FLANDERS CORP
Form 10-Q
July 28, 2004

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 June 30, 2004

Commission File No. 0-27958

FLANDERS CORPORATION

(Exact name of registrant as specified in its charter)

North Carolina	13-3368271
(State or other jurisdiction of incorporation or organization.)	(IRS Employer ID Number)
2399 26th Avenue North, St. Petersburg, Florida	
(Address of principal executive offices)	33713

(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO__

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

YES__ NO X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 28, 2004.

26,216,846 shares of common stock, par value $.001 per share

(Title of Class)

FLANDERS CORPORATION

FORM 10-Q

FOR QUARTER ENDED June 30, 2004

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December 31, 2003

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PART I - FINANCIAL INFORMATION

Item 1.

Financial Statements

FLANDERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(In thousands)

ASSETS	**June 30, 2004 (unaudited)**	**December 31, 2003**
Current assets		
Cash and cash equivalents	$ 755	$ 1,098
Receivables:		
Trade, less allowance:		
6/30/2004 $2,785; 12/31/2003 $2,949	39,319	35,908
Other	349	265
Inventories	33,958	33,066
Deferred taxes	2,889	2,889
Other current assets	1,948	1,461
Total current assets	79,218	74,687
Related party receivables	367	362
Property and equipment, less accumulated depreciation: 6/30/2004		
$51,084; 12/31/2003 $47,414	67,806	67,855
Intangible assets, less accumulated amortization: 6/30/2004		
$724; 12/31/2003 $641	984	880
Other assets	2,833	1,631
	$ 151,208	$ 145,415
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Current maturities of long-term debt and capital lease obligations	$ 2,537	$ 2,542
Accounts payable	10,582	11,501
Accrued expenses	15,532	15,097
Total current liabilities	28,651	29,140
Long-term capital lease obligations, less current maturities	2,587	2,805
Long-term debt, less current maturities	22,145	20,943

Long-term liabilities, other		1,568		1,850
Deferred taxes		10,081		9,968
Commitments and contingencies				
Stockholders' equity				
Preferred stock, $.001par value, 10,000 shares authorized; none issued		-		-
Common stock, $.001 par value; 50,000 shares authorized; issued and outstanding: 26,217 and 26,084 shares in June 2004 and December 2003, respectively		26		26
Additional paid-in capital		90,783		90,527
Notes receivable - secured by common shares		(7,537)		(9,028)
Accumulated other comprehensive loss		(941)		(1,110)
Retained earnings		3,845		294
		86,176		80,709
	$	151,208	$	145,415

FLANDERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS

(In thousands, except per share data)

(unaudited)

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Net sales	$ 47,138	$ 44,262	$ 92,492	$ 87,311
Cost of goods sold	35,227	33,424	70,618	67,013
Gross profit	11,911	10,838	21,874	20,298
Operating expenses	8,425	8,223	16,367	15,572
Operating income	3,486	2,615	5,507	4,726
Nonoperating income (expense):				
Other income, net	317	1,526	693	1,761
Interest expense	(377)	(470)	(792)	(973)
	(60)	1,056	(99)	788
Earnings before income taxes	3,426	3,671	5,408	5,514
Provision for income taxes	1,329	1,411	1,857	1,610
Net earnings	$ 2,097	$ 2,260	$ 3,551	$ 3,904
Net earnings per share				
Basic	$ 0.08	$ 0.09	$ 0.14	$ 0.15
Diluted	$ 0.08	$ 0.09	$ 0.13	$ 0.15
Weighted average common shares outstanding				
Basic	26,168	26,033	26,143	26,033
Diluted	27,116	26,099	27,055	26,068

FLANDERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF STOCKHOLDERS EQUITY

(In thousands)

	Common Stock	**Additional Paid-In Capital**	**Notes Receivable**	**Accumulated Other Comprehensive (Loss)**	**Retained Earnings / (Deficit)**	**Total**
Balance, January 1, 2003	$ 26	$ 90,331	$ (8,695)	$ (1,294)	$ (7,440)	$ 72,928
Accrued interest on notes receivable secured by common shares	-	-	(333)	-	-	(333)
Purchase & Retirement of Common Shares	(1)	(188)	-	-	(12)	(201)
Common Shares issued from exercise of stock options	1	384	-	-	-	385
Net earnings	-	-	-	-	7,746	7,746
Gain on cash flow hedges	-	-	-	184	-	184
Total comprehensive earnings	-	-	-	-	-	7,930
Balance, December 31, 2003	26	90,527	(9,028)	(1,110)	294	80,709
Accrued interest on notes receivable secured by common shares (unaudited)	-	-	(175)	-	-	(175)
Proceeds from notes receivable secured by common shares (unaudited)			1,666			1,666
Common Shares issued from exercise of stock options (unaudited)	-	256	-	-	-	256
Comprehensive income (loss)						
Net earnings (unaudited)	-	-	-	-	3,551	3,551
Income on cash flow hedges (unaudited)	-	-	-	169	-	169
Total comprehensive earnings (unaudited)						3,720
Balance, June 30, 2004 (unaudited)	$ 26	$ 90,783	$ (7,537)	$ (941)	$ 3,845	$ 86,176

