1,545	2,688	3,805
Litigation settlement	(3,371)	-	-



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Receivable securitization expense	547	993	1,559
Other (income) expense, net	(280)	(85)	(148)
	-----	-----	-----
Income before income taxes	14,909	14,382	7,464
Income tax expense	5,344	5,058	1,525
	-----	-----	-----
Net income	\$ 9,565	\$ 9,324	\$ 5,939
	=====	=====	=====

BASIC

Weighted average number of common shares outstanding (in thousands)	12,983	13,731	15,083
Earnings per share	\$ .74	\$ .68	\$ .39

DILUTED

Weighted average number of common shares and potential common shares outstanding (in thousands)	13,877	14,297	15,574
Earnings per share	\$ .69	\$ .65	\$ .38

The accompanying notes are an integral part of these financial statements

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(DOLLARS IN THOUSANDS, EXCEPT SHARE AMOUNTS)

	Common Shares		Additional Paid-in Capital	N Rece
	Number	Amount		
Balance at December 31, 1999	25,464,352	\$ 212	\$ 42,528	
Compensatory effect of stock rights			361	
Shares issued from stock option plan	44,800		149	
Purchase of treasury shares				
Net income				
	-----	-----	-----	
Balance at December 31, 2000	25,509,152	212	43,038	
Compensatory effect of stock rights			586	

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Shares issued from stock option plan	320,300	2	1,086
Note Receivable for shares sold			
Purchase of treasury shares			
Net income			
	-----	-----	-----
Balance at December 31, 2001	25,829,452	214	44,710
Compensatory effect of stock rights			1,148
Shares issued from stock option plan	134,400	2	542
Purchase of treasury shares			
Net income			
	-----	-----	-----
Balance at December 31, 2002	25,963,852	\$ 216	\$ 46,400
	=====	=====	=====

	Retained Earnings	Treasury Shares		To Shareh Equ
	-----	Number	Amount	-----
Balance at December 31, 1999	\$ 55,226	8,491,000	\$ (53,297)	\$ 4
Compensatory effect of stock rights				
Shares issued from stock option plan				
Purchase of treasury shares		3,289,500	(20,065)	(2)
Net income	5,939			
	-----	-----	-----	-----
Balance at December 31, 2000	61,165	11,780,500	(73,362)	3
Compensatory effect of stock rights				
Shares issued from stock option plan				
Note Receivable for shares sold				
Purchase of treasury shares		585,200	(2,886)	(
Net income	9,324			
	-----	-----	-----	-----
Balance at December 31, 2001	70,489	12,365,700	(76,248)	3
Compensatory effect of stock rights				
Shares issued from stock option plan				
Purchase of treasury shares		737,100	(3,993)	(
Net income	9,565			
	-----	-----	-----	-----
Balance at December 31, 2002	\$ 80,054	13,102,800	\$ (80,241)	\$ 4
	=====	=====	=====	=====

The accompanying notes are an integral part of these financial statements.

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(DOLLARS IN THOUSANDS)

	2002	2001
	-----	-----
Cash flows from operating activities:		
Net income	\$ 9,565	\$ 9,324
	-----	-----
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	16,794	15,279
Compensatory effect of stock rights	1,148	586
Gain sale of property, plant and equipment, net	-	-
Deferred income taxes	(754)	(382)
(Increase) decrease in assets:		
Accounts receivable, net	(4,729)	5,971
Inventories, net	2,499	(5,337)
Prepaid expenses and other	(857)	77
Other	(1,629)	(1,509)
Increase (decrease) in liabilities:		
Trade accounts payable	(2,760)	5,224
Accrued advertising and promotion	1,204	(1,907)
Accrued salaries, benefits, and payroll taxes	(1,340)	3,903
Accrued income taxes	3,152	1,681
Accrued warranty and customer returns	(650)	150
Accrued other	(802)	388
	-----	-----
Total adjustments	11,276	24,124
	-----	-----
Net cash from operating activities	20,841	33,448
	-----	-----
Cash flows from investing activities:		
Purchases of tooling, property, plant, and equipment, net	(9,137)	(10,244)
Proceeds from sale of property, plant and equipment	-	-
Decrease (increase) in computer software and tooling deposits	2,737	(3,598)
	-----	-----
Net cash from investing activities	(6,400)	(13,842)
	-----	-----
Cash flows from financing activities:		
(Payments) proceeds on bank debt, net	(4,000)	(14,400)
Payments on notes payable	-	-
Proceeds from exercise of stock options	544	545
Payments on capital lease obligations	(136)	(148)
Purchase of treasury shares	(3,993)	(2,886)
	-----	-----
Net cash from financing activities	(7,585)	(16,889)
	-----	-----
Net increase (decrease) in cash and cash equivalents	6,856	2,717
	-----	-----

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Cash and cash equivalents at beginning of year	3,421	704
	-----	-----
Cash and cash equivalents at end of year	\$ 10,277	\$ 3,421
	=====	=====
Supplemental disclosure of cash flow information:		
Cash payments for:		
Interest	\$ 1,592	\$ 2,611
	=====	=====
Income taxes, net of refunds	\$ 2,946	\$ 3,759
	=====	=====

The accompanying notes are an integral part of these financial statements.

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

#### 1. ACCOUNTING POLICIES:

DESCRIPTION OF BUSINESS - Royal Appliance Mfg. Co. ("Royal" or the "Company"), an Ohio corporation with its corporate offices in the Cleveland, Ohio metropolitan area, develops, assembles or sources and markets a full line of cleaning products for home and some for commercial use, primarily in North America under the Dirt Devil(R) and Royal(R) brand names. The Company has used the Dirt Devil brand name recognition to gain acceptance for other Dirt Devil floorcare products. The Company continues to market certain metal vacuum cleaners for home and commercial use under the Royal brand name.

On December 16, 2002, the Company entered into a definitive agreement ("agreement") for its acquisition by Techtronic Industries ("TTI"). The agreement provides for Royal shareholders to receive \$7.37 per share in cash, for a total price of \$105 million. The agreement also provides for change-in-control payments to be made to fourteen officers of the Company aggregating \$2.4 million. Under the terms of the agreement, Royal will be merged with a subsidiary of TTI which, following the completion of the merger, will operate as a wholly owned, indirect subsidiary of TTI. The transaction is expected to close on April 23, 2003. It is subject to, among other things, the approval by the shareholders of both TTI and Royal. The parties have received early termination of the Hart-Scot-Rodino waiting period.

During 2001, the Company's subsidiary, Privacy Technologies, Inc. ("Privacy Technologies(TM)") introduced the TeleZapper(TM) - a telephone attachment that helps block unwanted telemarketing calls and removes consumers' phone numbers from the telemarketers' computerized dialing lists.

In July 2002, the Company acquired the North American rights to the home, health and beauty line of products from Medisana AG, along with certain other assets for approximately \$800. Medisana home, health and beauty products were offered in North America for the past three years through their North American wholly-owned subsidiary Medisana USA.

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The following is a summary of significant policies followed in the preparation of the accompanying Consolidated Financial Statements.

**BASIS OF PRESENTATION** - The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries after elimination of all intercompany accounts and transactions. The companies are hereinafter referred to as "Royal" or the "Company".

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates. Significant estimates include the allowance for doubtful accounts, the reserve for returns and allowances, and depreciation and amortization, among others.

Certain prior year amounts have been reclassified to conform to the 2002 presentation.

Net income per common share is computed based on the weighted average number of common shares outstanding for basic earnings per share and on the weighted average number of common shares and, when not antidilutive, potential common shares outstanding for diluted earnings per share.

The Company's revenue recognition policy is to record sales upon shipment from the Company's distribution centers. Although a majority of customers are shipped "FOB shipping point", the Company has a select number of customers who use EDI for invoicing and are shipped "FOB destination".

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

##### 1. ACCOUNTING POLICIES (CONTINUED):

Customers that have "FOB destination" terms are primarily the Company's large retail customers. The Company's three distribution centers are strategically located within a relatively close proximity to these large retail customers' distribution centers. As a result, and in response to definitive just-in-time delivery parameters mandated by the retailers' product placement programs, shipments from the Company in transit and not received by the customer at year-end are de minimis.

All sales are final upon shipment of product to the customer. The Company records estimated reductions to net sales for customer programs and incentive offerings including pricing arrangements, promotions and other volume based incentives.

The Company includes royalty income from various license agreements in net sales. For the three years ended December 31, 2002, royalty income totaled \$3,687, \$340 and \$497, respectively.

Shipping and handling costs are included in cost of sales.

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International operations, primarily Canadian, are conducted in their local currency. Assets and liabilities denominated in foreign currencies are translated at current exchange rates, and income and expenses are translated using weighted average exchange rates. The net effect of currency (gains) and losses realized on these business transactions was \$(145), \$192 and \$347 for the years ended December 31, 2002, 2001 and 2000 respectively, and have been classified as other (income) expense, net in the accompanying Consolidated Statement of Operations.

The Company has used forward exchange contracts from time to time to reduce fluctuations in foreign currency cash flows related to receivables denominated in foreign currencies. The terms of the currency instruments are consistent with the timing of the transactions being hedged. The purpose of the Company's foreign currency management activity is to protect the Company from the risk that the eventual cash flows from the foreign currency denominated transactions may be adversely affected by changes in exchange rates. Gains and losses on forward exchange contracts are deferred and recognized in income when the related transactions being hedged are recognized. Such gains and losses are generally reported on the same financial line as the hedged transaction. The Company does not use derivative financial instruments for trading or speculative purposes. There were no forward exchange contracts outstanding as of December 31, 2002 and 2001.

