

**UNITED STATES OF AMERICA**  
**SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2006

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number **000-51372**

**Omega Flex, Inc.**

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**23-1948942**  
(I.R.S. Employer  
Identification No.)

**451 Creamery Way, Exton, PA**  
(Address of principal executive offices)

**19341**  
(Zip Code)

Registrant's telephone number, including area code

**610-524-7272**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
**Common**

Name of each exchange on which registered  
**The NASDAQ Stock Market LLC**

Securities registered pursuant to section 12(g) of the Act:

Not applicable  
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of voting and non-voting common shares held by non-affiliates of the registrant as of June 30, 2006, the last business day of the most recently completed second quarter of 2006 was \$20.05.

**APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY PROCEEDINGS  
DURING THE PRECEDING FIVE YEARS:**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

The number of shares of the registrant's common stock issued and outstanding as of March 30, 2007 was 10,153,633.

Portions of the registrant's definitive proxy statement relating to the registrant's 2007 Annual Meeting of Shareholders to be filed hereafter are incorporated by reference into Part III (Items 10-14) of this Report on Form 10-K and certain Exhibits to previous filings with the Securities and Exchange Commission are incorporated by reference into Part IV, Item 15 of this Report on Form 10-K.

## **PART I**

### **Item 1 - BUSINESS**

#### **CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

*Certain statements in this Annual Report on Form 10-K that are not historical facts -- but rather reflect our current expectations concerning future results and events -- constitute forward-looking statements. The words “believes,” “expects,” “intends,” “plans,” “anticipates,” “intend,” “estimate,” “potential,” “continue,” “hopes,” “likely,” “will,” and similar expressions, or the negative of these terms, identify such forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements of Omega Flex, or industry results, to differ materially from future results, performance or achievements expressed or implied by such forward-looking statements.*

*Important factors that might cause our actual results to differ materially from the results contemplated by these forward-looking statements are contained in “Risk Factors” on page 11 and elsewhere in this report and our future filings with the Securities and Exchange Commission.*

*Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect management’s view only as of the date of this annual report statement. We undertake no obligation to update the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, conditions or circumstances.*

### **GENERAL**

#### **DESCRIPTION OF OUR BUSINESS**

##### **Overview of the Company**

We are a leader in the manufacture and sale of flexible metal hose for applications in conveying various liquids and gases within a number of diverse industries, including construction, transportation, steel, pharmaceutical, and petrochemical. The various product lines include corrugated metal hoses in a broad range of sizes and alloys, including three grades of stainless steel, bronze, Inconel and Hastelloy. We also manufacture a wide range of pressure reinforcing braids for our hoses in both metallic and synthetic constructions. These products are used in a wide variety of applications primarily for the processing industries, transportation industry, medical and semiconductor markets, and for instrumentation, as well as the construction industry.

##### **Industry Overview**

The flexible metal hose industry is highly fragmented and diverse, with over 10 companies producing flexible metal hose in the United States, and at least that many in Europe and Asia. Because of its simple and ubiquitous nature, flexible metal hose can be applied and has been applied to a number of different applications across a broad range of industries.

The major market categories for flexible metallic hose include automotive, aerospace, residential and commercial construction, and general industrial. Omega Flex participates in the latter two, which in the aggregate represent about 50% of the total market opportunity for flexible metallic hose. The major use of corrugated stainless steel tubing in the residential and commercial construction markets is primarily for flexible gas piping and gas appliance connectors and secondarily as pump connectors and seismic loops to isolate vibration in mechanical piping systems in commercial buildings. The general industrial market includes all of the processing industries, the most important of which include primary steel, petrochemical, pharmaceutical, and specialty applications for transfer of fluids at both extremely low and high temperatures, (such as the conveying of cryogenic liquids) and a highly fragmented OEM market, as well as a maintenance and repair market.