FLANDERS CORPORATION AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended June 30, 2004	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES				
Net cash provided by operating activities	$ 1,322	$ 2,361	$ 424	$ 5,302
CASH FLOWS FROM INVESTING ACTIVITIES				
Purchase of property and equipment	(1,877)	(902)	(3,934)	(2,598)
Proceeds from sale of property and equipment	94	-	117	70
Proceeds (Payments) from notes receivables	(2)	4	(5)	4
(Increase) Decrease in other assets	59	4	154	(149)
Net cash used in investing activities	(1,726)	(894)	(3,668)	(2,673)
CASH FLOWS FROM FINANCING ACTIVITIES				
Principal payments on long-term borrowings	(572)	(473)	(1,168)	(1,152)
Net proceeds from (payments on) revolving credit agreement	(1,983)	(1,573)	2,147	(3,415)
Payment of debt issuance costs	-	(13)	(1)	(47)
Proceeds from notes receivable secured by common shares	1,666	-	1,666	-
Proceeds from exercise of stock options	135	-	257	-
Net cash provided by (used in) financing activities	(754)	(2,059)	2,901	(4,614)
Net decrease in cash and cash equivalents	(1,158)	(592)	(343)	(1,985)
CASH AND CASH EQUIVALENTS				
Beginning of period	1,913	1,413	1,098	2,806
End of period	$ 755	$ 821	$ 755	$ 821
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION				
Cash paid during the period for:				
Income taxes	$ 1,285	$ 809	$ 3,791	$ 314
Interest	$ 503	$ 568	$ 837	$ 1,068
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES				
Capital lease obligations incurred for property and equipment	$ -	$ -	$ -	$ 215
Note receivable in lieu of accounts receivable trade	$ 2,124	$ -	$ 2,124	$ 149

Note A.

Nature of Business and Interim Financial Statements

Nature of business:

The Company designs, manufactures and markets air filters and related products, and is focused on providing environmental filtration systems for end uses ranging from controlling contaminants in residences and commercial office buildings through specialized manufacturing environments for semiconductors, pharmaceuticals and nuclear related activities. The Company also designs and manufactures much of its own production equipment to automate processes to decrease labor costs associated with its standard products. The Company also produces various glass-based air filter media for many of its products. The vast majority of the Company s current revenues come from the sale of after-market replacement filters, since air filters are typically placed in equipment designed to last much longer than the filters.

The Company sells some products for end users outside of the United States. through domestic clean room contractors These sales are accounted for as domestic sales. The Company also sells products through foreign distributors, primarily in Europe, the Pacific Rim and the Far East. Sales through foreign distributors and

its wholly owned foreign subsidiary total less than 5% of net sales. Assets held outside the United States are negligible.

Interim financial statements:

The interim consolidated condensed financial statements presented herein are unaudited and have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. These statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2003. In the opinion of management the interim statements include all adjustments (consisting only of normal recurring adjustments) necessary to summarize fairly our financial position, results of operations, and cash flows. The results of operations and cash flows for the three and six months ended June 30, 2004 may not be indicative of the results that may be expected for the year ending December 31, 2004.

Other comprehensive income (loss):

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

As of June 30, 2004, accumulated comprehensive loss consisted of the following:

Balance at December 31, 2003	$	(1,110)
Net change during the period related to cash flow hedges		169
Balance at June 30, 2004	$	(941)

Accounts receivable:

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

Principles of consolidation:

The consolidated financial statements include the accounts and operations of the Company and its subsidiaries, all of which are wholly owned except for Superior Diecutting, Inc. of which 50% is owned by two officers and directors and 50% is owned by other shareholders unrelated to the Company or any of its officers and directors. In accordance with FIN 46, Consolidation of Variable Interest Entities, the Company has consolidated Superior Diecutting, Inc., which has been

Note A.

Nature of Business and Interim Financial Statements - continued

determined to be a variable interest entity of which the Company is a primary beneficiary. Superior Diecutting, Inc. provides custom die cuts and inserts to the Company. Substantially all of the assets of Superior Diecutting, Inc. have been pledged as collateral in the financing agreements with Fleet Capital Corporation. Creditors of Superior Diecutting, Inc. have no recourse to the general assets of the Company.