**CASH AND CASH EQUIVALENTS** - The Company considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents.

**ALLOWANCE FOR DOUBTFUL ACCOUNTS** - The Company maintains an allowance for trade accounts receivable for which collection on specific customer accounts is doubtful. In determining collectibility, management reviews available customer financial statement information, credit rating reports as well as other external documents and public filings. When it is deemed probable that a specific customer account is uncollectible, that balance is included in the reserve calculation.

**RESEARCH AND DEVELOPMENT COSTS** - Research and development costs are expensed as incurred. Research and development costs totaled approximately \$6,834, \$7,909 and \$6,785 in 2002, 2001 and 2000, respectively.

**ADVERTISING AND PROMOTION** - Cost incurred for producing and communicating advertising are expensed during the period aired, including costs incurred under the Company's cooperative advertising program. Advertising and promotion costs were \$34,112, \$37,372 and \$40,446 for the years ended December 31, 2002, 2001 and 2000, respectively.

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

### 1. ACCOUNTING POLICIES (CONTINUED):

In fiscal 2001, the Emerging Issues Task Force ("EITF") issued EITF No. 00-14, "Accounting for Certain Sales Incentives," and EITF No. 00-25, "Vendor Income Statement Characterization of Consideration to a Purchaser of the Vendor's Products or Services" (both of which were clarified by EITF 01-09 "Accounting for Consideration Given by Vendor to a Customer"). These

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pronouncements address the recognition, measurement and statement of operations classification for certain sales incentives and are effective January 1, 2002. The Company adopted these pronouncements in the first quarter of fiscal 2002 and as a result certain items previously included in selling, general and administrative expenses were reclassified as a reduction of net sales. Additionally, prior period amounts were reclassified to conform to the new requirements. The impact of these two issues resulted in a reduction of net sales of \$5,212, \$7,114 and \$6,708 for the years ended December 31, 2002, 2001 and 2000, respectively. These amounts, consisting principally of promotional allowances to the Company's retail customers were previously recorded as selling, general and administrative expenses; therefore, there was no impact to net income for any period.

INVENTORIES - Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) method.

Inventories at December 31, consisted of the following:

	2002	2001
Finished goods	\$ 40,942	\$ 43,277
Work in process and component parts	7,366	7,530
	\$ 48,308	\$ 50,807
	=====	=====

PROPERTY, PLANT AND EQUIPMENT - The Company capitalizes, as additions to property, plant and equipment, expenditures at cost for molds, tooling, land, buildings, equipment, furniture, computer software, and leasehold improvements. Expenditures for maintenance and repairs are charged to operating expense as incurred. The asset and related accumulated depreciation or amortization accounts are adjusted to reflect retirements and disposals and the resulting gain or loss is included in the determination of net income.

Internal and external costs incurred to develop internal use computer software during the application development stage are capitalized and amortized on the straight line method over the estimated useful life of software. Capitalized costs include payroll costs and related benefits, costs of related hardware and consulting fees. During 2001, \$185 of such internal costs was capitalized.

Plant and equipment are depreciated over the estimated useful lives of the respective classes of assets. Leasehold improvements and assets held under capital leases are amortized over the shorter of useful lives or their respective lease terms. Accumulated amortization on assets under capital leases totaled \$1,703 and \$1,555 at December 31, 2002 and 2001, respectively.

Depreciation for financial reporting purposes is computed on the straight-line method using the following depreciable lives:

Buildings.....	40 years
Building under capital lease .....	20 years
Molds, tooling, and equipment .....	2 - 5 years
Furniture, office and computer equipment, and software .....	2 - 5 years
Vehicles .....	3 years
Internal use software .....	2 - 5 years

Accelerated methods as permitted by the applicable tax law are used for tax reporting purpose.

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Depreciation expense was \$15,724, \$14,477 and \$15,396 in 2002, 2001 and 2000, respectively.

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

#### 1. ACCOUNTING POLICIES (CONTINUED):

INTANGIBLE ASSETS - Intangible assets are included within other long-term assets in the accompanying balance sheets and consist of patents and trademarks and are amortized on a straight-line method over their legal or estimated useful life. The Company does not have any intangibles with indefinite lives. The Company evaluates the remaining useful life of intangible assets each reporting period to determine whether events and circumstances warrant a revision to the remaining period of amortization.

The following summarizes the gross carrying value and accumulated amortization for each major category of intangible asset:

	2002		2001	
	Patents	Trademarks	Patents	Trademarks
Gross carrying amount	\$ 2,813	\$ 213	\$ 2,334	\$ 159
Accumulated amortization	(1,237)	(95)	(659)	(69)
	-----	-----	-----	-----
Net balances	\$ 1,576	\$ 118	\$ 1,675	\$ 90
	=====	=====	=====	=====

Amortization expense for the above intangibles was \$722, \$441 and \$208 in 2002, 2001, and 2000, respectively. The estimated amortization expense for intangibles for the five years ending December 31, 2003 through 2007 is as follows: 2003 - \$762; 2004 - \$514; 2005 - \$230; 2006 - \$139, and 2007 - \$49.

IMPAIRMENT REVIEW POLICY FOR LONG LIVED ASSETS - The Company reviews for impairment whenever events or changes in circumstances indicate that the carrying amount of property, plant and equipment or amortizable intangible assets may not be recoverable. If it is determined that an impairment loss has occurred based on expected undiscounted future cash flows, the loss as measured using discounted cash flows is recognized on the Consolidated Statement of Operations.

PRODUCT WARRANTY COSTS AND SERVICE RETURNS - The Company's return policy is to replace, repair or issue credit for product under warranty. Returns received during the current period are expensed as received and a reserve is maintained for future returns from current shipments. Management calculates the reserve



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utilizing historical return rates by product family. These rates are reviewed and adjusted periodically as actual results become available.

A reconciliation of warranty reserve activity is as follows for the years ended December 31, 2002 and 2001:

	2002	2001
	-----	-----
Balance at the beginning of year	\$ 9,950	\$ 9,800
Provision for warranties issued	15,708	20,958
Net settlements made during the year	(16,358)	(20,808)
	-----	-----
Balance at the end of the year	\$ 9,300	\$ 9,950
	=====	=====

FAIR VALUE OF FINANCIAL INSTRUMENTS - Financial instruments consist of a revolving credit agreement that is carried at an amount which approximates fair value.

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

#### 1. ACCOUNTING POLICIES (CONTINUED):

STOCK-BASED COMPENSATION - At December 31, 2002, the Company has a stock-based employee compensation plan comprised on non-qualified stock options and stock rights, which is described more fully in Note 8. The Company accounts for the stock options under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees". No stock-based employee compensation cost is reflected in net income for the stock options, as all options are granted at an exercise price equal to the market value of the underlying common stock on the date of grant. The fair value of each option grant is estimated on the date of grant using Black-Scholes option-pricing model. Compensation expense is recognized over the vesting period for the stock rights.

The Company adopted the disclosure only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". As permitted by SFAS No. 123, the Company continues to measure compensation cost in accordance with Accounting Principles Board ("APB") Opinion No. 25 and related interpretations in accounting for its plans. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under these plans consistent with the method of SFAS 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

Year Ended December 31,		
2002	2001	2000
-----	-----	-----
----	----	----

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Net income (in thousands)	As reported.....	\$ 9,565	\$ 9,324	\$ 5,939
	Pro forma.....	\$ 8,939	\$ 9,091	\$ 5,623
Basic earnings per share	As reported.....	\$ .74	\$ .68	\$ .39
	Pro forma.....	\$ .69	\$ .66	\$ .37
Diluted earnings per share	As reported.....	\$ .69	\$ .65	\$ .38
	Pro forma.....	\$ .64	\$ .64	\$ .36

The effect on net income and earnings per share is not expected to be indicative of the effects on net income and earnings per share in future years. Since the SFAS No. 123 method of accounting has not been applied to options granted prior to 1995, the resulting pro forma compensation costs may not be representative of those to be expected in future years. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Year Ended December 31,		
	2002	2001	2000
Expected volatility.....	34.0%	35.7%	36.6%
Risk-free interest rate.....	3.35%	4.85%	5.12%
Expected life of options in years.....	7 years	7 years	7 years
Expected dividend yield.....	0%	0%	0%

During fiscal years 2002, 2001 and 2000 the weighted average grant-date fair value of options granted was \$2.33, \$2.17 and \$2.39 per share, respectively.

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

1. ACCOUNTING POLICIES (CONTINUED):

NEW ACCOUNTING PRONOUNCEMENTS - In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 142, "Goodwill and Other Intangible Assets", effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests. Other intangibles continue to be amortized over their useful lives and will be assessed for impairment under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The adoption of SFAS No. 142 did not impact the results of operations, financial position or liquidity of the Company.

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In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143 requires companies to record the fair value of a liability for an asset retirement obligation in the period in which it was incurred. The amount recorded as a liability will be capitalized by increasing the carrying amount of the related long-lived asset, which is then depreciated over its useful life. SFAS No. 143 became effective for the Company on January 1, 2003. The Company does not expect the adoption of SFAS No. 143 to have a material impact on its results of operations, financial position or liquidity.

In October 2001, the FASB issued SFAS No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets." This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement superseded FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations". The Company adopted the provisions of this statement effective January 1, 2002, at which time it had no effect on its results of operations, financial position or liquidity.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", effective for exit or disposal activities initiated after December 31, 2002. This Statement nullifies EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." This Statement requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue No. 94-3, a liability for exit costs was recognized at the date of the entity's commitment to an exit plan. This Statement also establishes that fair value is the objective for initial measurement of the liability. The Company does not expect the adoption of this Statement to have a material impact on its results of operations, financial position or liquidity.

