QEP CO INC
Form 10-Q
July 15, 2008
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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, 2008

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)**

(561) 994-5550

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	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 11, 2008 is 3,433,363 shares of Common Stock, par value $0.001 per share.

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

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

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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, 2008 (Unaudited)	February 29, 2008
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,294	$ 949
Accounts receivable, less allowance for doubtful accounts of $474 and $431 as of May 31, 2008 and February 29, 2008, respectively	29,353	32,543
Inventories	28,073	26,496
Prepaid expenses and other current assets	1,938	2,505
Deferred income taxes	746	754
Total current assets	61,404	63,247
Property and equipment, net	7,524	7,851
Deferred costs	3,168	
Deferred income taxes	1,787	1,787
Goodwill	9,707	9,685
Other intangible assets, net	2,659	2,717
Other assets	333	339
Total Assets	$ 86,582	$ 85,626
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES		
Trade accounts payable	$ 16,038	$ 15,968
Accrued liabilities	9,439	11,690
Lines of credit	27,127	24,537
Current maturities of long term debt	1,630	1,977
Total current liabilities	54,234	54,172
Notes payable	4,243	4,472
Other long term debt	250	250
Other long term liabilities	425	377
Total Liabilities	59,152	59,271
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, 2008 and February 29, 2008	337	337
Common stock; 20,000,000 shares authorized, $.001 par value; 3,528,341 shares issued and 3,433,363 shares outstanding at May 31, 2008 and February 29, 2008	3	3
Additional paid-in capital	10,190	10,154

Retained earnings		17,806		16,574
Treasury stock; 94,978 shares (held at cost) outstanding at May 31, 2008 and February 29, 2008		(756)		(756)
Accumulated other comprehensive income (loss)		(150)		43
Total Shareholders Equity		27,430		26,355
Total Liabilities and Shareholders Equity	$	86,582	$	85,626

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

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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,	
	2008	**2007**
Net sales	$ 52,885	$ 56,963
Cost of goods sold	36,849	40,410
Gross profit	16,036	16,553
Operating costs and expenses:		
Shipping	5,607	6,099
General and administrative	4,454	4,690
Selling and marketing	3,625	3,100
Other expense (income), net	(112)	1
Total operating costs and expenses	13,574	13,890
Operating income	2,462	2,663
Change in put warrant liability		(39)
Interest expense, net	(455)	(660)
Income before provision for income taxes	2,007	1,964
Provision for income taxes	769	1,107
Net income	$ 1,238	$ 857
Net income per share:		
Basic	$ 0.36	$ 0.25
Diluted	$ 0.35	$ 0.23
Weighted average number of common shares outstanding		
Basic	3,433	3,440
Diluted	3,496	3,601

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

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	For the Three Months Ended May 31, 2008	2007
Cash flows from operating activities:		
Net income	$ 1,238	$ 857
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	463	553
Change in fair value of put warrant liability		39
Bad debt expense	34	90
Gain on sale of businesses		41
Stock-based compensation expense	(35)	37
Deferred income taxes		701
Changes in assets and liabilities:		
Accounts receivable	3,098	713
Inventories	(1,964)	111
Prepaid expenses and other current assets	564	(9)
Deferred costs and other assets	(3,176)	62
Trade accounts payable and accrued liabilities	(2,025)	1,596
Net cash provided by (used in) operating activities	(1,803)	4,791
Cash flows from investing activities:		
Capital expenditures	(131)	(206)
Proceeds from sale of businesses	335	250
Net cash provided by investing activities	204	44
Cash flows from financing activities:		
Net borrowings under lines of credit	2,568	(4,117)
Borrowings of long-term debt		1,400
Repayments of long-term debt	(573)	(918)
Repayments of acquisition debt		(871)
Purchase of treasury stock	(40)	(30)
Dividends	(6)	(11)
Net cash provided by (used in) financing activities	1,949	(4,547)
Effect of exchange rate changes on cash	(5)	40
Net increase in cash	345	328
Cash and cash equivalents at beginning of period	949	822
Cash and cash equivalents at end of period	$ 1,294	$ 1,150

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

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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 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 US 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 29, 2008 (fiscal 2008). The results of operations for the quarter ended May 31, 2008, are not necessarily indicative of the results to be expected in future quarters or for the year ending February 28, 2009. All significant intercompany transactions have been eliminated.

Our fiscal year ends on February 28, 2009 (fiscal 2009). All references to the first quarter of fiscal 2009 are to the quarter ended May 31, 2008.

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 US, Canada, Europe, Australia, Latin America and Asia. 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 Inventories

Inventories consisted of the following (in thousands):

	May 31, 2008	February 29, 2008
Raw materials and work-in-process	$ 4,744	$ 3,891
Finished goods	23,329	22,605
	$ 28,073	$ 26,496

NOTE C Goodwill and Other Intangible Assets

Under Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), intangible assets with definite lives are amortized or expensed while intangibles with indefinite lives, such as goodwill, are tested annually for impairment or when 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 determined that there was no impairment to goodwill and other intangible assets. The Company will continue to assess the impairment of goodwill and other intangible assets in accordance with SFAS 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.

As of May 31, 2008, the Company had $6.5 million of goodwill in the Domestic segment, $1.0 million in the Canada segment, $0.4 million in the Europe segment and $1.8 million in the Australia/New Zealand segment. No goodwill remains in the Other segment.

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

		May 31, 2008			February 29, 2008		
	Weighted Avg Useful Life	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Trademarks	20	$ 3,089	$ (1,210)	$ 1,879	$ 3,081	$ (1,165)	$ 1,916
Other intangibles	5	1,429	(649)	780	1,419	(618)	801
		$ 4,518	$ (1,859)	$ 2,659	$ 4,500	$ (1,783)	$ 2,717

The Company incurred approximately $0.1 million of amortization cost for trademarks and other intangibles in the three months ended May 31, 2008. The Company expects to incur a total of approximately $0.3 million of amortization cost for trademarks and other intangibles in fiscal 2009. Other intangibles include customer lists, non-compete agreements and patents.

NOTE D Deferred Costs

The Company records the upfront consideration given to customers as deferred costs within the noncurrent assets classification. These deferred costs are expensed as a reduction to sales over the term of the contract, currently approximately three years. As of May 31, 2008, the Company had deferred costs of $3.2 million. No deferred costs were recorded as of February 29, 2008. The Company evaluates the impairment of deferred cost assets on a quarterly basis.