Derivative financial instruments:

The Company has two interest rate swap agreements to hedge against the potential impact on earnings from increases in market interest rates of two variable rate bonds. Under the interest rate swap agreements, the Company receives or makes payments on a monthly basis, based on the differential between 5.14% and a tax exempt interest rate as determined by a remarketing agent. These interest rate swap agreements are accounted for as a cash flow hedge in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133) as amended by SFAS 138, "Accounting for Certain Derivative Instruments and Hedging Activities -- an Amendment to FASB Statement No. 133." The tax affected fair market value of the interest rate swaps of $941 at June 30, 2004 is included in other comprehensive loss. The interest rate swap contracts expire in 2013 and 2015.

Advertising costs:

Advertising costs are charged to operations when incurred and are included in operating expenses. Advertising costs for the quarters ended June 30, 2004 and 2003 were, $1,299 and $439, respectively.

Stock Options and Warrants:

The following table summarizes the activity related to all Company stock options and warrants for the six months ended June 30, 2004 and the year ended December 31, 2003:

		Stock	Exercise Price per Share		Weighted Average Exercise Price per Share	
	Warrants	Options	Warrants	Options	Warrants	Options
Outstanding at January 1, 2003	-	4,599	-	$1.50 - 7.50	-	$ 4.76
Granted	-	225	-	1.65 - 5.00	-	3.51
Exercised	-	(106)	-	1.65 - 3.94	-	3.45
Canceled or expired	-	(183)	-	1.50 - 5.38	-	4.44
Outstanding at December 31, 2003	-	4,535	-	1.50 - 7.50	-	4.75
Granted	-	85	-	5.21 - 6.49	-	5.48
Exercised	-	(133)	-	1.65 - 6.49	-	1.96
Canceled or expired	-	-	-	-	-	-
Outstanding at June 30, 2004	-	4,487	-	$1.50 - 7.50	-	$ 4.84
Exercisable at June 30, 2004	-	4,232	-	$1.65 - 7.50	-	$ 4.90

The options expire at various dates ranging from July 2004 through March 2009.

At June 30, 2004, the Company has three stock-based employee compensation plans, all of which have been approved by our shareholders. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement 123, Accounting for Stock-Based Compensation , to stock-based employee compensation.

Note A.

Nature of Business and Interim Financial Statements - continued

In determining the pro forma amounts below, the value of each grant is estimated at the grant date using the Black-Scholes option model with the following weighted average assumptions for options granted in 2004 and 2003: Dividend rate of 0%; risk-free interest rate of 3.25% and

3.00%, respectively; expected lives of 5 years; and expected price volatility of 96% and 92%, respectively.

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net earnings, as reported	$ 2,097	$ 2,260	$ 3,551	$ 3,904
Deduct: Total stock based employee compensation expense determined under fair value based methods for all awards, net of taxes	(28)	(141)	(55)	(173)
Pro forma net earnings	$ 2,069	$ 2,119	$ 3,496	$ 3,731
Weighted-average common shares outstanding used for calculation of basic earnings per share	26,168	26,033	26,143	26,033
Total shares used for calculation of diluted net earnings per share	27,116	26,099	27,055	26,068
Basic earnings per share:				
As reported	$ 0.08	$ 0.09	$ 0.14	$ 0.15
Pro forma	$ 0.08	$ 0.08	$ 0.13	$ 0.14
Diluted earnings per share:				
As reported	$ 0.08	$ 0.09	$ 0.13	$ 0.15
Pro forma	$ 0.08	$ 0.08	$ 0.13	$ 0.14

Note B.

Inventories

Inventories consist of the following at June 30, 2004 and December 31, 2003:

	6/30/2004	12/31/2003
Finished goods	$ 15,772	$ 14,625
Work in progress	4,196	3,403
Raw materials	15,174	16,361
	35,142	34,389
Less allowances	1,184	1,323
	$ 33,958	$ 33,066

Note C.

Litigation

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

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

Item 2.

Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussions should be read in conjunction with our Consolidated Condensed Financial Statements and the notes thereto presented in "Item 1 Financial Statements" and our audited financial statements and the related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our report on Form 10-K for the year ended December 31, 2003. The information set forth in this "Management s Discussion and Analysis of Financial Condition and Results of Operations" includes forward-looking statements that involve risks and uncertainties. Many factors, including those discussed below under "Factors That May Affect Future Results" and Outlook could cause actual results to differ materially from those contained in the forward-looking statements below.

Overview

Flanders is a full-range air filtration product Company engaged in designing, manufacturing and marketing high performance, mid-range and standard-grade air filtration products and related products and services. Our focus has evolved from expansion through acquisition to increasing the quality and efficiency of our high-volume replacement filtration products, and using these benefits to compete more effectively in the marketplace. We also design and manufacture much of our own production equipment and produce glass-based air filter media for many of our air filtration products.