In November 2002, the FASB issued Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires certain guarantees to be recorded at fair value. The initial recognition and measurement provisions of FIN 45 are applicable, on a prospective basis, to guarantees issued or modified after December 31, 2002. FIN 45 also requires a guarantor to make new disclosures regarding guarantees. The disclosure provisions of FIN No. 45 are effective for periods ending after December 15, 2002. The recognition provisions are effective on a prospective basis to guarantees issued or modified after December 31, 2002. The Company has adopted the disclosure provisions of FIN No. 45 in these financial statements and does not expect the adoption of the recognition provisions of FIN No. 45 to have a material impact on its results of operations, financial position or liquidity.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FAS 123, Accounting For Stock-Based Compensation", effective for financial statements for fiscal years ending after December 15, 2002. This Statement amends FAS No. 123, and provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. This Statement also amends FAS No. 123 and requires disclosure about the effects on reported net income with respect to the stock-based employee compensation. Lastly, this Statement amends APB Opinion No. 28, and requires disclosure about the effects of stock-based employee compensation in interim financial information. See Note 8 in the Notes to Consolidated Financial Statements for further details.

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

2. CHANGES IN DEPRECIABLE LIVES AND CHARGES FOR TOOLING OBSOLESCENCE:

During 2002, 2001 and 2000, the Company shortened the useful lives of tooling for certain product families due to declining sales volumes, reduced product life cycles and the launch of replacement products. As a result of the reduced useful lives for certain product families, the Company recorded accelerated depreciation expense of \$586, \$191 and \$1,788 during 2002, 2001 and 2000, respectively.

Also during 2000, the Company relocated its corporate headquarters. As a result of the move, the remaining net book value of leasehold improvements associated with the former corporate headquarters was amortized on an accelerated basis from the date the decision was made to move through the actual date of the move. Due to this event, accelerated depreciation expense of approximately \$1,200 was recorded in 2000.

3. FINANCING:

At December 31, 2002, the Company had a collateralized revolving credit facility with availability of up to \$70,000, including letters of credit, and a maturity date of April 1, 2005. Under the agreement, pricing options of the bank's base lending rate and LIBOR rate are based on a defined formula. In addition, the Company pays a commitment fee based on a defined formula on the unused portion of the facility. The revolving credit facility contains covenants which require, among other things, the achievement of minimum net worth levels and the maintenance of certain financial ratios. The Company was in compliance with all applicable covenants as of December 31, 2002. The revolving credit facility is collateralized by the assets of the Company. As long as the Company remains in compliance with all covenants, the revolving credit facility permits share repurchases and dividends based on a defined formula up to \$18,369 as of December 31, 2002. The Company's effective interest rate was 4.99%, 7.34% and 9.28% for 2002, 2001 and 2000, respectively. Letters of credit and standby letters of credit outstanding at December 31, 2002 total \$812.

The Company utilizes a \$35,000 revolving trade accounts receivable securitization program to sell without recourse, through a wholly-owned subsidiary, certain trade accounts receivable. Pursuant to the terms of the securitization program, the Company transfers certain trade accounts receivable, on a revolving basis, to a wholly owned, bankruptcy-remote subsidiary of the Company, Royal Appliance Receivables, Inc. ("RAR"), which is consolidated for financial reporting purposes. In turn, RAR sells an undivided interest on a revolving basis, of up to \$35,000 in its accounts receivable to a special purpose bank sponsored commercial paper conduit. The Company retains an interest in the pool of trade receivables transferred to RAR which are not sold to the commercial paper conduit. These receivables represent ineligible receivables, which include but are not limited to receivables that are past due, concentrations over limits with specific customers and certain reserve amounts. The Company believes that the risk of loss associated with the unsold trade accounts receivable is minimal because of the high credit quality of the receivables that are included in the pool. During 2002 and 2001, the Company sold approximately \$142,000 and \$153,000, respectively, in total new securitization transactions. The loss recorded on these sales was \$547, \$993 and \$1,559 in 2002, 2001 and 2000, respectively, and has been classified as

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receivable securitization expense in the accompanying Consolidated Statements of Operations. The Company accounts for the portion of the receivables not sold as trade receivables on the Consolidated Balance Sheets. The Company continues to service the accounts receivable without being compensated by the bank sponsored commercial paper conduit. The Company has recorded a servicing liability, based on its estimate of adequate compensation for the services that are being performed, of \$56 and \$62 as of December 31, 2002 and 2001, respectively. The servicing liability is included within accrued liabilities - other on the Consolidated Balance Sheets.

As of December 31, 2002, RAR sold \$22,600 of undivided interests in accounts receivable. The proceeds from those sales were reflected as a reduction of accounts receivable on the Consolidated Balance Sheets and as operating cash flows in the Consolidated Statements of Cash Flows. The sale proceeds were used to pay down the Company's revolving credit facility. Additionally, the securitization program contains covenants that the Company was in compliance with as of December 31, 2002.

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

#### 4. LEASES:

Royal leases various facilities, equipment, computers, software and vehicles under capital and operating lease agreements. Operating lease payments totaled \$3,912, \$2,905 and \$1,912 for the years ended December 31, 2002, 2001, and 2000, respectively.

Minimum commitments under all capital and operating leases at December 31, 2002 are as follows:

Year	Capital	Operating
-----	-----	-----
2003 .....	\$ 315	\$ 3,422
2004 .....	317	3,102
2005 .....	314	2,425
2006 .....	318	2,098
2007 .....	313	1,803
Thereafter .....	1,249	13,623
	-----	-----
Total minimum lease payments .....	2,826	\$ 26,473
		=====
Less amount representing interest .....	837	
	-----	
Total present value of capital obligation ....	1,989	
Less current portion .....	161	
	-----	
Long-term obligation under capital leases.....	\$ 1,828	
	=====	

#### 5. COMMITMENTS AND CONTINGENCIES:

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At December 31, 2002, the Company estimates having contractual commitments for future advertising and promotional expense of approximately \$1,950, including commitments for television advertising through December 31, 2003. Other contractual commitments for items in the normal course of business total approximately \$2,075.

The Company is self-insured with respect to workers' compensation benefits in Ohio and carries excess workers' compensation insurance covering aggregate claims exceeding \$350 per occurrence. The excess workers' compensation insurance covers up to \$1,000 per claim. The Company has additional insurance in place to cover claims greater than \$1,000.

The Hoover Company (Hoover) filed a lawsuit in federal court, in the Northern District of Ohio (case #1:00cv 0347), against the Company on February 4, 2000, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserted that the Company's Dirt Devil Easy Steamer infringed three utility patents and two design patents held by Hoover, and also that the Easy Steamer design infringed the trade dress of Hoover's carpet extractor products. The Court had dismissed charges of infringement against Royal regarding one of the three utility patents, and found that the Dirt Devil Easy Steamer infringed one claim of a second utility patent. The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:01cv 2775), against The Hoover Company (Hoover) on December 10, 2001, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserted that Hoover infringed certain patents relating to bagless technology held by the Company. On October 17, 2002, the Company and Hoover reached a settlement of all patent-related litigation described above. Hoover has granted rights to the Company with regard to its existing carpet extractor patents. The Company has granted rights to Hoover with regard to its existing bagless upright vacuum cleaner patents. The settlement includes net cash payments to the Company and resulted in a gain of \$3,371 which was included in the caption "Litigation Settlement" on the Consolidated Statement of Operations.

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

##### 5. COMMITMENTS AND CONTINGENCIES: (CONTINUED)

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 0338), against Bissell Homecare, Inc. (Bissell) on February 22, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that Bissell infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

Bissell Homecare, Inc. (Bissell) filed a lawsuit in federal court, in Michigan (case #02cv71079), against the Company on March 20, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that the Company's Dirt Devil Easy Steamer and Platinum Force Extractor products infringe certain design and utility patents held by Bissell. Bissell seeks damages, injunction on future production, and legal fees. On June 19, 2002, the Court transferred the case (now #1:02cv 1358) to the Northern District of Ohio. The Company is vigorously defending the suit and believes it

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is without merit. If Bissell were to prevail on all its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 1127), against White Consolidated, Ltd. (Eureka) on June 14, 2002, under the patent, trademark and unfair competition laws of the United States. The Complaint asserts that Eureka infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

The Company filed a lawsuit in federal court, in the Northern District of Ohio against Euro-Pro Corporation and Sanyo North America Corporation (together referred to as "Defendants") on November 15, 2002, under the patent, trademark and unfair competition laws of the United States. The complaint asserts that Defendants infringed certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production and legal fees.

Phone Zap, LLC ("Phone Zap") filed a lawsuit in United States District Court, District of Columbia, against the Company and its subsidiary, Privacy Technologies, Inc. on January 6, 2003, under the patent, trademark and unfair competition laws of the United States. The complaint asserts trademark infringement by the Company through the use of the Company's TeleZapper(R) trademark. The Company is vigorously defending the suit and believes it is without merit. If Phone Zap were to prevail on all its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company is involved in various other claims and litigation arising in the normal course of business. The Company has product liability and general liability insurance policies in amounts management believes to be reasonable. There can be no assurance, however, that such insurance will be adequate to cover all potential product or other liability claims against the Company. In the opinion of management, the ultimate resolution of these actions will not materially affect the consolidated financial position, results of operations, or cash flows of the Company.