The Company expensed approximately $0.3 million of deferred costs in the three months ended May 31, 2008. The Company expects to expense approximately $1.5 million of deferred costs in fiscal 2009.

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 May 2008, the Company amended the facility to extend the maturity date for the $29 million revolving credit facility and the mortgage on the Canadian facility to May 20, 2011. The amendment revised the loan agreement so that the loan agreement will no longer provide for the BV loan or term loan and will consist solely of the revolving credit loan and mortgage on the Canadian facility. The amendment also made the following modifications to the loan agreement: (i) all foreign subsidiaries other than Roberts Company Canada Limited were released as borrowers under the loan agreement, (ii) all foreign subsidiaries excluding all subsidiaries in Canada, the U.K., France, Australia and New Zealand executed negative pledge agreements, and (iii) the covenants relating to the maintenance of a minimum current ratio and a minimum tangible net worth were eliminated. The total amount available for borrowing under the revolving credit loan, the interest rate applicable to the borrowings outstanding and all other covenants under the loan agreement remain unchanged from the loan agreement, as amended by prior amendments. 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.

At May 31, 2008 the rate was Libor (2.83%) plus 1.75% and the Company had borrowed approximately $23.5 million and had $2.4 million available for future borrowings under its revolving loan facility net of approximately $0.6 million in outstanding letters of credit.

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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 $2.0 million of which $1.4 million was outstanding at May 31, 2008. The facility is considered a demand note and carries an interest rate of the Australian Commercial Bill Rate (7.94% as of May 31, 2008) plus 1.25%.

The Company s U.K. subsidiary has an asset based loan agreement with a domestic financial institution to provide a revolving credit facility with a borrowing capacity of $3.5 million for the Company s U.K. operations. The facility has a term that varies with the term of the Company s other domestic revolving credit facility and bears an interest rate that ranges from Sterling Libor plus 1.50% to Sterling Libor plus 2.25%. This agreement is collateralized by substantially all of the Company s UK operation s assets and is guaranteed by the Company. The agreement similarly prohibits the Company s U.K. operations from incurring certain additional indebtedness, limits certain investments, advances or loans, restricts substantial asset sales and capital expenditures, and prohibits the payment of dividends. At May 31, 2008 the interest rate was Sterling Libor (5.46%) plus 2.00%. The Company s U.K. operations had borrowed approximately $2.2 million under this facility and had $0.1 million available for future borrowing. The facility is considered a demand note.

Term Loan Facilities

As discussed previously, the Company had a term loan financing arrangement under the asset based loan agreement that provided for repayment of this facility at a rate of $0.2 million per month. The term loan was fully repaid during the first quarter of fiscal 2009.

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 loan requires quarterly payments of AUD 0.1 million (US $0.1 million) with a final balloon payment. The balance of this term note was US $1.3 million at May 31, 2008. The term loan is collateralized by substantially all of the assets of the subsidiary (approximately $12.4 million) as well as a parent company guaranty.

Mortgage Facility

In July 2003, the Company refinanced its mortgage loan in Canada to finance the expansion of the Canadian physical facilities. In May 2008, the Company entered into an agreement with its existing lenders to renew the Canadian mortgage for an additional three years. As of May 31, 2008, the mortgage balance was $1.8 million and is amortized based on a 15-year period. The mortgage bears an interest rate of Libor (3.21% as of May 31, 2008) plus 2.00% and will mature in May 2011. The mortgage loan requires payments of less than $0.1 million per month. On June 10, 2008, the company amended its loan facility to draw down an additional CAD 0.5 million (US$ 0.5 million) under the existing Canadian mortgage. The payments continue to be less than $0.1 million per month.

In February 2008, the Company entered into a mortgage agreement to finance the purchase of its manufacturing and distribution facility located in Adelanto, California. As of May 31, 2008, the mortgage balance is approximately $1.7 million and is amortized based on a 15-year period. The mortgage bears an interest rate of LIBOR (2.83% at May 31, 2008) plus 1.50% and will mature in February 2013. The mortgage loan requires principal payments of less than $0.1 million per month.

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.

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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.

Under Statement of Financial Accounting Standards No. 123R, Share-Based Payment , the Company is required to select a valuation technique or option-pricing model that meets the criteria as stated in the standard, which includes a binomial model and the Black-Scholes model. At present, the Company is continuing to use the Black-Scholes model, which requires the input of subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options and stock appreciation rights before exercising, the interest rate, the estimated volatility of the Company s common stock price over the expected term and the number of options and stock appreciation rights that will ultimately not complete their vesting requirements. The expected stock price volatility is based on the historical volatility of the Company s stock. Changes in the subjective assumptions can materially affect the estimate of fair value of stock-based compensation. No stock options or stock appreciation rights were issued during the first three months of fiscal 2009 or during fiscal 2008.

The fair value of each option at date of grant was estimated using the Black-Scholes option pricing model with the weighted average assumptions for grants noted in the table below. Expected volatility is based on the historical volatility of the Company s stock. The expected lives of the options represents the period that the options granted are expected to be outstanding and was calculated based on historical averages. The risk free rate is based on the yield curve of a zero coupon U.S. Treasury bond. The Company does not expect to pay a dividend on common stock.

The following table represents the assumptions used to estimate the fair value of the stock appreciation rights outstanding as of May 31, 2008:

Expected stock price volatility	41.9%
Expected lives of options:	
Directors and officers	4.2 years
Employees	4.2 years
Risk-free interest rate	2.5%
Expected dividend yield	0.0%

The fair value was estimated using the Black-Scholes option pricing. Expected volatility is based on the historical volatility of the Company s stock. The expected lives of the options represents the period that the options granted are expected to be outstanding and was calculated based on historical averages. The risk free rate is based on the yield curve of a zero coupon U.S. Treasury bond. The Company does not expect to pay a dividend on common stock.

In the three months ended May 31, 2008, the Company recognized compensation income of less than $0.1 million related to stock options issued and stock appreciation rights granted in previous periods. This amount is included in general and administrative expenses.