Critical Accounting Policies

The following discussion and analysis is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of our financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses, and assets and liabilities during the periods reported. Estimates are used when accounting for certain items such as revenues, allowances for returns, early payment discounts, customer discounts, doubtful accounts, employee compensation programs, depreciation and amortization periods, taxes, inventory values, insurance programs, and valuations of investments, goodwill, other intangible assets and long-lived assets. We base our estimates on historical experience, where applicable, and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from our estimates under different assumptions or conditions. We believe that the following critical accounting policies reflect our more significant judgments and estimates used in preparation of our consolidated financial statements.

We maintain allowances for estimated losses resulting from the inability of our customers to make required payments. We base our estimates on the aging of our accounts receivable balances and our historical write-off experience, net of recoveries. If the financial condition of our customers were to deteriorate, additional allowances may be required.

We value our inventories at the lower of cost or market. We write down inventory balances for estimated obsolescence or unmarketable inventory equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Estimates of our insurance costs are developed by management s evaluation of the likelihood and probable amount of potential claims based on historical experience and evaluation of each claim. Changes in the key assumptions may occur in the future, which would result in changes to related insurance costs.

Poor operating performance of the business activities related to intangible assets or long-lived assets could result in future cash flows of these assets declining below carrying values, which could require a write-down of the carrying value of these assets, which would adversely affect operating results.

Generally, sales are recognized when shipments are made to customers. Rebates, allowances for damaged goods and other advertising and marketing program rebates are accrued pursuant to contractual provisions and included in accrued expenses. An insignificant amount of our revenues fall under the percentage-of-completion method of accounting used for long-term contracts. Under this method, sales and gross profit are recognized as work is performed based on the relationship between actual costs incurred and total estimated costs at completion. Sales and gross profit are adjusted prospectively for revisions in estimated total contract costs and contract values. Estimated losses are recorded when identified.

Results of Operations for Three Months Ended June 30, 2004 Compared to June 30, 2003

The following table summarizes our results of operations as a percentage of net sales for the three months ended June 30, 2004 and 2003.

	Three Months Ended June 30,			
	2004		2003	
Net sales	$ 47,138	100.0%	$ 44,262	100.0%
Gross profit	11,911	25.3	10,838	24.5

Operating expenses	8,425	17.9	8,223	18.6
Operating income	3,486	7.4	2,615	5.9
Nonoperating income (expense)	(60)	(0.1)	1,056	2.4
Provision for income taxes	1,329	2.8	1,411	3.2
Net earnings	2,097	4.4	2,260	5.1

Net sales: Net sales for the second quarter of 2004 increased by $2,876, or 6.5%, to $47,138 from $44,262 for the second quarter of 2003. The air filtration market was flat during the quarter, particularly in our industrial product lines; our primary customers for our industrial products are manufacturing companies, and the U.S. manufacturing sector was flat during the quarter, despite the general economic turnaround. We have been successful in expanding our customer base for our industrial and wholesale products, and we have continued to capture additional market share.

Gross Profit: Gross profit for the second quarter of 2004 increased by $1,073, or 9.9%, to $11,911, which represented 25.3% of net sales, from $10,838, which represented 24.5% of net sales, for the second quarter of 2003. The US economy experienced cost increases due to inflation including increases in in-bound shipping costs due to increased fuel costs, raw material costs, especially in the cost of metal. These costs were more than offset by increased volume as well as vertical integration of certain manufacturing processes.

Operating expenses: Operating expenses for the second quarter of 2004 increased by $202, or 2.5%, to $8,425, representing 17.9% of net sales, from $8,223, representing 18.6% of net sales, for the second quarter of 2003. The increase in operating expenses was primarily due to the increase in net sales.

Nonoperating income (expense): Net nonoperating expenses for the second quarter of 2004 increased by $1,116, or 105.7%, to $(60), representing (.1%) of net sales, from $1,056, representing 2.4% of net sales, for the second quarter of 2003. This decrease is due to the Company reaching a one time settlement with a vendor during the second quarter of 2003.

Provision for income taxes: Our income tax provision for the quarter ended June 30, 2003 included the realization of one-time tax credits and adjustments. Excluding the realization of these one-time credits and adjustments, our provision for the three months of 2004 and 2003 were a blended state and federal rate of approximately 38% of pretax earnings.

Results of Operations for Six Months Ended June 30, 2004 Compared to June 30, 2003

The following table summarizes our results of operations as a percentage of net sales for the six months ended June 30, 2004 and 2003.