### 6. INCOME TAXES:

The income tax expense consisted of the following:

	2002	2001	2000
	-----	-----	-----
Current:			
Federal	\$ 5,076	\$ 4,888	\$ 782
State and local	1,022	552	125
Deferred	(754)	(382)	618
	-----	-----	-----
Total	\$ 5,344	\$ 5,058	\$ 1,525
	=====	=====	=====

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### 6. INCOME TAXES: (CONTINUED)

Deferred income taxes reflect the impact, for financial statement reporting purposes, of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities. At December 31, 2002 and 2001, the components of the net deferred tax asset were as follows:

	2002	2001
Deferred tax assets:		
Warranty and customer returns	\$ 3,034	\$ 3,881
Bad debt reserve	428	1,170
Inventory basis difference	437	636
Accrued vacation, compensation and benefits	1,171	866
State and local taxes	211	127
Accrued advertising	-	98
Self insurance reserves	133	90
Deferred compensation plan	200	164
Deferred tax liabilities:		
Basis difference in fixed and intangible assets	(2,113)	(4,566)
State and local taxes	-	(240)
Other	(2,209)	(1,688)
	\$ 1,292	\$ 538
	=====	=====

The differences between income taxes at the statutory federal income tax rate of 34% and those reported in the Consolidated Statements of Operations are as follows:

	Year Ended December 31,			
	2002	% of Pre-tax Income	2001	% of Pre-tax Income
Tax expense at statutory rate	\$ 5,069	34.0%	\$ 4,890	34.0%
Research & experimentation credit	(300)	(2.0)	(400)	(2.8)
State and local income taxes, net of federal benefit	675	4.5	360	2.5
Federal surtax on income over \$10 million	49	0.3	42	0.3
Other, net	(149)	(1.0)	166	1.2
	\$ 5,344	35.8%	\$ 5,058	35.2%
	=====	=====	=====	=====

During 2000, the Company performed a detailed study of Research and Experimentation ("R&E") expenses over the preceding three-year period. As a result of this study, it was determined that additional expenditures qualify under the current guidance. Based on revised calculations, the Company was entitled to R & E credits of \$462, \$166 and \$302 for the years ended 1999, 1998



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and 1997, respectively. These Federal Income Tax refunds were received in 2001. For the years ended December 31, 2002, 2001 and 2000, the R & E credit amounted to \$300, \$400 and \$200, respectively.

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED) (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

##### 7. MAJOR CUSTOMERS:

Royal's three largest customers represented approximately 27.5%, 15.1%, and 15.0% of total net sales in 2002. The Company's three largest customers represented approximately 31.1%, 14.3% and 14.1% in 2001 and 32.6%, 13.5% and 13.1% of total net sales in 2000. Additionally, a significant concentration of Royal's business activity is with major domestic mass market retailers whose ability to meet their financial obligations with Royal is dependent on economic conditions germane to the retail industry. Due to the concentration in the volume of sales with a limited number of customers, the loss of one or more of these customers would have a material adverse effect on the consolidated financial position, results of operations and cash flows of the Company. During recent years, several major retailers have experienced significant financial difficulties and some, including Kmart, have filed for protection from creditors under applicable bankruptcy laws. As of December 31, 2002, the net exposure related to Kmart's pre-bankruptcy balance as well as other customers' balances for which management believes collection is doubtful was included in the calculation of allowance for doubtful accounts. The Company sells its products to certain customers that are in bankruptcy proceedings.

The Company provides credit, in the normal course of business, to the retail industry which includes mass market retailers, warehouse clubs, and independent dealers. The Company performs ongoing credit evaluations of its customers and establishes appropriate allowances for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information.

##### 8. STOCK BASED PLANS:

Under the terms of the Company's stock option plans for employees, outside directors and consultants, all outstanding options have been granted at prices at least equal to the then current market value on the date of grant. Typically, stock options granted become exercisable in cumulative 20% installments, commencing one year from date of grant with full vesting occurring on the fifth anniversary date, and expire in ten years. Certain stock options granted vest at the end of five years ("5 year cliff vesting") and expire in six to ten years, while certain other stock options granted vest 50% immediately with the remaining 50% vesting ratably over the next twelve months. All stock options are subject to earlier termination in certain events related to termination of employment. Vesting may be accelerated in certain events relating to change of the Company's ownership.

The following summarizes the changes in the number of Common Shares under option:

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	2002 ----	2001 ----	
Options outstanding at beginning of the year	2,371	2,673	
Options granted during the year	562	204	
Options exercised during the year	(134)	(321)	
Options canceled during the year	(817)	(185)	
	-----	-----	-----
Options outstanding at end of the year	1,982	2,371	
	=====	=====	=====
Options exercisable at end of the year	1,156	1,651	
Option price range per share	\$2.50 to \$6.38	\$2.50 to \$10.25	\$2.50 to \$10.25

The 1,156 exercisable options at December 31, 2002 are exercisable at an average exercise price of \$4.44. The Company's current option plans, which provide for a total of 3,060 options, have 314 options remaining for future grants at December 31, 2002. If the merger, as described in Note 1 is approved by the shareholders of both companies, vesting will be accelerated and all outstanding options will be exercised at closing.

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

8. STOCK BASED PLANS: (CONTINUED)

The Company has also established compensation plans under which stock rights have been granted to certain key employees to receive Company stock upon exercise. These rights typically become 60% vested on the third anniversary from date of grant and an additional 20% vested for each subsequent year while certain other rights vest ratably over 36 months, subject to earlier termination in certain events related to termination of employment. Vesting may be accelerated in certain events relating to change of the Company's ownership. During 2002 and 2001, the Company awarded 334 and 116 stock rights under the plans, respectively, with a weighted average fair value at the date of grant of \$4.79 and \$4.25 per share for the years ended December 31, 2002 and 2001, respectively. Compensation expense is calculated as the number of stock rights granted multiplied by the closing stock price on the date of issue. The Company amortizes unearned compensation to expense over the five-year vesting period. Compensation expense related to these awards was \$1,148, \$586 and \$361 for 2002, 2001 and 2000, respectively. At December 31, 2002, 43 total stock rights were reserved for future issuance. If the merger, as described in Note 1 is approved by the shareholders of both companies, vesting will be accelerated and all outstanding stock rights will be exercised at closing.

9. SHAREHOLDER RIGHTS PLAN:

The Company has a Shareholder Rights Plan which provides that under certain circumstances each Right will entitle the shareholder to purchase one one-hundredth of a share of Series A Participating Preferred Stock at an

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exercise price of \$40. Upon the occurrence of certain other events, including if a "Person" becomes the beneficial owner of more than 20% of the outstanding Common Shares or an "Adverse Person" becomes the beneficial owner of 10% of the outstanding Common Shares, the holder of a Right will have the right to receive, upon exercise, Common Shares of the Company, or Common Stock of the acquirer, having a value equal to two times the exercise price of the Right. The Shareholder Rights Plan is designed to deter abusive market manipulation or unfair takeover tactics and to prevent an acquirer from gaining control of the Company without offering a fair price to all shareholders. The Rights expire on November 2, 2003, unless redeemed prior to that date. The Rights can be redeemed at a price of \$.01 per Right. The Shareholder Rights Plan was amended in December 2002 so as not to be triggered by the contemplated merger as described further in Note 1.

### 10. BENEFIT PLANS:

The Company sponsors a 401(k) defined contribution plan which covers substantially all of its employees who have satisfied the plan's eligibility requirements. Participants may contribute to the plan by voluntarily reducing their salary up to a maximum of 90% of qualified compensation subject to annual I.R.S. limits. All contributions vest immediately. For each of the last three years, the matching contribution was 100%, up to the first 3% of qualified compensation, and 50% of the next 2% of such compensation. The Company has also made discretionary contributions to the plan. The Company's provisions for matching and discretionary contributions totaled approximately \$1,171, \$965 and \$1,017, for the years ended December 31, 2002, 2001 and 2000, respectively. Voluntary after-tax contributions and certain rollover contributions are also permitted.

The Company also sponsors a non-qualified deferred compensation plan which permits key employees to annually elect (via individual contracts) to defer a portion of their compensation on a pre-tax basis until retirement. The retirement benefit to be provided is based on the amount of compensation deferred, Company match and investment earnings. All contributions vest immediately. Although the Plan is designed to be unfunded, the Company has funded the deferred compensation liability with investments in marketable securities, primarily stock mutual funds, which are classified as current assets. The Company's provisions for matching and discretionary contributions totaled approximately \$54, \$72, and \$77 for the years ended December 31, 2002, 2001 and 2000, respectively. The deferred compensation liability which equals the related assets recorded by the Company was \$513 and \$419 as of December 31, 2002 and 2001, respectively.

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

### 10. BENEFIT PLANS: (CONTINUED)

The Company recorded severance expense of \$870, \$130, and \$670 for the years ended December 31, 2002, 2001 and 2000, respectively, related to the termination of certain employees. Substantially all severance expense was paid during each respective period.

The Company does not offer any other post-retirement benefits, accordingly,

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it is not subject to the provisions of SFAS No. 106, "Employers' Accounting for Post Retirement Benefits Other Than Pensions."

### 11. SHARE REPURCHASE PROGRAM:

In February 2000, the Company's Board of Directors authorized a common share repurchase program that enabled the Company to purchase, in the open market and through negotiated transactions, up to an additional 4,250 of its outstanding common shares. The Company completed the program repurchasing 3,289 shares for an aggregate purchase price of \$20,065 in February 2001. In April 2001, the Company's Board of Directors authorized another common share repurchase program that enabled the Company to purchase, in the open market and through negotiated transactions, up to an additional 3,400 of its outstanding common shares. The Company repurchased approximately 1,322 shares for an aggregate purchase price of \$6,900 under the program that expired in December 2002.