NOTE G Income Taxes

The Company recorded a provision for income taxes in the first quarter of fiscal 2009 of approximately $0.8 million (38% effective tax rate), inclusive of valuation allowances on foreign net operating losses of approximately $0.1 million. This compares with a provision for income tax of $1.1 million (56% effective tax rate), inclusive of US taxes on foreign deemed dividends of approximately $0.3 million, in the same period in fiscal 2008. The fiscal 2009 and 2008 provisions were based upon the statutory tax rates available in every jurisdiction in which the Company operates.

In accordance with FIN 48, the Company recognized an increase of less than $0.1 million in the liability for unrecognized tax benefits associated with uncertain income tax positions for the three months ended May 31, 2008. The liability for unrecognized tax benefits was $0.4 million at May 31, 2008. Any benefit ultimately recognized will reduce the Company s annual effective tax rate. The Company is subject to income taxes in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Tax regulations

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within each jurisdiction are subject to interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for the years before 2003. The Company has concluded its exam with the U.S. federal taxing authorities for fiscal year 2005. The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next 12 months. The Company classifies interest and penalties related to unrecognized tax benefits in tax expense and had approximately $0.1 million of interest and penalties accrued at May 31, 2008.

NOTE H Earnings Per Share

Basic earnings per share is computed by dividing net income, after deducting preferred stock dividends accumulated during the period, by the weighted average number of shares of common stock outstanding. Diluted earnings per share is computed by dividing net income, after deducting preferred stock dividends accumulated during the period, by the weighted average number of shares of common stock and dilutive common stock equivalent shares outstanding. The amount of preferred stock dividends is immaterial in all periods presented. There were approximately 0.1 million and 0.2 million of common stock equivalent shares excluded from the dilutive earnings per share calculation because they were anti-dilutive in the three months ended May 31, 2008 and 2007, respectively. The following is a reconciliation of the number of shares used in the basic and diluted computation of net income per share (in thousands)

	For the Three Months Ended May 31,	
	2008	2007
Weighted average number of common shares outstanding basic	3,433	3,440
Dilution from stock options and warrants	63	161
Weighted average number of common shares outstanding diluted	3,496	3,601

NOTE I Comprehensive Income

The Company records foreign currency translation adjustments as other comprehensive income. For the three months ended May 31, 2008 and 2007, comprehensive income totaled $1.0 million and $1.5 million, respectively.

Note J Segment Information

In accordance with Statement of Financial Accounting Standards No. 131, Disclosures About Segments of an Enterprise and Related Information , in this report, the Company has determined that it operates in five business segments: Domestic, Canada, Europe, Australia/New Zealand and Other. The Other segment is made up of operations in Latin America and Asia. Management has chosen to organize the operations into geographic segments, with each segment being the responsibility of a segment manager. Each segment markets and sells flooring-related products to the residential, new construction, do-it-yourself and professional remodeling and renovation markets and home centers.

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The performance of the business is evaluated at the segment level. We manage cash, debt and income taxes centrally. Accordingly, we evaluate performance of our segments based on operating earnings exclusive of financing activities and income taxes. Segment results were as follows (in thousands):

	For the Three Months Ended May 31,	
	2008	2007
Sales		
Domestic	$ 34,374	$ 38,975
Canada	6,237	5,837
Europe	4,777	5,250
Australia/New Zealand	6,627	6,115
Other	870	786
	$ 52,885	$ 56,963
Operating income (loss)		
Domestic	$ 1,518	$ 1,580
Canada	902	1,171
Europe	221	(36)
Australia/New Zealand	(248)	67
Other	(43)	(118)
Subtotal	2,350	2,664
Other (income) expense	(112)	1
Operating income	$ 2,462	$ 2,663
Change in put warrant liability		(39)
Interest expense, net	(455)	(660)
Income before provision for income taxes	$ 2,007	$ 1,964

	As of May 31, 2008	As of February 29, 2008
Total assets		
Domestic	$ 50,942	$ 49,949
Canada	9,734	9,594
Europe	9,819	9,943
Australia/New Zealand	13,452	13,499
Other	2,635	2,641
	$ 86,582	$ 85,626

During the quarter ended May 31, 2008, the Company recorded a net charge of $0.2 million for inventory, accounts receivable and equipment adjustments in the Australia/New Zealand segment. Although this charge related to prior periods, it was recorded in the current period as the Company deemed the charge to be immaterial to those prior periods.

The results from the Canadian operations are included as their own segment according to the provisions of Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information . The reported results do not contain allocations of corporate expenses and sales infrastructure and their product costs are not burdened based on Canada s level of sales to external customers.

Amounts are attributed to the country of the legal entity that recognized the sale or holds the assets. The intercompany sales are billed at prices established by the Company. The price takes into account the product cost and overhead of the selling location.

NOTE K Contingencies

The Company is involved in litigation from time to time in the course of business. Based on information currently available to management, the Company does not believe that the outcome of any of the legal proceedings in which the Company is involved will have a material adverse impact on the Company.

The Company is subject to federal, state and local laws, regulations and ordinances governing activities or operations that may have adverse environmental effects, such as discharges to air and water, handling and disposal practices for solid, special and hazardous

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wastes, and imposing liability for the cost of clean up, and for certain damages resulting from sites of past spills, disposal or other releases of hazardous substances (together, Environmental Laws). Sanctions which may be imposed for violation of Environmental Laws include the payment or reimbursement of investigative and clean up costs, administrative penalties and, in certain cases, prosecution under environmental criminal statutes. The Company s manufacturing facilities are subject to environmental regulation by, among other agencies, the Environmental Protection Agency, the Occupational Safety and Health Administration, and various state authorities in the states where such facilities are located. The activities of the Company, including its manufacturing operations at its leased facilities, are subject to the requirements of Environmental Laws. The Company believes that the cost of compliance with Environmental Laws to date has not been material to the Company. Based on information currently available to management, the Company is not aware of any situation requiring remedial action by the Company or which would expose the Company to liability under Environmental Laws which are reasonably expected to have a material adverse effect on the Company as a whole. As the operations of the Company involve the storage, handling, discharge and disposal of substances which are subject to regulation under Environmental Laws, there can be no assurance that the Company will not incur any material liability under Environmental Laws in the future or will not be required to expend funds in order to effect compliance with applicable Environmental Laws.