	Six Months Ended June 30,	
	2004	2003

Net sales	$ 92,492	100.0%	$ 87,311	100.0%
Gross profit	21,874	23.6	20,298	23.2
Operating expenses	16,367	17.7	15,572	17.8
Operating income	5,507	6.0	4,726	5.4
Nonoperating income (expense)	(99)	(0.1)	788	0.9
Provision for income taxes	1,857	2.0	1,610	1.8
Net earnings	3,551	3.8	3,904	4.5

Net sales: Net sales for the first half of 2004 increased by $5,181, or 5.9%, to $92,492 from $87,311 for the first half of 2003. The air filtration market continues to be flat, particularly in our industrial product lines; our primary customers for our industrial products are manufacturing companies, and the U.S. manufacturing sector was flat for the first half of the year, despite the general economic turnaround. We have been successful in expanding our customer base for our industrial and wholesale products, and expect to continue to capture additional market share..

Gross Profit: Gross profit for the first half of 2004 increased by $1,576, or 7.8%, to $21,874, which represented 23.6% of net sales, from $20,298, which represented 23.2% of net sales, for the first half of 2003. The US economy experienced cost increases due to inflation including increases in in-bound shipping costs due to increased fuel costs, raw material costs, especially in the cost of metal. These costs were more than offset by increased volume as well as vertical integration of certain manufacturing processes.

Operating expenses: Operating expenses for the first half of 2004 increased by $795, or 5.1%, to $16,367, representing 17.7% of net sales, from $15,572, representing 17.8% of net sales, for the first half of 2003. The increase in operating expenses was primarily due to the increase in sales.

Nonoperating expense: Nonoperating expenses for the first half of 2004 increased by $887, or 112.6%, to $(99), representing (.1%) of net sales, from $1,610, representing 1.8% of net sales, for the first half of 2003. This increase is due to the Company reaching a one time settlement with a vendor during the second quarter of 2003. .

Provision for income taxes: Our income tax provision for the six months ended June 30, 2004 and June 30, 2003 included the realization of one-time tax credits and adjustments. Excluding the realization of these one-time credits and adjustments, our provision for the six months of 2004 and 2003 were a blended state and federal rate of approximately 38% of pretax earnings.

Liquidity and Capital Resources

Our working capital was approximately $50,567 at June 30, 2004, compared to approximately $45,547 at December 31, 2003. This includes cash and cash equivalents of $755, at June 30, 2004 and $1,098 at December 31, 2003.

Our trade receivables increased $3,411, or 9.5%, to $39,319 at June 30, 2004, from $35,908 at December 31, 2003. Days sales outstanding, the ratio of receivables to average daily sales during the prior three months was 73 days at June 30, 2004 and 70 days at December 31, 2003. These ratios for day s sales outstanding typically vary between 60 and 70 days, depending on timing differences in shipments and payments received.

Inventories increased $892, or 2.7%, to $33,958 at June 30, 2004 from $33,066 at December 31, 2003. During the second quarter we maintained a higher level of inventories to avoid product shortages. The Company was able to maintain its on-time delivery and in stock percentages during the busiest time of the year. Larger inventories also help smooth out labor requirements. Inventories are expected to increase during the first and second quarters and decrease during the third and fourth quarter.

Our continuing operations generated $915 and $2,361 of cash during the second quarter of 2004 and 2003, respectively. Historically, our business is seasonal, with our second and third quarters having higher sales than our first and fourth quarters. We attempt to moderate swings in labor requirements and product shortages due to this seasonal variance by increasing inventories in the first and second quarters. Larger inventories reduce the likelihood of stock shortages during our busy season and help smooth out our labor requirements. In general, we expect operations to consume cash, or generate substantially less cash during our first and second quarters because of increases in inventory. Our financing activities consumed $754 of cash during the second quarter of 2004, primarily consisting of payments on the line of credit offset by proceeds from notes receivable secured by common shares. Our investing activities consumed $1,319 of cash during the second quarter of 2004, primarily used to purchase property and equipment.

We currently have a credit facility with Fleet Capital Corporation. The $40 million facility consists of a $7 million term loan and a $33 million revolving credit line, both of which expire on October 17, 2007. The term loan bears interest, at our option, at either (i) LIBOR plus between 2.5% and 3%, dependent on the Company's fixed charge coverage during the prior twelve months; or (ii) the greater of the Federal Funds Effective Rate plus 0.5% or Fleet's base rate, plus between 0.5% and 1%, dependent on the Company's fixed charge coverage during the prior twelve months. The Company qualified for a rate reduction to 0.5% during October 2003. The $33 million revolving credit facility bears interest at 0.25% less than the term loan. Up to $11 million of the revolving credit facility may be used to issue letters of credit. The facility is collateralized by substantially all of the Company's assets. The line of credit agreement requires maintenance of certain financial ratios, and restricts capital expenditures, dividends and share repurchases. There are no prepayment penalties on any of the credit facilities with Fleet Capital Corporation.

In connection with the working capital credit facility and notes payable to a regional development authority and bank, the Company has agreed to certain restrictive covenants which include, among other things, restricting capital expenditures to less than $4,750 per year, not paying dividends or repurchasing its stock without prior written consent, and maintenance of certain financial ratios at all times including: a minimum current ratio, minimum tangible net worth, a maximum ratio of total liabilities to tangible net worth and a minimum fixed charge coverage ratio.

