QEP CO INC
Form 10-Q
July 16, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended May 31, 2007

Or

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

Commission File Number 0-21161

Q.E.P. CO., INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**13-2983807**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1001 BROKEN SOUND PARKWAY NW, SUITE A, BOCA RATON, FLORIDA 33487

(Address of principal executive offices)(Zip Code)

Registrant s telephone number, including area code: (561) 994-5550

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large Accelerated filer ¨ Accelerated filer ¨ Non-Accelerated filer x

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

The number of shares outstanding of each of the registrant s classes of common stock as of July 13, 2007 is 3,440,401 shares of Common Stock, par value $0.001 per share.

Q.E.P. CO., INC. AND SUBSIDIARIES

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* Information derived from the Company s audited financial statements on Form 10-K.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Q.E.P. CO., Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands, except share data)

	May 31, 2007 (Unaudited)	February 28, 2007
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,150	$ 822
Accounts receivable, less allowance for doubtful accounts of $441 and $354 as of May 31, 2007 and February 28, 2007, respectively	33,904	34,491
Inventories	27,113	27,042
Prepaid expenses and other current assets	1,369	1,349
Deferred income taxes	1,875	1,299
Total current assets	65,411	65,003
Property and equipment, net	6,766	6,770
Deferred income taxes	1,475	2,764
Goodwill	9,548	9,563
Other intangible assets, net	2,793	2,831
Other assets	188	225
Total Assets	$ 86,181	$ 87,156
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Trade accounts payable	$ 18,319	$ 17,705
Accrued liabilities	11,010	9,868
Lines of credit	23,364	27,405
Current maturities of long term debt	4,256	4,085
Put warrant liability	900	861
Total current liabilities	57,849	59,924
Notes payable	2,912	2,398
Other long term debt	1,651	2,551
Other long term liabilities	370	
Total Liabilities	62,782	64,873
Commitments and Contingencies		
SHAREHOLDERS EQUITY		
Preferred stock, 2,500,000 shares authorized, $1.00 par value; 336,660 shares issued and outstanding at May 31, 2007 and February 28, 2007	337	337
Common stock; 20,000,000 shares authorized, $.001 par value; 3,523,341 shares issued and 3,440,401 shares outstanding at May 31, 2007 and February 28, 2007	3	3
Additional paid-in capital	10,017	9,981
Retained earnings	15,479	15,003

Treasury stock; 82,940 shares (held at cost) outstanding		(639)		(639)
Accumulated other comprehensive loss		(1,798)		(2,402)
		23,399		22,283
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$	86,181	$	87,156

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

Q.E.P. CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands except per share data)

(Unaudited)

	For the Three Months Ended May 31,	
	2007	**2006**
Net sales	$ 56,963	$ 54,013
Cost of goods sold	40,410	38,866
Gross profit	16,553	15,147
Operating costs and expenses:		
Shipping	6,099	5,867
General and administrative	4,690	5,052
Selling and marketing	3,100	3,120
Other expense (income), net	1	(2)
Total operating costs and expenses	13,890	14,037
Operating income	2,663	1,110
Change in put warrant liability	(39)	85
Interest expense, net	(660)	(724)
Income before provision for income taxes	1,964	471
Provision for income taxes	1,107	142
Net income	$ 857	$ 329
Net income per share:		
Basic	$ 0.25	$ 0.09
Diluted	$ 0.23	$ 0.08
Weighted average number of common shares outstanding		
Basic	3,440	3,392
Diluted	3,601	3,767

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

Q.E.P. CO., INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	For the Three Months Ended May 31, 2007	2006
Cash flows from operating activities:		
Net income	$ 857	$ 329
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	553	648
Change in fair value of put warrant liability	39	(85)
Bad debt expense	90	25
Loss on sale of business	41	
Stock-based compensation expense	37	103
Deferred income taxes	701	(38)
Changes in assets and liabilities:		
Accounts receivable	713	334
Inventories	111	681
Prepaid expenses and other current assets	(9)	407
Other assets	62	41
Trade accounts payable and accrued liabilities	1,596	(3,695)
Net cash provided by (used in) operating activities	4,791	(1,250)
Cash flows from investing activities:		
Capital expenditures	(206)	(189)
Proceeds from sale of business	250	
Net cash provided by (used in) investing activities	44	(189)
Cash flows from financing activities:		
Net borrowings under lines of credit	(4,117)	2,669
Borrowings of long-term debt	1,400	
Repayments of long-term debt	(918)	(693)
Repayments of acquisition debt	(871)	(1,069)
Payments related to the purchase of treasury stock	(30)	(30)
Proceeds from exercise of stock options		43
Dividends	(11)	(10)
Net cash (used in) provided by financing activities	(4,547)	910
Effect of exchange rate changes on cash	40	408
Net increase (decrease) in cash	328	(121)
Cash and cash equivalents at beginning of period	822	852
Cash and cash equivalents at end of period	$ 1,150	$ 731