None of our competitors is dominant in more than one market. We are a leading supplier of flexible metal hose in each of the two broad markets in which we participate. Our assessment of our overall competitive position is based on several factors. The flexible gas piping market in the U.S. is currently concentrated in the residential housing market, and based on the reports issued by the national trade groups on housing construction, the level of acceptance of flexible gas piping in the construction market, and the average usage of flexible gas piping in a residential building, we are able to estimate with a high level of accuracy the size of the total gas piping market, and, based on our sales, our position within that market. For other applications, industry trade groups collect and report on the size of the relevant market, and we can estimate our percentage of the relevant market based on our sales as compared to the market as a whole.

Furthermore, the customer base for the products that we sell is widely known, as is the identity of the manufacturers aligned with those customers. Independent manufacturers' sales representatives have good estimates and in many cases, factual information on the volume of purchases of customers in their territories. Because there are gross differences in the market shares of many of the competing manufacturers, it is possible to reasonably assess shared positions. Large national accounts also have a sense as to shared positions as well, because they have relationships with most of the competing manufacturers and will share opinions. Lastly, the term "leading" implies a host of factors other than sales volume and market share position. This includes the range and capability of the product line, history of product development and new product launches, all of which information is in public domain. Based on this alone, we are without question the undisputed leader in at least one of the two major market segments in which we participate.

## **Development of Business**

We were incorporated in 1976 under the name of Tofle America, Inc. as the subsidiary of a Japanese manufacturer of flexible metal hose. For a number of years, we were a manufacturer of flexible metal hose that was sold primarily to customers using the hose for incorporation into finished assemblies for industrial applications. We later changed our name to Omega Flex, Inc., and in 1996, we were acquired by Mestek, Inc. In 1997, we introduced our first new product – TracPipe<sup>®</sup> corrugated stainless steel tubing for use in carrying fuel gas within residential, commercial and industrial buildings. Our growth since 1997 has been primarily as a result of the growth in the use and acceptance of corrugated stainless steel tubing as an alternative to the traditional black iron pipe throughout the construction industry, and through the development of our AutoFlare<sup>®</sup> patented fittings and accessories to the corrugated stainless steel tubing that

differentiate our systems from those of our competitors. In January 2005, Mestek announced its intention to distribute its equity ownership in our common stock to the Mestek shareholders. A registration statement for the Omega Flex common stock was filed with the Securities and Exchange Commission and the registration statement was declared effective on July 22, 2005. We also listed our common stock on NASDAQ National Market (now the NASDAQ Global Market) under the stock symbol "OFLX", and began public trading of our common stock on August 1, 2005. All Mestek shareholders as of the record date for the distribution received one share of Omega Flex common stock for each share of Mestek common stock owned as of the record date. We are now a totally separate company from Mestek, and we do not use or share any material assets or service of Mestek in conducting our business. Our operating plans for 2007 are to continue to grow the distribution and sale of our TracPipe<sup>®</sup> flexible gas piping and industrial products, as well as to nurture new product development.

## **Overview of Current Business**

### ***Products***

We have had the most success within the residential construction industry where our TracPipe<sup>®</sup> flexible gas piping has enjoyed wide acceptance due to its reliability and durability. Within that industry, the flexible gas piping products that we offer and similar products offered by our competitors have sought to overcome the use of black iron pipe that has traditionally been used by the construction industry in the United States and Canada for the piping of fuel gases within a building. Prior to the introduction of the first corrugated stainless steel piping system in 1989, nearly all construction in the United States and Canada used traditional black iron pipe for gas piping. However, the advantages of corrugated stainless steel tubing in areas subject to high incidence and likelihood of seismic events had been first demonstrated in Japan. In a seismic event, the corrugated stainless steel tubing was shown to withstand the stresses on a piping system created by the shifting and movement of a seismic event better than rigid pipe. However, the advantages of corrugated stainless steel tubing over the traditional black iron pipe also include lower overall installation costs because the corrugated stainless steel tubing can be installed in long uninterrupted lines within the building.

The flexibility of the tube allows it to be bent by hand without any tools when a change in direction in the line is required. In contrast, black iron pipe requires that each bend in the pipe have a separate fitting attached. This requires the installer to thread the ends of the black iron pipe, apply an adhesive to the threads, and then screw on the fitting, all of which is labor intensive and costly, including testing and rework if the work is not done properly. As a result of these advantages, corrugated stainless steel tubing now commands approximately one-half of the market for fuel gas piping in new and remodeled residential construction in the United States, and the use of rigid iron pipe and to a lesser degree copper tube, accounts for the other half of the market. We have not yet established a strong presence in the commercial or institutional construction markets in the United States but continue to pursue those opportunities.