We believe that our cash on hand, cash generated by operations, and cash available from our existing credit facilities is sufficient to meet the capital demands of our current operations during the 2004 fiscal year. Any major increases in sales, particularly in new products, may require substantial capital investment for the manufacture of filtration products. Failure to obtain sufficient capital could materially adversely impact our growth potential.

On September 22, 2000, the Board of Directors authorized the repurchase of up to two million shares of common stock through open market or negotiated transactions. Further repurchases under this program are restricted under our current line of credit agreement, and require prior consent of Fleet Capital Corporation. As of July 28, 2004, approximately 575,000 shares had been repurchased in the open market under this authorization.

Outlook

Unit shipments for the first half of 2004 were up compared to the first half of 2003. This, along with other indications that we have successfully increased our market share during the past year, indicates there is a trend toward replacing higher-performance pleated filters with less expensive filters. This trend, which became noticeable during the first quarter of 2003, continues to date.

The U.S. manufacturing sector, which are the major users for most of our wholesale and industrial air filtration products, was flat through the second quarter of 2004. This has resulted in intensifying competition among companies supplying products to manufacturers. We believe wholesale and industrial filter companies are experiencing a wave of consolidation, as weaker companies try to compete in a shrinking market created by the current manufacturing climate. We anticipate that our financial stability, manufacturing capacity and delivery performance will enable us to acquire a leading market position in industrial and wholesale filter products as this process continues.

We are continuing to experience heightened interest in our nuclear and biological filtration systems for application in government and commercial settings. This is an underdeveloped market, and we currently have no reliable data as to the size of this niche. We are currently pursuing contracts for these types of applications.

During the past three years, we have captured additional market share among big box retailers like The Home Depot and Wal Mart, capitalizing on our ability to service national accounts from regional distribution centers and our improved on-time delivery performance. We anticipate additional market gains among these types of retailers during the next two years, and are introducing new products focused on their marketing and end-user requirements and will begin a national advertising program stressing the need to change your air filter to enhance a healthier living environment. . Sales to these retail outlets, while seasonal, also tend to follow progress in the overall economy. Additional gains in market share may not have a significant impact on revenues without some recovery in the overall U.S. economy. Additionally, significant revenue enhancement to these customers is largely dependent upon the success of the new products we are introducing to this marketplace.

During the past three years, we introduced air filtration products which use the Arm &Hammer® brand name. We have recently completed the introduction of antimicrobial air filtration products using the Lysol™ brand name. These products are expected to contribute to our expansion in the retail marketplace, but the extent to which they will do so, and their impact on the bottom line, is currently indeterminable.

Sales of air filtration products for semiconductor facilities, historically a major market, are beginning to show some signs of improvement. The economy is expected to start having a positive effect on sales of air filtration products across all product lines and end-user categories. .

We have collected data that indicates that residential filter users replace their filters, on average, approximately once per year. Manufacturers of residential furnace and air conditioning systems recommend that these filters be changed every month. A minor trend toward increased maintenance of these residential heating and cooling systems could have a positive impact on our business.

Our most common products, in terms of both unit and dollar volume, are residential throw-away spun-glass filters, which usually sell for prices under $1.00. Any increase in consumer concern regarding air pollution, airborne pollens, allergens, and other residential airborne contaminants could result in replacement of some of these products with higher value products. Our higher value products include our NaturalAire higher-efficiency filters for residential use, and our Lysol™ and Arm &Hammer® co-branded products, with associated sales prices typically over $5.00 each. Any such trend would have a beneficial effect on our business. If our residential air cleaners are successful, we believe replacement filter sales, and the increased awareness of indoor air quality engendered by the simple presence of the air cleaners, will help to create and/or accelerate this trend.

We believe there is currently a gradually increasing public awareness of the issues surrounding indoor air quality and that this trend will continue for the next several years. We also believe there is an increase in public concern regarding the effects of indoor air quality on employee productivity, as well as an increase in interest by standards-making bodies in creating specifications and techniques for detecting, defining and solving indoor air quality problems. We further believe there will be an increase in interest in our Absolute Isolation Barriers in the future because these products may be used in both semiconductor and pharmaceutical manufacturing plants to prevent cross-contamination between different lots and different processes being performed at the same facility. These products also increase production yields in many applications.

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

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

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

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

Factors That May Affect Future Results

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

If our business expands in the future, the additional growth will place burdens on management to manage such growth while maintaining profitability. Our ability to compete effectively and manage future growth depends on our ability to:

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

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

Our Business May Suffer If Our Competitive Strategy is Not Successful

Our continued success depends on our ability to compete in an industry that is highly competitive. This competition may increase as new competitors enter the market. Several of our competitors may have longer operating histories and greater financial, marketing and other resources than we do. Additionally, our competitors may introduce new products or enhancements to products that could cause a decline in sales or loss of market acceptance of our existing products. Under our current competitive strategy, we endeavor to remain competitive by:

- increasing our market share,

- expanding our market through the introduction of new products which require periodic replacement, and
- improving operating efficiencies.