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

Q.E.P. CO., INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE A Interim Reporting

The accompanying financial statements for the interim periods are unaudited and include the accounts of Q.E.P. Co., Inc. and its subsidiaries, which are collectively referred to as we , us , our , Q.E.P. or the Company . The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q for interim financial reporting pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). While these statements reflect all normal recurring adjustments which are, in the opinion of management, necessary for fair presentation of the results of the interim period, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. Therefore, the interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the fiscal year ended February 28, 2007. All significant intercompany transactions have been eliminated.

Q.E.P. Co. Inc. is a leading manufacturer, marketer and distributor of a broad line of specialty tools and flooring related products for the home improvement market. Under brand names including Q.E.P.®, ROBERTS®, Capitol®, QSet, Vitrex® and Elastiment, the Company markets specialty tools and flooring related products used primarily for the surface preparation and installation of ceramic tile, carpet, vinyl and wood flooring. The Company markets approximately 3,000 products in the U.S., Canada, Europe, Australia and Latin America. The Company sells its products primarily to large home improvement retail centers, as well as traditional distribution outlets in all of the markets it serves.

NOTE B Sale of Business

On May 4, 2007, the Company entered into agreements with Bon Tool Co., a U.S. supplier of construction tools, equipment and decorative concrete products, for the sale of the business, inventory and certain intangible assets of the Company s O Tool operation, and the sublease of the warehouse space previously occupied by the O Tool operation. Proceeds for the sale are required to be paid over a period of one year, subject to specified minimum and maximum payments, based on the gross margin realized by the purchaser upon the sale of purchased inventory. The sales proceeds are collateralized by a first priority lien on unsold inventory. The assets sold consist mainly of inventory with a cost of approximately $1.3 million at May 31, 2007. During the first quarter of fiscal 2008, the Company recorded a loss on the sale of the O Tool business of less than $0.1 million. This transaction was not disclosed as a discontinued operation due to the immateriality of the transaction to the Company s overall operation.

NOTE C Inventories

Inventories consisted of the following (in thousands):

	May 31, 2007	February 28, 2007
Raw materials and work-in-process	4,973	4,703
Finished goods	22,140	22,339
	27,113	27,042

NOTE D Goodwill and Other Intangible Assets

Under Statement of Financial Accounting Standard No. 142, Goodwill and Other Intangible Assets , intangible assets with definite lives are amortized while intangibles with indefinite lives, such as goodwill, are tested annually for impairment or when changes events or changes in circumstances indicate the carrying value may not be recoverable. The Company performs an impairment test on goodwill during the second quarter of each fiscal year. The impairment test in the previous fiscal year resulted in a final impairment charge of $7.5 million. The Company will continue to assess the impairment of goodwill and other assets in accordance with SFAS

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No. 142 in the future. If the Company s operating performance and resulting cash flows in the future are less than expected, an additional impairment charge could be incurred which may have a material impact on the Company s results of operations.

All other intangible assets are subject to amortization. The total balance of definite-lived intangible assets is classified as follows (in thousands):

		May 31, 2007			February 28, 2007		
	Weighted Avg Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademarks	20	3,016	(1,028)	1,988	3,007	(986)	2,021
Other intangibles	5	1,324	(519)	805	1,303	(493)	810
		$ 4,340	$ (1,547)	$ 2,793	$ 4,310	$ (1,479)	$ 2,831

The Company incurred $0.1 million of amortization expense in the three months ended May 31, 2007. The Company expects to incur a total of approximately $0.3 million in fiscal 2008. Other intangibles include customer lists, non-compete agreements, patents and financing fees.