The Company completed testing at its facility in Bramalea, Ontario, Canada for leakage of hazardous materials and, as a result, in fiscal 1999 the Company prepared a plan to remediate the contamination over a period of years and this plan was subsequently approved by the Canadian Ministry of Environment. From fiscal 1999 through fiscal 2008, the Company has spent approximately $0.9 million and anticipates spending less than $0.1 million on ongoing monitoring of wells and other environmental activity per year for approximately the next three years. The accrued liability at May 31, 2008 was approximately $0.1 million.

During fiscal 2002, the Company received notice from the United States Environmental Protection Agency (the EPA) that an entity identified as Roberts Consolidated Industries, Inc. may be involved in the contamination of landfill sites in Clark County, Ohio and Santa Barbara County, California. In addition, in April 2003 and October 2006, the record owner and a prior owner of certain real property in Vancouver, Washington informed the Company that an entity known as Roberts Consolidated Industry, Inc. owned or operated a facility during which time hazardous substances were disposed of or released at the site, and that, pursuant to Washington State law, the Company is or may be liable for clean up costs at the site. At this time, the Company is not aware whether these entities are predecessors to any of its affiliates or whether they are unrelated entities.

During fiscal 2005, the Company settled a lawsuit that was filed on December 27, 2002 whereby Roberts Holdings International, Inc. (Roberts Holding), an inactive subsidiary of the Company, was named as a third party defendant in a case before the United States District Court for the Western District of Michigan titled Strebor Inc. v. International Paper Co., Case No. 1:02 CV0948. The third party plaintiff alleged that Roberts Holding is a successor to a company known as Roberts Consolidated Industries, Inc. and is required to indemnify previous owners for costs associated with the clean-up of a property in Kalamazoo, Michigan. The Company agreed to pay $40,000 per year beginning in October 2004 for five consecutive years in settlement of this action.

On October 15, 2007, the court entered an order of dismissal approving the Stipulation of Dismissal Without Prejudice jointly filed by the plaintiff and the Company on October 4, 2007 as to the Company as a Defendant, providing for the voluntary dismissal of plaintiff s claims against the Company in Greene v. Ashland Chemical, Inc., et al., Case No. 03-CV-231458, Div. 7, which matter was pending in the Circuit Court of Jackson County, Missouri at Kansas City. In this wrongful death matter, the plaintiff alleged that the Company, and Roberts Consolidated Industries, Inc., a wholly owned subsidiary of the Company, along with more than 30 other defendants, manufactured products containing benzene with which the plaintiff came into contact while working between approximately 1954 and 1999, and which allegedly caused his death. This action was originally instituted against the Company on August 11, 2006, when the plaintiff served the Company with a petition for unspecified damages. An answer to the complaint was filed in December 2006 denying the allegations and asserting several defenses.

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On October 29, 2007, Roberts Consolidated Industries, Inc. and Roberts Holding International, Inc., wholly owned subsidiaries of the Company, received a notice of claim for indemnity from International Paper Corporation, one of many defendants named in a Verified Complaint in the lawsuit captioned John Rosebery et al v. 3M Marine, et al., Index No. 21464/07, pending in the New York Supreme Court, County of Suffolk. The plaintiff alleges that he contracted leukemia as a result of exposure to benzene in various products allegedly manufactured and distributed by several defendants, including International Paper Corporation or its predecessors. Although Roberts Consolidated Industries, Inc. and Roberts Holding International, Inc. are not named as defendants in the action, International Paper Corporation has stated in the demand for indemnity that the products identified by Mr. Rosebery appear to be products which, as of December 31, 1975, were products of Roberts. The Company has responded on behalf of its subsidiaries to International Paper s demand by requesting that International Paper provide additional documentation and information regarding the contentions. Insufficient information exists at this time for the Company to opine on the merits, if any, of the claim for indemnity or the underlying claims.

NOTE L Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. For financial assets and liabilities, this statement is effective for fiscal periods beginning after November 15, 2007 and does not require any new fair value measurements. In February 2008, the FASB Staff Position No. 157-2 was issued which delayed the effective date of FASB Statement No. 157 to fiscal years ending after November 15, 2008 for nonfinancial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS No. 157 did not have a material effect on the consolidated financial statements. We are currently evaluating the impact of adopting the provisions of FSP 157-2.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets . This proposed FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of an intangible asset under FASB Statement No. 142, Goodwill and Other Intangibles (FAS 142). The FSP aims to improve the consistency between the useful life of an intangible asset as determined under FAS 142 and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141, Business Combinations , and other applicable accounting literature. As a result of this FSP, entities generally will be able to align the assumptions used for valuing an intangible asset with those used to determine its useful life. This FSP will be effective for financial statements issued for fiscal years beginning after December 15, 2008 (the Company s fiscal year ending February 28, 2010) and interim periods within those fiscal years. The Company is currently evaluating the effect, if any, of this statement on its consolidated financial statements.

In December 2007, the FASB issued FAS No. 141(R) Business Combinations , which applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (the Company s fiscal year ending February 28, 2010). This statement retains the fundamental requirements in FAS 141 that the acquisition method be used for all business combinations and for an acquirer to be identified for each business combination. FAS 141(R) broadens the scope of FAS 141 by requiring application of the purchase method of accounting to transactions in which one entity establishes control over another entity without necessarily transferring consideration, even if the acquirer has not acquired 100% of its target. Among other changes, FAS 141(R) applies the concept of fair value and more likely than not criteria to accounting for contingent consideration, and preacquisition contingencies. As a result of implementing the new standard, since transaction costs would not be an element of fair value of the target, they will not be considered part of the fair value of the acquirer s interest and will be expensed as incurred. This pronouncement may impact the Company in the event that acquisitions are done in the future.

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In December 2007, the FASB also issued FAS No. 160, Accounting for Noncontrolling Interests , which is effective for fiscal years beginning on or after December 15, 2008 (the Company s fiscal year ending February 28, 2010). This statement clarifies the classification of noncontolling interests in the consolidated statements of financial position and the accounting for and reporting of transactions between the reporting entity and the holders of non-controlling interests. The Company does not expect that the adoption of this standard will have a significant impact on its consolidated financial statements.