Although our executive management team continues to review and monitor our strategic plans, we have no assurance that we will be able to follow our current strategy or that this strategy will be successful.

Our Market Share May Not Continue to Increase if We are Unable to Acquire Additional Synergistic Businesses

In the past several years we have significantly increased our market share by acquiring synergistic businesses. Although we intend to continue to increase our market share in this manner, we have no assurance that future acquisition opportunities will be available, and do not anticipate that future acquisitions will be of a size that would result in immediate significant increases in the size of our business. Additionally, in the future we may not have access to the substantial debt or equity financing to finance potential acquisitions. Moreover, these types of transactions may result in potentially dilutive issuances of equity securities, the incurrence of additional debt and other acquisition-related expenses, all of which could adversely affect our profitability or cash flows. Our strategy of growth through acquisition also exposes us to the potential risks inherent in assessing the value, strengths, weaknesses, and potential profitability of acquisition candidates and in integrating the operations of acquired companies. We do not currently have any binding agreements with respect to future acquisitions.

Our Business May Suffer if Our Strategy to Increase the Size and Customer Base of the Air Filtration Market is Unsuccessful

We are developing new products as part of our strategy to increase the size and customer base of the air filtration market. We have no assurance that this strategy will be successful. We have no guarantee that any new products we develop will gain acceptance in the marketplace, or that these products will be successful. Additionally, we have no assurance we will be able to recoup the expenditures associated with the development of these products. To succeed in this area we must:

- increase public awareness of the issues surrounding indoor air quality,
- adequately address the unknown requirements of the potential customer base,
- develop new products that are competitive in terms of price, performance and quality, and
- avoid significant increases in current expenditure levels in development, marketing and consumer education.

We May Experience Critical Equipment Failure Which Could Have a Material Adverse Effect on Our Business

If we experience extended periods of downtime due to the malfunction or failure of our automated production equipment, our business, financial condition and operations may suffer. We design and manufacture much of the automated production equipment used in our facilities. We also use other technologically advanced equipment for which manufacturers may have limited production capability or service experience. If we are unable to quickly repair our equipment or quickly obtain new equipment or parts from outside manufacturers, we could experience extended periods of downtime in the event of malfunction or equipment failure.

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

We are currently completing the implementation of plans to centralize overhead functions and eliminate duplication of efforts between our subsidiaries in the following areas:

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

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

Our Success Depends on Our Ability to Retain and Attract Key Personnel

Our success and future operating results depend in part upon our ability to retain our executives and key personnel, many of who would be difficult to replace. Our success also depends on our ability to attract highly qualified engineering, manufacturing, technical, sales and support personnel for our operations. Competition for such personnel, particularly qualified engineers, is intense, and there can be no assurance that we will be successful in attracting or retaining such personnel. Our failure to attract or retain such persons could have a material adverse effect on our business, financial condition and results of operations.

Our Current Distribution Channels May be Unavailable if Our Manufacturers Representatives Decide to Work Primarily With One of Our Competitors

We provide our manufacturers representatives with the ability to offer a full product line of air filtration products to existing and new customers. Some of our competitors offer similar arrangements. We do not have exclusive relationships with most of our representatives. Consequently, if our representatives decide to work primarily with one of our competitors, our current distribution channels, and hence, our sales, could be significantly reduced.

Management Controls a Significant Percentage of Our Stock

As of July 28, 2004, our directors and executive officers beneficially held approximately 42.9% of our outstanding common stock. As a result, such shareholders effectively control or significantly influence all matters requiring shareholder approval. These matters include the election of directors and approval of significant corporate transactions. Such concentration of ownership may also have the effect of delaying or preventing a change in control.

We May be Required to Issue Stock in the Future That Will Dilute the Value of Our Existing Stock

We have granted options to purchase a total of 4,487,000 shares of common stock to various parties with exercise prices ranging from $1.50 to $7.50 per share. The majority of these options are currently exercisable. The exercise of these options may result in the issuance of stock at prices lower than we might otherwise be able to obtain. Additionally, if the option holders exercise their options, the interests of current shareholders may be diluted.