### 12. EARNINGS PER SHARE:

Basic earnings per share excludes dilution and is computed by dividing income by the weighted average number of common shares outstanding for the period. Diluted earnings per share includes the dilution of potential common shares.

	2002 -----	2001 -----
Net income	\$ 9,565 =====	\$ 9,320 =====
<b>BASIC:</b>		
Common shares outstanding, net of treasury shares, beginning of year	13,464	13,720
Weighted average common shares issued during year	64	17
Weighted average treasury shares repurchased during year	(545)	(16)
	-----	-----
Weighted average common shares outstanding, net of treasury shares, end of year	12,983 =====	13,730 =====
Net income per common share	\$ .74 =====	\$ .68 =====
<b>DILUTED:</b>		
Common shares outstanding, net of treasury shares, beginning of year	13,464	13,720
Weighted average common shares issued during year	64	17
Weighted average potential common shares	894	56
Weighted average treasury shares repurchased during year	(545)	(16)
	-----	-----
Weighted average common shares outstanding, net of treasury shares, end of year	13,877 =====	14,290 =====
Net income per common share	\$ .69 =====	\$ .68 =====

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

13. BUSINESS SEGMENT INFORMATION:

The Company has two reportable segments: Consumer Products - Floorcare and Consumer Products - Other. The operations of the Consumer Products - Floorcare segment includes the design, assembly or sourcing, marketing and distribution of a full line of plastic and metal vacuum cleaners. The primary brand names associated with this segment include Dirt Devil and Royal. These products are sold primarily to major mass merchant retailers and independent dealers in North America. The operations of the Consumer Products - Other segment represents business conducted by Privacy Technologies, Inc., Medisana, Inc. and Product Launch Partners, Inc., all of which are wholly owned subsidiaries of the Company. Currently, the primary product line within this segment is the TeleZapper, a telephone attachment that helps block unwanted telemarketing calls and removes consumers' phone numbers from telemarketers' computerized dialing lists. These products are sold primarily to major mass merchant retailers and national electronic chains in North America.

The Company's reportable segments are distinguished by the nature of products sold. The Company evaluates performance and allocates resources to reportable segments primarily based on net sales and operating income. The accounting policies of the reportable segments are the same as those described in Note 1, the accounting policies footnote. The Company records its federal and state tax assets and liabilities at corporate. There are no intersegment sales.

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

13. BUSINESS SEGMENT INFORMATION: (CONTINUED)

Financial information for the Company's reportable segments consisted of the following:

Year ended December 31,

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	2002 -----	2001 -----	2000 -----
Net Sales			
Consumer Products - Floorcare	\$353,427	\$399,388	\$401,515
Consumer Products - Other	36,299	21,923	--
	-----	-----	-----
Consolidated Total	\$389,726	\$421,311	\$401,515
	=====	=====	=====
Income from Operations			
Consumer Products - Floorcare	\$ 6,972	\$ 15,882	\$ 12,680
Consumer Products - Other	6,378	2,096	--
	-----	-----	-----
Consolidated Total	\$ 13,350	\$ 17,978	\$ 12,680
	=====	=====	=====
Capital Expenditures			
Consumer Products - Floorcare	\$ 5,006	\$ 6,011	\$ 7,298
Consumer Products - Other	78	74	--
	-----	-----	-----
Total for Reportable Segments	5,084	6,085	7,298
Corporate	1,316	7,757	6,076
	-----	-----	-----
Consolidated Total	\$ 6,400	\$ 13,842	\$ 13,374
	=====	=====	=====
Depreciation and Amortization			
Consumer Products - Floorcare	\$ 11,465	\$ 12,079	\$ 13,046
Consumer Products - Other	498	208	--
	-----	-----	-----
Total for Reportable Segments	11,963	12,287	13,046
Corporate	4,831	2,992	2,790
	-----	-----	-----
Consolidated Total	\$ 16,794	\$ 15,279	\$ 15,836
	=====	=====	=====
Total Assets			
Consumer Products - Floorcare	\$107,117	\$114,376	\$124,638
Consumer Products - Other	6,163	6,773	--
	-----	-----	-----
Total for Reportable Segments	113,280	121,149	124,638
Corporate	27,889	19,295	13,914
	-----	-----	-----
Consolidated Total	\$141,169	\$140,444	\$138,552
	=====	=====	=====

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)  
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

13. BUSINESS SEGMENT INFORMATION: (CONTINUED)

Financial information related to the Company's operations by geographic

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location consisted of the following:

	2002	2001	2000
	-----	-----	-----
Revenues, net:			
United States	\$370,895	\$401,293	\$383,264
All other Countries	18,831	20,018	18,251
	-----	-----	-----
	\$389,726	\$421,311	\$401,515
	=====	=====	=====
Long lived assets, net:			
United States	\$ 24,542	\$ 32,527	\$ 38,109
All other Countries	6,445	5,047	3,699
	-----	-----	-----
	\$ 30,987	\$ 37,574	\$ 41,808
	=====	=====	=====

#### 14. RELATED PARTY NOTE RECEIVABLE:

On April 2, 2001, the Company and its Chief Executive Officer (Officer) entered into a Promissory Note Agreement in the principal amount of approximately \$543. The non-interest bearing note, which is included in the equity section of the Consolidated Balance Sheets, was used by the Officer to fund the exercise of stock options to purchase 167 common shares of the Company. The promissory note is due and payable in full on April 2, 2008 or, if earlier, within twelve months after the Officer's voluntary termination of employment with the Company. The Officer simultaneously entered into a Stock Pledge Agreement with the Company pledging the 167 common shares as security for the Promissory Note. In accordance with the merger agreement that the Company has entered into with Techtronic Industries, the \$543 note will be paid in full at closing (see Note 1 for further description of Merger Agreement with Techtronic Industries).

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#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None

#### PART III

#### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

##### BOARD OF DIRECTORS

The Board of Directors is divided into two classes, each of whose members serve for a staggered two-year term. The Board is comprised of three Class I Directors and three Class II Directors.

Name of Director	Age	Principal Occupation
-----	-----	-----
Jack Kahl Jr.	62	Chief Executive Officer of Jack Kahl & Assoc., LLC
Michael J. Merriman	46	Chief Executive Officer and President of the Company

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E. Patrick Nalley	83	Director of Invacare Corporation
Joseph B. Richey II	65	President of Invacare Technologies
John P. Rochon	51	Chairman of the Richmond Corporation
R. Louis Schneeberger	48	Financial Advisor

JACK KAHL JR. has served as a Director of the Company since September 1995. Mr. Kahl was Chief Executive Officer of Manco, Inc., a manufacturer of pressure sensitive tapes, home weatherization products and shipping supplies, from 1971 to 2000. He currently serves as CEO of Jack Kahl & Associates, LLC. Mr. Kahl is also a Director of American Greetings Company and Acorn Products, Inc.

MICHAEL J. MERRIMAN has served as a Director of the Company since October 1993 and as Chief Executive Officer and President since 1995.

E. PATRICK NALLEY has served as a Director of the Company since the Company's formation in 1981. In 1992, Mr. Nalley retired from his positions as Executive Vice President of Sales and Assistant to the President of Invacare Corporation, a provider of home health care medical equipment. Mr. Nalley also serves as a Director of Invacare Corporation.

JOSEPH B. RICHEY II has served as a Director of the Company since July 1994. Since 1992, Mr. Richey has been President - Invacare Technologies and Senior Vice President - Total Quality Management for Invacare Corp. Mr. Richey is also a Director of Invacare Corporation, Steris Corporation and Unique Mobility Inc.

JOHN P. ROCHON has served as a Director of the Company since September 1995. Mr. Rochon is Chairman of the Richmond Corporation, a merchant bank and family office.

R. LOUIS SCHNEEBERGER has served as Chairman of the Board since July 1995 and as a Director of the Company since August 1991. Mr. Schneeberger has been involved in several early stage technology companies since March 2000; Viztec, Cardinal Commerce and Compliant. Previously he served 13 years as Chief Financial Officer, director, and earlier a partner in Olympic Steel, Inc., a national steel service center. He also serves as a board member for several private companies.

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### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT (CONTINUED)

#### EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below is certain information with respect to the named executive officers of the Company.

NAME	AGE	POSITION AND OFFICES WITH THE COMPANY
----	---	-----
Michael J. Merriman	46	President and Chief Executive Officer
Richard C. Farone	39	Executive Vice President - Sales, Marketing & Engi
Richard G. Vasek	38	Chief Financial Officer, Vice President - Finance
David M. Brickner	36	Vice President - Operations



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The following is a brief account of the business experience during the past five years of each such executive officer:

Michael J. Merriman was appointed Chief Executive Officer and President in 1995 and Director in October 1993.

Richard C. Farone has been Executive Vice President - Sales, Marketing & Engineering since December 2000. Since 1987, he has served in several different roles in the Company's marketing and new products areas, most recently as Vice President - Product Development.

Richard G. Vasek was appointed Chief Financial Officer and Vice President - Finance in September 1998, and Secretary in January 1996. From February 1992 until his appointment as Chief Financial Officer and Vice President - Finance he served as the Company's Corporate Controller.

David M. Brickner has been Vice President -Operations since 2001. Prior to that, he was Vice President - Manufacturing from December 1998 to 2001. Since 1988, he has served in several different roles in the Company's engineering, purchasing, and sourced products areas.

### SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Act of 1934, as amended, requires the Company's officers and directors, and persons who own greater than 10% of the Company's Common Stock, to file reports of ownership and changes in ownership to the Securities and Exchange Commission. Officers, directors and more than 10% shareholders are required by the SEC to furnish to the Company copies of all Section 16(a) reports they file. Based solely upon a review of Forms 3 and 4 and amendments thereto furnished to the Company during 2002 and Form 5 and amendments thereto furnished to the Company with respect to 2002, or a written representation from the reporting person that no Form 5 is required, all filings required to be made by the Company's officers, directors and greater than 10% shareholders were timely made.