NOTE M Subsequent Event

Payable to banks under mortgage facilities

On June 10, 2008, the company amended its loan facility with two domestic lenders to draw down an additional CAD 0.5 million (US$ 0.5 million) under the existing Canadian mortgage. The payments continue to be less than $0.1 million per month.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Executive Overview

The Company is a worldwide leader in the manufacturing, marketing and distribution of a broad line of specialty tools and flooring related products, marketing over 3,000 specialty tools and related products used primarily for surface preparation and installation of ceramic tile, carpet, vinyl and wood flooring. The Company s products are sold to home improvement retailers, specialty distributors to the hardware, construction, flooring and home improvement trades, chain or independent hardware, tile and carpet retailers for use by the do-it-yourself consumer as well as the construction or remodeling professional, and original equipment manufacturers. The Company has executed a growth strategy intended to improve overall performance and profitability of operations that includes expanding product offerings and increasing penetration with its largest customers, expanding market share by obtaining new customers, introducing new and innovative products and enhancing the cross selling of products among its channels of distribution.

In the first quarter of fiscal 2009, the Company experienced a decrease in sales of approximately $4.1 million or 7% compared to the same period in the previous fiscal year. The sales decrease was primarily in the Company s North America operations and resulted from a significant decline in sales to the Company s second largest home center customer and from the reduction in sales associated with the sale of the Company s O Tool and Stone Mountain operations in the first and second quarter of fiscal 2008, respectively.

Gross profit decreased in the three months ended May 31, 2008 by $0.5 million or 3% compared to the same periods in the previous fiscal year. However, gross profit as a percentage of sales, increased to 30.3% in the first quarter of fiscal 2009 from 29.1% in the first quarter of fiscal 2008 due to favorable changes in customer and product mix resulting from the increased sales of higher margin underlayment products.

In the first quarter of fiscal 2009, total operating expenses decreased by $0.3 million or 2% compared to the first quarter of fiscal 2008. As a percentage of net sales, operating expenses were 26% in the first quarter of fiscal 2009 compared to 24% in the corresponding period in fiscal 2008. This increase is due to fixed cost being spread across lower sales in the fiscal 2009 period compared to the fiscal 2008 period.

Net income for the first quarter of fiscal 2009 was $1.2 million or $0.35 per diluted share compared with net income of $0.9 million or $0.23 per diluted share in the first quarter of fiscal 2008, an increase of $0.3 million or $0.12 per diluted share.

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Critical Accounting Policies and Estimates

Revenue Recognition

Sales are recognized when merchandise is shipped and title has passed to the customer, the selling price is fixed and determinable and collectibility of the sales price is reasonably assured. Such revenue is recorded net of estimated sales returns, discounts and allowances. The Company establishes reserves for returns and allowances based on current and historical information and trends. Sales and accounts receivable have been reduced by such amounts. The Company adopted Emerging Issues Task Force (EITF) Issue 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation). EITF Issue 06-3 became effective for the Company on March 1, 2007. This adoption has not had an impact on the Company s financial statements as the Company has not changed its existing accounting policy which is to present taxes within the scope of EITF Issue 06-3 on a net basis.

The Company accounts for upfront consideration given to customers in accordance with EITF No. 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products). This incentive is recorded as a reduction to revenue at the earlier of the Company making payment or incurring an obligation to the customer, unless the Company has an agreement with the vendor in which the Company can control the benefit, in such case, the incentive is recorded as a deferred cost asset and is expensed as a reduction to revenue over the term of the agreement. The Company evaluates the impairment of deferred cost assets on a quarterly basis.

Inventories

The Company records inventory at the lower of standard cost, which approximates actual cost, or market. The Company maintains reserves for excess and obsolete inventory based on market conditions and expected future demand. If actual market conditions were to be less favorable than those projected by management, additional inventory reserves could be required.

Accounts Receivable

The Company s accounts receivable are principally due from home centers or flooring accessory distributors. Credit is extended based on an evaluation of a customer s financial condition, and collateral is not required. Accounts receivable are due at various times based on each customer s credit worthiness and selling arrangement. The outstanding balances are stated net of an allowance for doubtful accounts. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the customer s previous loss history, the customer s ability to pay its obligations and the condition of the general economy and the industry as a whole.

Impairment Evaluations

The Company evaluates the recoverability of long-lived assets, including property, plant and equipment, and identifiable intangible assets, whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company performs indefinite-lived impairment tests on at least an annual basis and more frequently in certain circumstances. When the Company determines that the carrying amount of long-lived assets may not be recoverable based upon the existence of certain indicators, the assets are assessed for impairment based on the future undiscounted cash flows expected to result from the use of the asset. For goodwill and other indefinite-lived intangibles, impairment assessments are generally determined using the estimated future discounted cash flows of the asset s reporting unit using a discount rate determined by management to be commensurate with the risk inherent in the current business model. In both instances, if the carrying amount of the asset being tested exceeds its fair value, an impairment of the value has occurred and the asset may be written down. The Company s annual impairment assessment date is August 31st.

Income Taxes

The Company is required to estimate income tax in each jurisdiction in which it operates. This process involves estimating actual current tax exposure and deferred income taxes to reflect the tax consequences on future years of differences between the tax basis of

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assets and liabilities and their financial reporting amounts each year-end. The Company must then consider the likelihood that any deferred tax assets will be recoverable from future taxable income and to the extent that it believes that recoverability is not likely, the Company establishes a valuation allowance.

For the first quarter of fiscal 2009, the Company recognized an increase of less than $0.1 million in the liability for unrecognized tax benefits associated with uncertain income tax positions. Any benefit ultimately recognized will reduce the Company s annual effective tax rate.

Results of Operations

Sales

Net sales for the three months ended May 31, 2008 (the first quarter of fiscal 2009) were $52.9 million compared to $57.0 million for the three months ended May 31, 2007 (the first quarter of fiscal 2008), a decrease of $4.1 million or 7%.

Net sales at the Company s North American operations decreased by $4.2 million in the first quarter of fiscal 2009 compared to the first quarter of fiscal 2008. The sale of the Company s O Tool and Stone Mountain operations in fiscal 2008 contributed $1.6 million to the sales decline in fiscal 2009. The remaining decline was due to lower sales to the Company s second largest home center customer. Currency translation gains contributed $0.7 million in additional sales to the Company s North American operations due to changes in the Canadian Dollar compared to the U.S. Dollar.