From its introduction in 1997, TracPipe<sup>®</sup> flexible gas piping has grown to be our primary product line, with other applications representing a minor portion of our business. While we remain firmly committed to maintaining a presence in the other applications and markets for flexible metal hose (both because of the opportunities in those applications and because they suggest new markets and new applications), we have increasingly become an organization oriented to the manufacture and distribution of flexible gas piping products. The growth in the

flexible gas piping application domestically has superseded the prior technologies represented by traditional black iron pipe or copper tube. We plan to continue our growth through continued inroads against older technologies, in both the residential and commercial markets, in the United States and overseas in geographic areas that have access to natural gas distribution systems.

As noted below, our flexible metal hose is used in a wide variety of applications besides flexible gas piping. Our involvement in these markets is important because just as the flexible gas piping applications have sprung from our expertise in manufacturing annular metal hose, so other applications may also evolve from our participation in the industry. For example, we currently have several development projects underway in various stages for several new applications, including transportation, high purity gases, and underground pre-sleeved applications. Our transportation products require some additional development and testing for the product to begin to reach its potential and begin full commercialization. Our high purity gas and underground pre-sleeved applications are still in development.

Flexible metal hose is also used in a wide variety of industrial and processing applications where the unique characteristics of the flexible hose in terms of its flexibility, and its ability to absorb vibration and thermal expansion and contraction, has unique benefits over rigid piping. For example, in certain pharmaceutical processing applications, the process of developing the specific pharmaceutical may require rapid freezing of various compounds through the use of liquefied gases, such as liquefied nitrogen, helium or Freon. The use of flexible metal tubing is particularly appropriate in these types of applications. Flexible metal hose can accommodate the thermal expansion caused by the liquefied gases carried by it through the hose, and the total length of the hose will not significantly vary. In contrast, fixed or rigid metal pipe would expand and contract along its length as the liquid gases passed through it, causing stresses on the pipe junctions that would over time fatigue and fail. Alternatively, within certain industrial or commercial applications using steam, either as a heat source or in the industrial process itself, the pumps used to transfer the liquid or steam within the system are subject to varying degrees of vibration. Flexible metal hoses can be used as connections between the pump and the intake of the fluids being transferred to eliminate the vibration effects of the pumps on the piping transfer system.

### ***Manufacturing***

In each instance, whether the application is for corrugated stainless steel tubing for fuel gases, flexible metal hose for handling specialty chemicals or gases, or unique industrial applications requiring ability to withstand wide variations in temperature and vibration, all of our success rests on the metal hose made by Omega Flex. Most of our flexible metal hoses range in diameter from 1/4" to 2" while certain applications require diameters of up to 14". All of our smaller diameter pipe (2" inner diameter and smaller) is made by a proprietary process that is known as the rotary process. The proprietary process that we use to manufacture our annular hose is the result of a long-term development effort begun in 1995. Through continuous improvement, we have over the years developed and fine-tuned the process so that we can manufacture annular flexible metal hose on a high speed, continuous process. We believe that our own rotary process for manufacturing annular corrugated metal hose is the most cost efficient method in the industry, and that our rotary process provides us with a unique advantage in many of the industries in which we participate. As a result, we are able to provide our product on a demand basis. In December 2006, we achieved a delivery performance to the scheduled ship date of 96.9% for TracPipe® flexible gas piping. The quick inventory turnover reduces our costs

for in-process inventory, and further contributes to our gross margin levels. We have also improved our productivity on a historical basis.