NOTE E Debt

Revolving Credit Facility

The Company has an asset based loan agreement with two domestic financial institutions to provide a revolving credit facility, mortgage and term note financing. In March 2005, the Company amended the facility to consolidate the Company s term notes and increase the amount of borrowing capacity to $27 million through February 2006 and $29 million thereafter under the revolving facility using the same formula for eligible accounts receivable and inventory that previously existed for the Company. The revolving facility was also extended to July 2008. These loans are collateralized by substantially all of the Company s assets. The agreement also prohibits the Company from incurring certain additional indebtedness, limits certain investments, advances or loans, restricts substantial asset sales and capital expenditures and prohibits the payment of dividends, except for dividends due on the Company s Series A and C preferred stock. The loan agreement contains a subjective acceleration clause and lockbox arrangement; therefore, the borrowing under this agreement is classified as a current liability.

On April 26, 2007, the loan agreement was amended to make certain financial covenants from February 28, 2007 through July 2008 less restrictive and to increase the ability of the Company to borrow against eligible inventory of raw material and finished goods of the Company and certain subsidiaries. Using the newly agreed inventory advance rates, this amendment increased the Company s availability for future borrowings under its revolving loan facility by approximately $2.0 million.

At May 31, 2007 the rate was Libor (5.32%) plus 2.25% and the Company had borrowed approximately $20.1 million and had $5.5 million available for future borrowings under the revolving loan facility net of approximately $0.4 million in outstanding letters of credit.

International Credit Facilities

The Company s Australian subsidiary has a payment facility that allows it to borrow against a certain percentage of inventory and accounts receivable. In March 2007, this facility was amended to make the maximum permitted borrowing approximately $1.7 million of which $1.2 million was outstanding at May 31, 2007. The facility is considered a demand note and carries an interest rate of the Australian Commercial Bill Rate (6.46%) plus 1.25%.

In connection with the purchase of the assets of Vitrex Ltd., The Company s United Kingdom subsidiary entered into two financing arrangements with HSBC Bank in the United Kingdom. The first financing arrangement allows for borrowing up to £1.0 million (approximately U.S. $2.0 million) based on the advancement of up to 80% of the value of accounts receivable. In addition, the subsidiary may borrow up to £0.4 million (approximately U.S. $0.8 million) against the value of the inventory. Both of these facilities are collateralized by substantially all of the assets of the subsidiary (approximately $7.4 million) as well as a parent company guaranty. On May 31, 2007, $2.1 million was borrowed under these facilities. Both are considered short-term demand notes and have an interest rate of Libor (4.50%) plus 2.00%.

Term Loan Facilities

As discussed previously, in March 2005, the Company amended its domestic term loan agreements by consolidating the then existing two term facilities into one three year term facility. In addition, the Company received approximately $3.0 million of additional term financing under the amendment. The amendment provides for repayment of this facility at a rate of approximately $0.2 million per month at an interest rate of Libor plus 2.13% to Libor plus 2.63% through April 2008. The amendment also formally released the Company s Chairman and Chief Executive Officer of his guaranty of one of the term loans. In June 2006, the loan agreements were amended to increase the interest rate to Libor plus 2.13% to Libor plus 2.88%. The balance on this term note was $1.8 million at May 31, 2007.

As discussed previously, in March 2007, the Company s Australian subsidiary amended its payment facility by consolidating the then existing three term facilities into one three year term facility. The subsidiary received approximately $1.2 million of additional financing under the amendment. The loan requires quarterly payments of AUD 0.2 million (US $0.1 million) for the first four installments and AUD 0.1 million (US $0.1 million) thereafter with a final balloon payment. The balance of this term note was US $1.7 million at May 31, 2007. The term loan is collateralized by substantially all of the assets of the subsidiary (approximately $11.8 million) as well as a parent company guaranty.

NOTE F Stock Based Compensation

The Company grants stock options for a fixed number of shares to employees and directors with an exercise price of not less than 85% of the fair market value of the shares at the date of grant. Option term, vesting and exercise periods vary, except that the term of an option may not exceed 10 years. As of the current date, however, no options have been issued at a discount to market price.

The Company also grants stock appreciation rights for a fixed number of shares to various members of management. These rights vest three years after the grant date. The exercise price of the stock appreciation rights is equal to the fair market value of the shares at the date of grant.