Sales at the Company s foreign operations increased by $0.1 million in the first quarter of fiscal 2009 compared to the first quarter of fiscal 2008. This increase was due to currency translation gains of $1.1 million generated primarily by changes in the Australian Dollar and Euro compared to the U.S. Dollar. The currency translation gains were partially offset by declining sales volume in the Company s Australian and European operations.

Sales from the Company s non-North American subsidiaries were 23% and 21% of total sales in the first quarter of fiscal 2009 and 2008, respectively.

Gross Profit

Gross profit for the three months ended May 31, 2008 was $16.0 million compared to $16.6 million for the three months ended May 31, 2007, a decrease of $0.5 million or 3%. As a percentage of net sales, gross profit increased to 30.23% in the first quarter of fiscal 2009 from 29.1% in the first quarter of fiscal 2008.

The decrease in gross profit was primarily attributable to the lower sales volume in the first quarter of fiscal 2009 compared to the first quarter of fiscal 2008. Additionally, the Company s Australian operation was adversely affected by a $0.2 million adjustment for the valuation of inventory. The increase in gross profit as a percentage of sales was primarily due to favorable changes in customer and product mix at the Company s North American operations through the sales growth of higher margin products, primarily underlayment. Foreign currency exchange rate changes contributed $0.7 million in additional gross profit. The sale of the Company s O Tool and Stone Mountain operations in fiscal 2008 accounts for $0.4 million of the decline in gross profit.

Operating Expenses

Operating expenses for the three months ended May 31, 2008 were $13.7 million compared to $13.9 million for the three months ended May 31, 2007, a decrease of $0.2 million or 1%.

Shipping expenses for the first quarter of fiscal 2009 were $5.6 million compared to $6.1 million for the first quarter of fiscal 2008, a decrease of $0.5 million or 8%. The reduction in shipping cost was primarily due to lower sales volume. For the first quarter of fiscal 2009 and 2008, shipping expenses remained consistent as a percent of net sales at approximately 11%.

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General and administrative expenses for the first quarter of fiscal 2009 were $4.5 million compared to $4.7 million in the first quarter of fiscal 2008, a decrease of $0.2 million or 5%. The decrease was primarily due to reductions in consulting and legal fees that were incurred in the first quarter of fiscal 2008 related to the Company s Sarbanes Oxley 404 compliance project and an IRS Audit of the Company s 2005 tax return, respectively. As a percentage of net sales, general and administrative expenses remained consistent at 8% in the first quarter of fiscal 2009 and 2008.

Selling and marketing expenses for the first quarter of fiscal 2009 were $3.6 million compared to $3.1 million in the first quarter of fiscal 2008, an increase of $0.5 million or 17%. Increased expenses for trade shows and other product promotion activities at the Company s North American operations resulted in $0.2 million in additional marketing expenses. Additionally, the Company s Australian operation reorganized its sales operation resulting in an additional $0.2 million in selling expenses. Changes in foreign currency exchange rate changes contributed $0.2 million in additional selling and marketing expenses. As a percent of sales, selling and marketing expenses were 7% in the first quarter of fiscal 2009 compared to 5% in the first quarter of fiscal 2008.

Other Income / Expense

In connection with the disposition of certain of the Company s European operations in fiscal 2007 and 2008, the Company receives royalty income in connection with the associated license and royalty agreement entered into with Estillon B.V. During the first quarter of fiscal 2009, the Company recorded royalty income of approximately $0.1 million.

Changes in the Put Warrant Liability

In the second quarter of fiscal 2008, the Company paid a cash settlement of its liability under the then outstanding Warrant Agreement. In the first quarter of fiscal 2008, the company recorded an expense of less than $0.1 million related to the change in the fair value of the put warrant liability.

Interest Expense

Interest expense for the first quarter of fiscal 2009 was $0.5 million compared to $0.7 million for the first quarter of fiscal 2008. Interest expense has declined in the comparable periods due to lower borrowings and interest rates in the current period.

Income Taxes

The Company recorded a provision for income taxes in the first quarter of fiscal 2009 of approximately $0.8 million (38% effective tax rate), inclusive of valuation allowances on foreign net operating losses of approximately $0.1 million. This compares with a provision for income tax of $1.1 million in the same period in fiscal 2008. The fiscal 2009 and 2008 provisions were based upon the statutory tax rates available in every jurisdiction in which the Company operates.

Net Income

As a result of the above and specifically controlling operating expenses, incurring less interest costs and returning to a more normalized effective tax rate, net income for the first quarter of fiscal 2009 was $1.2 million or $0.35 per diluted share compared with net income of $0.9 million or $0.23 per diluted share in the first quarter of fiscal 2008, an increase of $0.3 million or $0.12 per diluted share.

Liquidity and Capital Resources

Working capital was approximately $7.2 million as of May 31, 2008, compared to approximately $9.1 million at May 31, 2007, a decrease of approximately $1.9 million.

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Net cash used in operating activities during the first three months of fiscal 2009 was approximately $1.8 million compared to net cash provided by operating activities of $4.8 million for the comparable fiscal 2008 period. During the first three months of fiscal 2009, the Company used cash of approximately $3.0 million to increase deferred cost assets relating to upfront consideration given to the Company s largest home center customer in exchange for a national contract to supply specialty tools. During the same period, the Company used cash of $2.0 million to increase inventory as part of the initial rollout of this national contract. This was partially offset by the decrease in accounts receivable of $3.1 million, primarily from the same home center customer. For the same period in fiscal 2008, reductions in inventory and accounts receivable provided cash of $0.8 million. During the first three months of fiscal 2009, reductions in accounts payable and accrued liabilities used cash of $2.0 million, primarily due to the reductions in customer rebates and allowances and taxes payable. This compares with cash provided by an increase in accounts payable and accrued liabilities of $1.6 million in the same period of the previous fiscal year.

Net cash provided by investing activities was $0.2 million in the first three months of fiscal 2009. This was comprised of the final proceeds from the sale of the Company s O Tool operation of $0.3 million that was partially offset by capital expenditures of $0.1 million. Cash provided by investing activities in the first three months of fiscal 2008 was less than $0.1 million, which was comprised of the initial proceeds from the sale of the Company s O Tool operation of $0.3 million that was offset by capital expenditures of $0.2 million.