### ***Raw Materials***

We use various materials in the manufacture of our products primarily stainless steel for our flexible metal hose and polyethylene for our jacketing material on TracPipe<sup>®</sup> flexible gas piping. We also purchase all of our proprietary AutoFlare<sup>®</sup> brass fittings for use with the TracPipe<sup>®</sup> flexible gas piping. Although we have multiple sources qualified for all of our major raw materials and components, we have historically used one or two sources of supply for such raw materials and components. Our current orders for stainless steel and fittings are each placed with one or two suppliers. If any one of these sources of supply were interrupted for any reason, then we would have to devote additional time and expense in obtaining the same volume of supply from our other qualified sources. This potential transition, if it were to occur, could affect our operations and financial results during the period of such transition. Commodities markets in general and stainless steel in particular has had significant upward price movement in 2006, resulting in increasing costs to manufacture products and, in some cases, a tightening supply. We believe that with our purchase commitments for stainless steel, polyethylene and for our proprietary fittings, that we have adequate sources of supply for these raw materials and components for 2007. We have not had significant difficulty in obtaining the raw materials, component parts or finished goods from our suppliers in prior years. We believe that constriction in the supply of stainless steel will continue until additional global capacity becomes available. Continued volatility in the commodities marketplace and competitive conditions in the sale of our products may not allow us to pass along raw materials or component part price increases to our customers.

### ***Business Seasonality***

The demand for our TracPipe<sup>®</sup> flexible gas piping product may be affected by the construction industry's demand, which generally may slacken in the winter months of each year due to cold and inclement weather. Accordingly, sales growth is usually higher in the spring, summer and fall, while sales in the winter may be static or rise only modestly. However, the effect of the winter weather may be offset by the increase in demand for flexible gas piping products in general as more contractors and installers choose to use flexible gas piping rather than black iron pipe.

### ***Customers***

We sell our products to customers scattered across a wide and diverse set of industries from construction to pharmaceutical with approximately 4,300 active customers. These sales channels include sales through independent sales representatives, distributors, original equipment manufacturers, direct sales, and sales through our website on the internet. We utilize various distribution companies in the sale of our TracPipe<sup>®</sup> flexible gas piping, and these distribution customers in the aggregate represent a material portion of our business. In particular, our customer, Ferguson Enterprises, and its various branches, represents 18% of the Company's Net Sales for the year ended December 31, 2006, and 14% of the Accounts Receivable balance at December 31, 2006. All of this business is done on a purchase order basis for immediate resale commitments or stocking, and there are no long-term purchase commitments. In the event we were to lose an account, we would not expect any long-term reduction in our sales due to the

broad end-user acceptance of our products. We would anticipate that in the event of a loss of any one or more distributors, that after an initial transition period, the sale of our products would resume at or near their historical levels. Furthermore, in the case of certain national distribution chains like Ferguson and other distributors, it is possible that there would continue to be purchasing activity from one or more regional or branch distribution customers. We sell our products within North America, primarily in the United States and Canada, and we also sell our products internationally, primarily in Europe through our sales office located in Oxfordshire, England. Our sales outside of North America are less than ten percent of our total net sales, with most of the sales occurring in the United Kingdom and elsewhere in Europe. We do not have a material portion of our long-lived assets located outside of the United States, and due to its small size, the foreign operations do not carry any additional risk from being located outside of the United States.

### ***Distribution of Sales***

As mentioned previously, we sell our products primarily through independent outside sales organizations, including independent sales representatives, distributors, fabricating distributors, wholesalers, and OEMs. We have a limited internal sales function that sells our products to key accounts, including OEMs and distributors of bulk hose. We believe that within each geographic market in which the independent sales representative, distributor or wholesaler is located that our outside sales organizations are the first or second most successful outside sales organization for the particular product line within that geographic area.