### ITEM 11. EXECUTIVE COMPENSATION

#### COMPENSATION OF DIRECTORS

Each Director who is not an employee of the Company receives a director's fee in the amount of \$30,000 per annum for up to five meetings, and reimbursement for out-of-pocket expenses incurred in connection with attending such meetings. An additional \$2,000 is paid for attending board meetings, if any, in excess of five meetings in any one year and \$2,000 is paid for attendance at any committee meeting held on a day other than a day of a Directors' meeting. Each non-employee Director received options to purchase 20,000 Common Shares upon joining the Board of Directors. In 1995, the non-employee Directors were granted options for an additional 30,000 Common Shares. In October 2001, two Directors were granted 20,000 options to replace expiring options. In April 2002, the non employee Directors were each granted 5,000 stock rights. These rights become 60% vested on the third anniversary from date of grant and an additional 20% vested for each subsequent year. If the merger agreement, as described in Item 1 is approved by the shareholders of both companies, vesting will be accelerated and all outstanding stock options and stock rights will be exercised at closing.

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## EXECUTIVE OFFICER'S COMPENSATION

Shown below is information concerning the annual and long-term compensation for services to the Company and its subsidiaries for the years ended December 31, 2002, 2001, and 2000, of those persons (the "Named Executive Officers") who served during 2002 as the Company's Chief Executive Officer and the other three executive officers of the Company:

Name & Principal Position	Year	Annual Compensation			Long-Term Compe
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)(1)	Awards Securities Underlying Options/SAR (#)
Michael J. Merriman Chief Executive Officer, President and Director	2002	400,000	406,539	0	305,000
	2001	400,000	435,339	0	0
	2000	400,000	0	0	120,000
Richard Farone Executive Vice President - Sales, Marketing & Engineering	2002	200,000	163,482	0	100,000
	2001	195,834	170,503	0	5,000
	2000	145,000	0	0	50,000
Richard G. Vasek Chief Financial Officer Vice President - Finance	2002	185,000	151,221	0	100,000
	2001	185,000	147,177	0	0
	2000	175,000	0	0	25,000
David M. Brickner Vice President - Manufacturies	2002	160,000	130,786	0	100,000
	2001	135,000	143,751	0	10,000
	2000	128,500	0	0	15,000

- (1) Perquisites provided to each of the Named Executive Officers, if any, do not exceed the disclosure thresholds established under the Securities and Exchange Commission rules and are not included in this total.
- (2) The amounts show in this column represents payments made to the Company's Defined Contribution Plans ("DCP") by the Company.

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## ITEM 11. EXECUTIVE COMPENSATION (CONTINUED)

### OPTION / SAR GRANTS IN 2002

Shown below is information on grants of options or stock rights pursuant to the Company's compensation plans made in the year ended December 31, 2002, to the Named Executive Officers which are listed in the Summary Compensation Table.

Number of Securities Underlying Options / SAR	Individual Grants		Exercise	Poten at A of Sto F
	% of Total Options / SAR			

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Name	Granted (#) (1)	Granted to Employees in Fiscal Year	Price (\$/Sh)	Expiration Date	5%
Michael J. Merriman	175,000 130,000	19.5% 14.5%	\$ 5.35 \$ -	3/1/12 2/11/12	
Richard C. Farone	75,000 25,000	8.4% 2.8%	\$ 5.35 \$ -	3/1/12 2/11/12	
Richard G. Vasek	50,000 50,000	5.6% 5.6%	\$ 5.35 \$ -	3/1/12 2/11/12	
David M. Brickner	50,000 50,000	5.6% 5.6%	\$ 5.35 \$ -	3/1/12 2/11/12	

(1) The March options vest 20% on each anniversary of the grant date with full vesting occurring on the fifth anniversary date, except for Mr. Merriman's which vested 50% immediately with the remaining 50% vesting ratably over twelve months, assuming the executive officer remains employed by the Company. The February stock rights become 60% vested on the third anniversary from the date of grant and 80% vested on the fourth anniversary with full vesting occurring on the fifth anniversary date, except for Mr. Merriman's which vest ratably over 36 months, assuming the executive officer remains employed by the Company. The Options and Rights expire in ten years from the date of grant, subject to earlier termination in certain events related to termination of employment. The Plans provide that in the event of a "change in control" of the Company, the Compensation Committee can cause all outstanding stock rights to be immediately exercisable and may accelerate the termination date of all such options. A "change in control" generally means the occurrence of (I) the acquisition by a person of 20% or more of the Company's Common Shares, (ii) the first purchase of shares pursuant to an exchange or tender offer, or (iii) shareholder approval of a merger in which the Company is not the surviving corporation or pursuant to which the Company's shares are converted into cash. See also "Change-in-Control Arrangements" herein.

(2) The dollar amounts set forth in these columns are the result of calculations at the 5% and 10% rates set by the Securities and Exchange Commission, and therefore are not intended to forecast possible future appreciation, if any, of the Company's Common Stock price. Using these rates, the total of potential realizable values for the named officers represents less than 6% of the gain that would be realized by all shareholders of the Company. Based on the number of shares outstanding and the market price on the February and March grant dates, the aggregate gain realized by the Company's shareholders assuming a 5% annual rate of stock appreciation for the option term would be in excess of \$39 million and \$45 million, respectively; a 10% annual rate of stock appreciation would result in a gain in excess of \$100 million and \$115 million, respectively.

ITEM 11. EXECUTIVE COMPENSATION (CONTINUED)

AGGREGATED OPTION / SAR EXERCISES IN 2002 AND YEAR-END OPTION / SAR VALUES

Shown below is information with respect to the unexercised stock options and stock rights to receive the Company's Common Shares under the plans held by the Named Executive Officers at December 31, 2002.

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Name	Shares Acquired on Exercise (#)	Value Realized (\$)	Number of Securities Underlying Unexercised Options / SAR at FY-End (#)		Value Realized (\$)
			Exercisable	Unexercisable	
Michael J. Merriman	-	-	309,270	315,730	\$ 889,270
Richard C. Farone	-	-	95,707	206,333	270,000
Richard G. Vasek	-	-	107,300	178,000	314,000
David M. Brickner	-	-	55,000	135,000	151,000

(1) Calculated on the basis of the fair market value of the underlying securities at December 31, 2002, minus the exercise price.

CHANGE-IN-CONTROL AND OTHER EMPLOYMENT ARRANGEMENTS

Michael J. Merriman, President and Chief Executive Officer, and the Company entered into a new Employment Agreement effective as of March 14, 2002. Under the Agreement, Mr. Merriman is entitled to a base salary of \$400,000 per year, and participates in the Company's annual management incentive plan ("MIP"). The term of the agreement is for one year, with automatic renewals unless one party gives notice of its intent not to renew the agreement. In the event of Mr. Merriman's termination without cause, termination due to death or disability, termination for "good reason" (as defined in the agreement), or if the Company gives notice of its intention not to renew the agreement (collectively, a "Triggering Termination"), Mr. Merriman is entitled to severance payments equal to: (a) three times the sum of his then current annual base salary and the average annual bonus based on the prior three years (paid in six semi-annual installments); (b) a prorated portion of his MIP award for the year in which the termination occurs, if applicable; (c) a lump sum severance payment determined annually by the Board (initially \$1.5 million) , (d) forgiveness of all amounts due from Mr. Merriman on his April 2001 \$542,750 note payable to the Company, and (e) continuation of his insurance and other employee benefits for 36 months. If any of these payments or any other payments made by the Company would precipitate an excise tax as a "parachute payment" under Internal Revenue Code, Mr. Merriman shall be entitled to receive an amount equal to the amount of those excise taxes plus a tax "gross-up" payment. If a Triggering Termination occurs following a change-in-control (as defined in the Agreement), Mr. Merriman's severance payments will be paid in a lump sum. The Agreement also contains a covenant by Mr. Merriman not to compete with the Company for up to 36 months following the termination of his employment. In the event of a Triggering Termination, any and all unvested stock options and phantom stock rights held by Mr. Merriman will fully vest.

In connection with the execution of the Merger Agreement with Techtronic Industries discussed in Item 1 and assuming the Merger is consummated, Mr. Merriman's employment agreement has been amended whereby Mr. Merriman has agreed to repay all amounts due on his \$542,750 note payable to the Company and forego the other benefits provided in clauses (a) through (e) above in exchange for a lump-sum payment of \$742,000. Moreover, in the event Mr. Merriman is terminated without "cause", as defined in his new employment agreement, after the Merger, or terminates his employment for "good reason", as defined in his new employment agreement, his severance shall be one-half the sum of his then-current base salary and the average of his annual bonus for the prior three years. Under Mr. Merriman's amended employment agreement, he is entitled to receive a stock option for 2,000,000 shares of Techtronic in May 2003, following release of

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Techtronic's earnings for fiscal 2002.

ITEM 11. EXECUTIVE COMPENSATION (CONTINUED)

CHANGE-IN-CONTROL AND OTHER EMPLOYMENT ARRANGEMENTS (CONTINUED)

The Company has entered into Severance Agreements with the other three Named Executive Officers that are designed to retain the executives and provide for continuity of management in the event of any actual or threatened change in the control of the Company. Each agreement only becomes operative upon a "Change in Control" as defined in the Agreements. After a Change in Control, if, during the three-year period commencing with the Change in Control, the executive's employment is terminated for reasons other than "cause" (as defined in the Agreement), death or disability, or the executive terminates his employment for "good reason" (as defined in the Agreement), under their respective agreements, the executive shall be entitled to receive a severance amount equal to three times of his then base salary. The Company may make an additional payment to reimburse such individuals for excise tax payments, if any, triggered by the foregoing severance payments. All options and stock rights held by the executives with respect to the Company's common stock will become immediately exercisable upon the date of termination of employment and remain exercisable for a period of up to three years.