Net cash provided by financing activities was approximately $1.9 million in the first three months of fiscal 2009 as compared to cash used in financing activities of approximately $4.5 million in the same period in the previous year. During the first three months of fiscal 2009 the Company borrowed an additional $2.6 million on its lines of credit to fund the payment of upfront consideration given to the Company s largest home center customer in exchange for a national contract to supply specialty tools. During the first three months of fiscal 2009, the Company repaid $0.6 million of long-term debt. For the comparable fiscal 2008 period, the Company repaid $4.1 million on its line of credit and $1.8 million of long-term and acquisition debt. During this period, the Company also borrowed $1.4 million of long-term debt to finance its Australian subsidiary. Subsequent to the first quarter of fiscal 2009 and as disclosed on Form 8-K filed on July 15, 2008, the Company entered into a Rule 10b5-1 purchase plan under which it may purchase up to $2,000,000 of the Company s common stock from time to time on the open market or in privately negotiated transactions. The Company intends to fund the repurchases through the use of existing sources of liquidity, borrowings under the current credit facility or new borrowings.

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 May 2008, the Company amended the facility to extend the maturity date for the $29 million revolving credit facility and the mortgage on the Canadian facility to May 20, 2011. The amendment revised the loan agreement so that the loan agreement will no longer provide for the BV loan or term loan and will consist solely of the revolving credit loan and mortgage on the Canadian facility. The amendment also made the following modifications to the loan agreement: (i) all foreign subsidiaries other than Roberts Company Canada Limited were released as borrowers under the loan agreement, (ii) all foreign subsidiaries excluding all subsidiaries in Canada, the U.K., France, Australia and New Zealand executed negative pledge agreements, and (iii) the covenants relating to the maintenance of a minimum current ratio and a minimum tangible net worth were eliminated. The total amount available for borrowing under the revolving credit loan, the interest rate applicable to the borrowings outstanding and all other covenants under the loan agreement remain unchanged from the loan agreement, as amended by prior amendments. 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.

At May 31, 2008 the rate was Libor (2.83%) plus 1.75% and the Company had borrowed approximately $23.5 million and had $2.4 million available for future borrowings under its revolving loan facility net of approximately $0.6 million in outstanding letters of credit.

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 $2.0 million of which $1.4 million was outstanding at May 31, 2008. The facility is considered a demand note and carries an interest rate of the Australian Commercial Bill Rate (7.94% as of May 31, 2008) plus 1.25%.

The Company s U.K. subsidiary has an asset based loan agreement with a domestic financial institution to provide a revolving credit facility with a borrowing capacity of $3.5 million for the Company s U.K. operations. The facility has a term that varies with the term of the Company s other domestic revolving credit facility and bears an interest rate that ranges from Sterling Libor plus 1.50% to Sterling Libor plus 2.25%. This agreement is collateralized by substantially all of the Company s UK operation s assets and is guaranteed by the Company. The agreement similarly prohibits the Company s U.K. operations from incurring certain additional indebtedness, limits certain investments, advances or loans, restricts substantial asset sales and capital expenditures, and prohibits the payment of dividends. At May 31, 2008 the interest rate was Sterling Libor (5.46%) plus 2.00%. The Company s U.K. operations had borrowed approximately $2.2 million under this facility and had $0.1 million available for future borrowing. The facility is considered a demand note.

The Company believes that its existing cash balances, internally generated funds from operations and available bank lines of credit will provide the liquidity necessary to satisfy its working capital needs, including changes in working capital balances, and will be adequate to finance anticipated capital expenditures and debt obligations for the next twelve months. There can be no assurance, however, that the assumptions upon which the Company bases its future working capital and capital expenditure requirements and the assumptions upon which it bases its belief that funds will be available to satisfy such requirements will prove to be correct. If these assumptions are not correct, the Company may be required to raise additional capital through loans or the issuance of debt or equity securities that would require the consent of the Company s current lenders.

To the extent the Company were to raise additional capital by issuing equity securities or obtaining borrowings convertible into equity, ownership dilution to existing stockholders may result, and future investors may be granted rights superior to those of existing stockholders. Moreover, additional capital may be unavailable on acceptable terms to the Company, or may not be available at all.

Impact of Inflation and Changing Prices

During fiscal 2008 and continuing into fiscal 2009, the Company experienced price increases in certain key commodities and components related to the purchase of raw materials and finished goods. The Company believes that its level of gross profit as a percent of net sales is affected by these increases. Other than the changes described, the effect of inflation on our operations has been minimal.

Recently Issued Accounting Standards

Refer to Note L to the notes to the consolidated financial statements for a discussion of recent accounting pronouncements.

Forward-Looking Statements

This report contains certain forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements present the Company s expectations or forecasts of future events. These statements can be identified by the fact that they do not relate strictly to historical or current facts. They are frequently accompanied by words such as believe , intend , expect , anticipate , plan , or estimate and other words of similar meaning, and include statements relating to the Company s liquidity sources and the adequacy of those sources to meet the Company s working capital needs, anticipated capital expenditures and debt obligations for the next twelve months; the Company s ability to successfully expand its market share, capitalize on new customers and cross-sell its products; the Company s ability to introduce new and innovative products, expand existing product lines, and increase its sales and market penetration; expectations regarding payment of dividends; expectations regarding recently issued accounting standards; the expected impact of the outcome of any legal proceedings in which

the Company is involved; the Company s expectation regarding its incurrence of amortization cost for trademarks and other intangibles in fiscal 2009; the amount and manner in which the Company may repurchase shares of its common stock and the source of funds for stock repurchases; the Company s expectation regarding the expensing of deferred costs in fiscal 2009; the Company s expectations regarding its future effective tax rate; the Company s expectation regarding the total amount of unrecognized tax benefit over the next 12 months; the cost of compliance with Environmental Laws and the Company s anticipated expenditures on monitoring of wells and other environmental activity for the next three years.