Our Shareholders May Not Realize Certain Opportunities Because of Our Charter Provisions and North Carolina Law

Our Articles of Incorporation and Bylaws contain provisions that are designed to provide our Board of Directors with time to consider whether a hostile takeover offer is in our best interest and the best interests of our shareholders. These provisions may discourage potential acquisition proposals and could delay or prevent a change of control in our business. Additionally, we are subject to the Control Shares Acquisition Act of the State of North Carolina. This act provides that any person who acquires control shares of a publicly held North Carolina corporation will not have voting rights with respect to the acquired shares unless a majority of the disinterested shareholders of the corporation vote to grant such rights. This could deprive shareholders of opportunities to realize takeover premiums for their shares or other advantages that large accumulations of stock would typically provide.

Our Business Can be Significantly Affected by Environmental Laws

The constantly changing body of environmental laws and regulations may significantly influence our business and products. These laws and regulations require that various environmental standards be met and impose liability for the failure to comply with such standards. While we endeavor at each of our facilities to assure compliance with environmental laws and regulations, and are currently not aware of any ongoing issues of this nature, we cannot be certain that our operations or activities, or historical operations by others at our locations, will not result in civil or criminal enforcement actions or private actions that could have a materially adverse effect on our business. We have, in the past, and may, in the future, purchase or lease properties with unresolved potential violations of federal or state environmental regulations. In these transactions, we have been successful in obtaining sufficient indemnification and mitigating the impact of the issues without recognizing significant expenses associated with litigation and cleanup. However, purchasing or leasing these properties requires us to weigh the cost of resolving these issues and the likelihood of litigation against the potential economic and business benefits of the transaction. If we fail to correctly identify, resolve and obtain indemnification against these risks, they could have a material adverse impact on our financial position.

Because of the foregoing factors, as well as other variables affecting our operating results, past financial performance should not be considered a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods.

The preceding discussion should be read in conjunction with our annual report on Form 10-K, which also includes additional "Factors That May Affect Future Results" which are still applicable during the current period.

Item 3.

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, primarily changes in interest rates. Market risk is the potential loss arising from adverse change in market rates and prices, such as foreign currency exchange and interest rates. For Flanders, these exposures are primarily related to changes in interest rates. We do not hold any derivatives or other financial instruments for trading or speculative purposes.

The fair value of the Company's total long-term debt, including capital leases and current maturities of long-term debt, at June 30, 2004 was approximately $27,269. Market risk was estimated as the potential decrease (increase) in future earnings and cash flows resulting from a hypothetical 10% increase (decrease) in the Company's estimated weighted average borrowing rate at June 30, 2004. Although most of the interest on the Company's debt is indexed to a market rate, there would be no material effect on the future earnings or cash flows related to the Company's total debt for such a hypothetical change.

The Company has only a limited involvement with derivative financial instruments. The Company has two interest rate swap agreements to hedge against the potential impact on earnings from increases in market interest rates of two variable rate bonds. Under the interest rate swap agreements, the Company receives or make payments on a monthly basis, based on the differential between 5.14% and a tax exempt interest rate as determined by a remarketing agent. These agreements are accounted for as a cash flow hedge in accordance with SFAS 133 and SFAS 138. The tax effected fair market value of the interest rate swap of $941 is included in Accumulated other comprehensive loss on the balance sheet. The interest rate swap contracts expire in 2013 and 2015.

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

Item 4.

Controls and Procedures

(a) Under the supervision and with the participation of the Company's management, including the Company's principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of the design and operations of its disclosure controls and procedures, as such term is defined in Rules 13a-1(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of the end of the period covered by this report. Based on their evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective such that the material information required to be included in our Securities and Exchange Commission (SEC) reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms relating to Flanders Corporation, including our consolidated subsidiaries, and was made known to them by others within those entities, particularly during the period when this report was being prepared.

(b) In addition, there were no significant changes in our internal control over financial reporting that could significantly affect these controls during the quarter. We have not identified any significant deficiency or material weaknesses in our internal controls, and therefore, there were no corrective actions taken.

PART II - OTHER INFORMATION

Item 1.

Legal Proceedings.

From time to time, we are a party to various legal proceedings incidental to our business. None of the current proceedings in which we are involved are material to our business, operations or financial condition.

Item 2.

Changes in Securities and the Use of Proceeds - None.

Item 3.

Defaults Upon Senior Securities - None.

Item 4.

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

Item 5.

Other Information - None

Item 6.

Exhibits and Reports on Form 8-K

(a)

Exhibits

Exhibit No.

Description

31

Certification of Chief Executive Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.

31

Certification of Chief Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.

32

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

(b)

Reports on Form 8-K

April 21, 2004 - Report on 8-K   Item 5. Other Event   Earnings Release for the quarter ended March 31, 2004.

SIGNATURES

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

Dated this 28th day of July, 2004.

FLANDERS CORPORATION

By: /s/Robert R. Amerson

Robert R. Amerson

President, Chief Executive Officer and Directory

By: /s/Steven K. Clark

Steven K. Clark

Chief Operating Officer, Vice President / Chief Financial Officer
Principal Accounting Officer and Director