In connection with the execution of the Merger Agreement, Messrs. Farone, Vasek and Brickner agreed to amend their severance agreements. In exchange for lump sum payments of \$311,000, \$289,000 and \$251,000, respectively, Messrs. Farone, Vasek and Brickner each agreed to new one-year employment contracts that provide for severance payments in the event of their termination of employment for reasons other than "cause" or for "good reason", as defined in their new agreements. The severance payments equal one-half the sum of the then current salary of the executive plus the average of the annual bonus for the prior three years. Under their employment agreements, Messrs. Farone, Vasek and Brickner each are entitled to receive stock options for 1,000,000 shares of Techtronic in May 2003, following release of Techtronic's earnings for fiscal 2002.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS

The following table sets forth each person or entity who, pursuant to SEC rules, had beneficial ownership of 5% or more of the Common Shares of the Company on January 31, 2003, based upon information furnished to the Company:

NAME AND ADDRESS OF BENEFICIAL OWNERS -----	SHARES AND NATURE OF BENEFICIAL OWNERSHIP -----	PERCENTA S
Richmont Capital Partners I, L.P..... 2400 Dallas Parkway, Suite 230; Plano, Texas 75093	2,969,900	
John P. Rochon..... 2400 Dallas Parkway, Suite 230; Plano, Texas 75093	2,991,400 (1)	

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E. Patrick Nalley .....	1,070,000	(2)
7005 Cochran Road; Glenwillow, Ohio 44139		
Dimensional Fund Advisors .....	925,900	(3)
1299 Ocean Avenue; Santa Monica, CA 90401		
Kestrel Investment Management Corporation .....	709,000	(4)
411 Borel Avenue; San Mateo, CA 94402		

- (1) Mr. Rochon is a general partner of Richmond Capital Partners I, L.P. Amount includes 2,969,900 shares owned by Richmond Capital Partners I L.P., 1,500 shares individually owned by Mr. Rochon, and 20,000 shares which can be acquired by the exercise of stock options.
- (2) Amount includes 50,000 which can be acquired by the exercise of stock options.
- (3) Based on Schedule 13(G) dated February 3, 2003, filed with the Securities and Exchange Commission.
- (4) Based on Schedule 13(G) dated February 13, 2003, filed with the Securities and Exchange Commission.

### SECURITY OWNERSHIP OF MANAGEMENT

The following table sets forth the amount of the Company's Common Shares beneficially owned by the Company's Directors, each of the named officers, and all the Directors and Executive Officers as a group as of January 31, 2003.

NAME ----	SHARES -----	
Jack Kahl Jr. ....	140,000	(1)
Michael J. Merriman .....	675,982	(1)
E. Patrick Nalley .....	1,070,000	(1)
Joseph B. Richey II .....	250,000	(1)
John P. Rochon .....	2,991,400	(1)
R. Louis Schneeberger.....	98,000	(1)
Richard C. Farone .....	142,391	(1)
Richard G. Vasek .....	151,855	(1)
David M. Brickner.....	81,762	(1)
Directors and Executive Officers as a group (9 persons).....	5,601,390	(4)

\* Less than 1%

- (1) Includes shares which can be acquired by the exercise of stock options on or prior to sixty days following January 31, 2003 as follows: Mr. Kahl - 20,000; Mr. Merriman - 453,982; Mr. Nalley - 50,000; Mr. Richey - 50,000; Mr. Rochon - 20,000; Mr. Schneeberger - 50,000; Mr. Farone - 139,707; Mr. Vasek - 146,300; Mr. Brickner - 76,000.
- (2) Includes 1,000,000 shares held of record by Mr. Nalley as Trustee.
- (3) Includes 2,969,900 shares beneficially owned by Richmond Capital Partners I, L.P. of which Mr. Rochon is a General Partner.

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- (4) Includes 1,005,989 shares exercisable within sixty days following January 31, 2003.

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ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None

ITEM 14. CONTROL AND PROCEDURES

The Company maintains a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. The Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures under supervision and with the participation of management, including the Company's Chief Executive Officer and Chief Financial Officer, within 90 days prior to the filing date of this report. Based upon that evaluation, the Company's Chief Executive officer and Chief Financial officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information required to be included in the Company's periodic Securities and Exchange Commission filings. No significant changes were made to the Company's internal controls or other factors that could significantly affect these controls subsequent to the date of evaluation.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

-----

- (a) (1) Financial Statements
- Report of Independent Accountants
- Consolidated Balance Sheets at December 31, 2002 and 2001
- Consolidated Statements of Operations - Years Ended  
December 31, 2002, 2001 and 2000
- Consolidated Statements of Shareholders' Equity - Years Ended  
December 31, 2002, 2001 and 2000
- Consolidated Statements of Cash Flows - Years Ended  
December 31, 2002, 2001 and 2000
- Notes to Consolidated Financial Statements

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(2) Financial Statement Schedules

The following consolidated financial statement schedule of Royal Appliance Mfg. Co. and Subsidiaries is included in Item 14(d):

Report of Independent Accountants on Financial Statement Schedule

Schedule II - Valuation and Qualifying Accounts

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions, are inapplicable, or the information has been included in the Notes to Consolidated Financial Statements

(3) Exhibits

The exhibits filed herewith are set forth on the Index to Exhibits filed as part of this report.

(b) Reports on Form 8-K

The following report on Form 8-K was filed during the quarter ended December 31, 2002:

On December 17, 2002, the Company filed a current report on Form 8-K which announced that it had entered into a definitive agreement and plan of merger, dated December 16, 2002 to be acquired by Techtronic Industries, for \$7.37 per share in cash.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, on this 26st day of March, 2003.

ROYAL APPLIANCE MFG. CO.  
Registrant

By /s/ Michael J. Merriman

-----  
Michael J. Merriman  
Chief Executive Officer and President

Date March 26, 2003  
-----

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated, as of the 26st day of March 2003.

Signature Title  
-----



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/s/ Michael J. Merriman ----- Michael J. Merriman	Chief Executive Officer, President and Director (Principal Executive Officer)
/s/ Richard G. Vasek ----- Richard G. Vasek	Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)
/s/ R. Louis Schneeberger * ----- R. Louis Schneeberger	Chairman of the Board
/s/ Jack Kahl Jr.* ----- Jack Kahl Jr.	Director
/s/ E. Patrick Nalley * ----- E. Patrick Nalley	Director
/s/ J.B. Richey * ----- J.B. Richey	Director
/s/ John P. Rochon * ----- John P. Rochon	Director

\* The undersigned, by signing his name hereto, does hereby sign this Form 10-K on behalf of Royal Appliance Mfg. Co., and the above named directors and officers of Royal Appliance Mfg. Co., pursuant to a Power of Attorney executed on behalf of Royal Appliance Mfg. Co. and each of such directors and officers and which has been filed with the Securities and Exchange Commission.

/s/ Michael J. Merriman  
-----  
Michael J. Merriman, Chief Executive Officer, President  
and Director, and Attorney-in-Fact

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CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO 18 U.S.C. 1350  
(SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002)

I, Michael J. Merriman, the Chief Executive Officer and President of Royal Appliance Mfg. Co. (the "Company"), certify that to the best of my knowledge, based upon a review of the Annual Report on Form 10-K for the period ended December 31, 2002 of the Company (the "Report"):

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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/s/ Michael J. Merriman

Michael J. Merriman,  
Royal Appliance Mfg. Co.  
Chief Executive Officer and President

March 26, 2003

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CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO 18 U.S.C. 1350  
(SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002)

I, Richard G. Vasek, Chief Financial Officer of Royal Appliance Mfg. Co. (the "Company") certify that to the best of my knowledge, based upon a review of the Annual Report on Form 10-K for the period ended December 31, 2002 of the Company (the "Report"):

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard G. Vasek

Richard G. Vasek  
Royal Appliance Mfg. Co.  
Chief Financial Officer

March 26, 2003

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CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO 15 U.S.C. 78m(a) OR 78o(d)  
(SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002)

I, Michael J. Merriman, the Chief Executive Officer and President of Royal Appliance Mfg. Co. (the "Company"), certify that:

- (1) I have reviewed this annual report on Form 10-K of the Company;
- (2) Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact

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necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

- (3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this annual report;
- (4) The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Company and we have:
  - a. designed such disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. evaluated the effectiveness of the Company's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
- (5) The Company's other certifying officer and I have disclosed, based on our most recent evaluation, to the Company's auditors and the audit committee of Company's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the Company's ability to record, process, summarize and report financial data and have identified for the Company's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls; and
- (6) The Company's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Michael J. Merriman  
-----

Michael J. Merriman,  
Royal Appliance Mfg. Co.  
Chief Executive Officer and President

March 26, 2003

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO 15 U.S.C. 78m(a) OR 78o(d)  
(SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002)

I, Richard G. Vasek, the Chief Financial Officer of Royal Appliance Mfg. Co. (the "Company"), certify that:

- (1) I have reviewed this annual report on Form 10-K of the Company;
- (2) Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this annual report;
- (4) The Company's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the Company and we have:
  - a. designed such disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b. evaluated the effectiveness of the Company's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
- (5) The Company's other certifying officer and I have disclosed, based on our most recent evaluation, to the Company's auditors and the audit committee of Company's board of directors (or persons performing the equivalent function):
  - a. all significant deficiencies in the design or operation of internal controls which could adversely affect the Company's ability to record, process, summarize and report financial data and have identified for the Company's auditors any material weaknesses in internal controls; and
  - b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal controls; and
- (6) The Company's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent

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evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

/s/ Richard G. Vasek  
-----

Richard G. Vasek,  
Royal Appliance Mfg. Co.  
Chief Financial Officer

March 26, 2003

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REPORT OF INDEPENDENT ACCOUNTANTS ON  
FINANCIAL STATEMENT SCHEDULE

To the Shareholders and Board of Directors of  
Royal Appliance Mfg. Co.