These forward-looking statements are based on currently available information and are subject to risks and uncertainties which could cause actual results to differ materially from those discussed in the forward-looking statements and from historical results of operations (See Item 1A-Risk Factors). Among the risks and uncertainties which could cause such a difference are the assumptions upon which the Company bases its assessments of its future working capital and capital expenditures; the Company s ability to satisfy its working capital needs and to finance its anticipated capital expenditures; the Company s dependence upon a limited number of customers for a substantial portion of its sales and the continued success of initiatives with those customers; the success of the Company s marketing and sales efforts; interruptions in supply or price changes in the items purchased by the Company; improvements in productivity and cost reductions; increased pricing pressures from customers and competitors and the ability to defend market share in the face of price competition; the Company s ability to maintain and improve its brands; the Company s reliance upon certain major foreign suppliers; the Company s reliance upon suppliers and sales agents for the purchase of finished products which are then resold by it; the level of demand for the Company s products among existing and potential new customers; the state of the housing, residential and commercial construction and home improvement markets; the Company s ability to successfully integrate its acquired businesses; the Company s dependence upon the efforts of Mr. Lewis Gould, the Company s Chief Executive Officer and certain other key personnel; the Company s ability to successfully integrate new management personnel into the Company; the Company s ability to accurately predict the number and type of employees required to conduct its operations and the compensation required to be paid to such personnel; the Company s ability to manage its growth, and the risk of economic and market factors affecting the Company or its customers; the availability of shares of common stock for repurchases; the availability of cash to effect stock repurchases; fluctuations in the market price of the Company s common stock; the impact of new accounting standards on the Company; the Company s belief that there will be no future adverse effect on the fair value of the Company s goodwill or other intangible assets; decisions by management related to accounting issues, and regulation and litigation matters; the general economic conditions in North America and the world; and other risks and uncertainties described elsewhere herein and in other reports filed by the Company with the Securities and Exchange Commission.

All forward looking statements included herein are made only as of the date such statements are made and the Company does not undertake any obligation to publicly update or correct any forward-looking statements to reflect events or circumstances that subsequently occur or of which the Company hereafter becomes aware. Subsequent written and oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the cautionary statements set forth above and elsewhere in this report and in other reports filed by the Company with the Securities and Exchange Commission.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not required.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

For the quarter ended May 31, 2008, the Company carried out an evaluation, under the supervision and with the participation of the Company s management, including Lewis Gould, the Company s Chief Executive Officer, and Stuart Fleischer, the Chief Financial Officer, of the effectiveness of the design and operation of the Company s disclosure controls and procedures as of the end of the period covered by this report pursuant to Exchange Act Rule 13a-15(e). The Company s disclosure controls and procedures are

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designed to provide reasonable assurance that the information required to be disclosed in its reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission s rules and forms, and is accumulated and communicated to management, including the Company s Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. Based upon the Company s evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that as a result of the material weaknesses in the Company s internal control over financial reporting described more fully below, the Company s disclosure controls and procedures were not effective as of May 31, 2008.

Internal Control Material Weaknesses and Remediation Steps

As disclosed in the Company s Form 10-K for the year ended February 29, 2008, as a result of the Company s evaluation of the effectiveness of its internal controls over financial reporting, management identified the following material weaknesses:

Intercompany Accounts A material weakness existed with the recording, reconciling and elimination of intercompany account balances between the Company s Domestic and foreign subsidiaries and amongst the Company s foreign subsidiaries.

Review of Foreign Operations A material weakness existed with the local preparation and review of the financial results of certain of the Company s foreign operations.

The Company has implemented and continues to implement various measures to address the identified material weaknesses and to improve the overall internal control over financial reporting. The following steps are planned for fiscal 2009 to remediate the conditions leading to the above stated material weaknesses:

Intercompany Accounts (i) develop and implement standardized policy and procedure for the recording of inter-company transactions, (ii) identify, procure and implement an appropriate technology to record, match and track intercompany transactions, (iii) complete timely reconciliation of all intercompany accounts, and (iv) record in a timely manner the foreign currency translation and exchange rate gains or losses related to intercompany accounts.

Review of Foreign Operations (i) use of a comprehensive, standard financial close disclosure checklist, (ii) provide additional training to financial personnel at the Company s foreign subsidiaries, and (iii) implement an internal review function over all foreign operations coordinated through the Company s corporate office.

Changes in Internal Control over Financial Reporting

There were no changes during the quarter ended May 31, 2008 in the Company s internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the registrant s internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On October 29, 2007, Roberts Consolidated Industries, Inc. and Roberts Holding International, Inc., wholly owned subsidiaries of the Company, received a notice of claim for indemnity from International Paper Corporation, one of many defendants named in a Verified Complaint in the lawsuit captioned John Rosebery et al v. 3M Marine, et al., Index No. 21464/07, pending in the New York Supreme Court, County of Suffolk. The plaintiff alleges that he contracted leukemia as a result of exposure to benzene in various products allegedly manufactured and distributed by several defendants, including International Paper Corporation or its predecessors. Although Roberts Consolidated Industries, Inc. and Roberts Holding International, Inc. are not named as defendants in the action,

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International Paper Corporation has stated in the demand for indemnity that the products identified by Mr. Rosebery appear to be products which, as of December 31, 1975, were products of Roberts. The Company has responded on behalf of its subsidiaries to International Paper s demand by requesting that International Paper provide additional documentation and information regarding the contentions. Insufficient information exists at this time for the Company to opine on the merits, if any, of the claim for indemnity or the underlying claims.

The Company is involved in litigation from time to time in the course of business. Based on information currently available to management, the Company does not believe that the outcome of any of the legal proceedings in which the Company is involved will have a material adverse impact on the Company (see Note K of the Company s Notes to Consolidated Financial Statements).

Item 1A. Risk Factors

The Company, its operations and performance are subject to risks. While the Company believes that its expectations are reasonable, they are not guarantees of future performance. The Company s results could differ substantially from its expectations if any of the events described in these risks occur.

There have been no material changes to the Company s risk factors from those disclosed in the Company s Form 10-K for the year ended February 29, 2008.

Item 6. Exhibits

3.1	Certificate of Incorporation of the Company [(1)]
3.2	Amended and Restated By-Laws of the Company [(2)]
4.1	Form specimen Certificate for Common Stock of the Company [(1)]
31.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Filed with the Company s Registration Statement on Form S-1 (Reg. No. 333-07477) filed with the Securities and Exchange Commission on July 2, 1996, and incorporated herein by reference.

(2) Filed with the Company s Current Report on Form 8-K filed with the Securities and Exchange Commission on August 28, 2007, and incorporated herein by reference.

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SIGNATURES

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

Q.E.P. CO., INC.

By: /s/ Stuart F. Fleischer
Stuart F. Fleischer
Chief Financial Officer and Duly Authorized Officer

July 15, 2008

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EXHIBIT INDEX

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