Our audits of the consolidated financial statements referred to in our report dated February 12, 2003, appearing on page 18 of the Form 10-K also included an audit of the financial statement schedule listed as Schedule II of this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers LLP

Cleveland, Ohio  
February 12, 2003

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

Schedule II - VALUATION AND QUALIFYING ACCOUNTS  
For Years Ended December 31, 2002, 2001 and 2001  
(Dollars in thousands)

	Balance at Beginning of Year -----	Additions (Reductions) Charged to Expenses and Costs -----	Dedu -----
Allowance for Doubtful Accounts: -----			
Year Ended December 31, 2000	\$ 900	\$ 321	\$
Year Ended			

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December 31, 2001	\$ 1,300	\$ 2,118	\$
Year Ended			
December 31, 2002	\$ 3,000	\$ (1,250) (D)	\$
Inventory Reserve:			
-----			
Year Ended			
December 31, 2000	\$ 2,328	\$ 2,707 (B)	\$3
Year Ended			
December 31, 2001	\$ 1,845	\$ 650 (B)	\$1
Year Ended			
December 31, 2002	\$ 1,187	\$ 1,416 (B)	\$1

Note:

-----

- (A) Uncollectible accounts charged off, less recoveries.
- (B) Reserve for product model changes.
- (C) Disposal of obsolete inventory.
- (D) Reduction of allowance for doubtful accounts, primarily associated with the Kmart pre-bankruptcy balance

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

Index to Exhibits  
for Form 10-K

Exhibit	Description
-----	-----
3(a)	Articles of Incorporation, amended and restated May 4, 1992, filed as Exhibit 3.1 of Quarterly Report on Form 10-Q for the quarter ended June 30, 1992, filed with the Commission on August 13, 1992, and incorporated herein by reference.
3(b)	Code of Regulations, amended and restated May 4, 1992, filed as Exhibit 3.2 of Regi Quarterly Report on Form 10-Q for the quarter ended June 30, 1992, filed with the C August 13, 1992, incorporated herein by reference.
3(c)	Amendment to Amended and Restated Articles of Incorporation October 21, 1993, filed to Registrant's Form 8-K filed with the Commission on November 1, 1993, and incorpo by reference.
4(a)	Credit Agreement dated as of April 1, 2002, by and among the Registrant and various

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including National City Bank as administrative agent, filed as Exhibit 4(a) to the Report on Form 10-Q for the Quarter ended March 31, 2002, incorporated herein by reference.

- 4(b) Receivables Purchase Agreement dated as of January 23, 2001, among Royal Appliance Inc., as Seller, the Registrant, Market Street Funding Corporation and PNC Bank, National Association, filed as Exhibit 4(b) to the Annual Report on Form 10-K for the year ended December 31, 2000, incorporated herein by reference.
- 4(c) Amendment No. 1 to Receivables Purchase Agreement dated August 24, 2001, filed as Exhibit 4(c) to the Annual Report on Form 10-K for the year ended December 31, 2001, incorporated herein by reference.
- 4(d) Amended and Restated Receivables Purchase Agreement among Royal Appliance Receivables Seller, Royal Appliance Mfg. Co. as Servicer and Fifth Third Bank as Issuer and as Administrative Agent, dated January 16, 2003.
- The Registrant agrees to furnish copies of certain of its other long-term debt to holders upon request.
- 4(e) Shareholder Rights Agreement dated as of October 21, 1993, filed as an Exhibit to the Registrant's Form 8-K filed with the Commission on November 1, 1993, and incorporated herein by reference.
- 4(f) Amendment No 1 to Shareholder Rights Agreement, dated as of December 16, 2002, between National City Bank, filed as Exhibit 4.1 to Form 8-K dated December 17, 2002, incorporated herein by reference.
- 10(a) Royal Appliance Mfg. Co. 1991 Stock Option Plan for Outside Directors, filed as Exhibit 10(a) to the Registrant's Registration Statement on Forms S-1, filed with the Commission on November 1, 1991, file number 33-41211 (the "Initial Registration Statement"), incorporated herein by reference.
- 10(b) Royal Appliance Mfg. Co. Employees and Consultants Stock Option Plan, filed as Exhibit 10(b) to the Initial Registration Statement, incorporated herein by reference.
- 10(c) Form of Indemnity Agreement for Directors and Officers of the Registrant, filed as Exhibit 10(c) to the Initial Registration Statement, incorporated herein by reference.
- 10(d) Form of Severance and Employment Arrangement between the Registrant and Messrs. Farouk Brickner, filed as Exhibit 10(g) to the Annual Report on Form 10-K for the year ended December 31, 1994, incorporated herein by reference.

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### ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

#### Index to Exhibits for Form 10-K

Exhibit -----	Description -----
10(e)	Annual Management Incentive Plan Description. Filed as Exhibit 10(f) to the Annual Report on Form 10-K for the year ended December 31, 1993, incorporated herein by reference.
10(f)	Royal Appliance Mfg. Co. Key Executive Long-Term Incentive Plan filed as Exhibit 10(f) to the Annual Report on Form 10-K for the year ended December 31, 1995, incorporated herein by reference.
10(g)	Separation Agreement between the Registrant and Mr. Moone dated March 6, 2002, filed as Exhibit 10(g) to the Annual Report on Form 10-K for the year ended December 31, 2001, incorporated herein by reference.

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- 10(h) Form of Amendment to Severance and Employment Agreement between the registrant and Vasek and Brickner filed as Exhibit 10(h) to the Annual Report on Form 10-K for December 31, 2000, incorporated herein by reference.
- 10(i) Employment Agreement dated March 14, 2002, between the Registrant and Mr. Merriman as Exhibit 10(i) to the Annual Report on Form 10K for the year ended December 31, 2002, incorporated herein by reference.
- 10(j) Royal Appliance 401(k) Plus Plan, effective October 1, 1999 filed as Exhibit 10(j) to the Annual Report on Form 10-K for the year ended December 31, 1999, incorporated herein by reference.
- 10(k) Royal Appliance Phantom Stock Plan, effective March 31, 2000, filed as Exhibit 10(k) to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, incorporated herein by reference.
- 10(l) Royal Appliance Phantom Stock Plan, effective December 15, 2000, filed as Exhibit 10(l) to the Annual Report on Form 10-K for the year ended December 31, 2000, incorporated herein by reference.
- 10(m) Royal Appliance Phantom Stock Plan, dated April 23, 2001, filed as Exhibit 10(m) to the Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, incorporated herein by reference.
- 10(n) Lease dated October 15, 1996, as amended, with respect to Glenwillow, Ohio property as Exhibit 10(l) of Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, and incorporated herein by reference.
- 10(o) Promissory Note dated April 2, 2001, between Michael J. Merriman and the Registrant as Exhibit 10(n) to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, incorporated herein by reference.
- 10(p) Stock Pledge Agreement dated April 2, 2001, between Michael J. Merriman and the Registrant as Exhibit 10(o) to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, incorporated herein by reference.
- 10(q) Royal Appliance Phantom Stock Plan dated February 11, 2002, filed as Exhibit 10(q) to the Quarterly Report on Form 10-Q for the Quarter ended June 30, 2002, incorporated herein by reference.
- 10(r) Royal Appliance Phantom Stock Plan for Directors dated April 25, 2002, filed as Exhibit 10(r) to the Quarterly Report on Form 10-Q for the Quarter ended June 30, 2002, incorporated herein by reference.

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

Index to Exhibits  
for Form 10-K

Exhibit -----	Description -----
10(s)	Agreement and Plan of Merger, dated as of December 16, 2002, among Royal, Techtron Co., Inc., RAMC Holdings, Inc. and TIC Acquisition Corp., filed as Exhibit 2.1 to the Annual Report on Form 10-K for the year ended December 31, 2002, incorporated herein by reference.



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- 10(t) Amended and Restated Employment Agreement, dated December 16, 2002, between Mich and Royal, filed as Exhibit 10.1 to Form 8-K dated December 17, 2002, incorporat reference.
- 10(u) Form of Employment Agreement, dated December 16, 2002, between Royal and Messrs. David Brickner and Richard Vasek, respectively, filed as Exhibit 10.2 to Form 8-17, 2002, incorporated herein by reference.
- 10(v) Form of Amendment No. 1 to Amended and Restated Severance and Employment Agreeeme Exhibit 10.3 to Form 8-K dated December 17, 2002, incorporated herein by referen
- 10(w) Amendment No. 1 to Change in Control Severance Compensation Plan, filed as Exhib 8-K dated December 17, 2002, incorporated herein by reference.
- 21 Subsidiaries of Registrant
- 23 Consent of PricewaterhouseCoopers LLP regarding S-8 Registration.
- 24 Powers of Attorney of the Registrant, Directors and Principal Financial Officer
- 99.1 Form 11-K Annual Report for Royal Appliance 401(k) Retirement Savings Plan.
- 99.2 Consent of independent accountants