### ***Competition***

There are approximately ten manufacturers of flexible metal hose in the United States, and approximately that number in Europe, several in South America, and six to eight in Asia. The U. S. manufacturers include Titeflex Corporation, Parker Hannifin Corporation, Ward Manufacturing, Truflex, Microflex, U. S. Hose, Hose Master, and several smaller privately held companies. No one manufacturer, as a general rule, participates in more than two of the major market categories as outlined above with most concentrating in just one. We estimate that we hold a number one or number two share position in the two major market categories in which we participate. In the flexible gas piping market, the U.S. market is currently concentrated in the residential housing market, and based on the reports issued by the national trade groups on housing construction, the level of acceptance of flexible gas piping in the construction market, and the average usage of flexible gas piping in a residential building, we are able to estimate with a high level of accuracy the size of the total gas piping market, and based on our sales our position within that market. For other applications, industry trade groups collect and report on the size of the relevant market, and we can estimate our percentage of the relevant market based on our sales as compared to the market as a whole. The larger of our two markets, the construction industry, has seen a reduction in the rate of growth in 2006. As discussed elsewhere, black iron pipe or copper tube was historically used by all builders of commercial and residential buildings until the advent of flexible gas piping and changes in the relevant building codes. Since that time, flexible gas piping has taken an increasing share of the total amount of fuel gas piping used in construction, until at present we estimate that flexible gas piping is approximately one-half of the market for the residential component, but significantly less for commercial. Within the flexible gas piping market, we compete against five other manufacturers of flexible metal hose, including Titeflex, Parker Hannifin, and Wardflex.



In the industrial market, due to the number of applications in which flexible metal hose may be used, and the number of companies engaged in the manufacture and sale of flexible metal hose, the market is very fragmented, and we estimate that no one company has a predominant market share of the business over other competitors. The general industrial markets within Europe are very mature and tend to offer opportunities which are interesting to us in niche markets or during periods in which a weak dollar increases the demand for our products on a competitive basis. Such has been the case for several years and has created new relationships for us. Currently, we are not heavily engaged in the manufacture of flexible metal hose for the aerospace or automotive markets, but we continue to review opportunities in all markets for our products to determine appropriate applications that will provide growth potential and high margins. In some cases, where the product offering is considered a commodity, price is the overriding competing factor. In other cases, a proprietary product offering or superior performance will be the major factors with pricing being secondary and in some cases, a non-factor. The majority of our sales are to distributors and wholesalers, and our relationships with these customers are on an arms-length basis in that neither we nor the customers are so dependent on the other to yield any significant business advantage. From our perspective, we are able to maintain a steady demand for our products due to the broad acceptance of our products by end users, regardless of which distributor or wholesaler sells the product.

### ***Backlog***

Management does not believe that backlog figures are material to an understanding of our business because most products are shipped promptly after the receipt of orders.

### ***Intellectual Property***

We have a comprehensive portfolio of intellectual property, including approximately 93 patents issued in 30 countries around the world. The patents cover (a) the AutoFlare<sup>®</sup> fittings used by the flexible gas piping to join the piping to a junction or assembly, (b) pre-sleeved corrugated stainless steel tubing for use in underground applications, (c) an electrically conductive jacket for flexible gas piping that we sell under the trademark CounterStrike<sup>®</sup>. Our AutoFlare<sup>®</sup> fitting is the leading fitting for use with flexible gas piping because it offers a metal-to-metal seal between the fitting and the tubing, and because of its robustness and ease of use. The metal-to-metal contact provides for a longer lasting and more reliable seal than fittings which use gaskets or sealing compounds that can deteriorate over time. In applications involving fuel gases in a building, the ability to maintain the seal and prevent the leaking of such gases over long periods of time is valued by our customers. We also have received a patent for the composition of the polyethylene jacket used in our CounterStrike<sup>®</sup> flexible gas piping product, which has increased ability to dissipate electrical energy in the event of a nearby lightning strike. The expiration dates for the several patents covering our AutoFlare<sup>®</sup> fittings will expire between 2016 and 2020 and the Counterstrike<sup>®</sup> patent will expire 2025. We currently have several patent applications pending in the United States and internationally covering improvements to our AutoFlare<sup>®</sup> fittings and our CounterStrike<sup>®</sup> polyethylene jacket. Finally, and as mentioned above, our unique rotary process for manufacturing flexible metal hose has been developed over the last ten years, and constitutes a valuable trade secret. In a recently concluded case, a Pennsylvania court has issued a ruling that confirms our proprietary rotary manufacturing process does constitute a “trade secret” under Pennsylvania law, and is entitled to protection against unauthorized disclosure or misappropriation.

We are currently engaged in a case currently pending in the U.S. District Court in Massachusetts, in which we have sued a flexible gas pipe competitor for infringement on one or more of our U.S. patents covering our AutoFlare<sup>®</sup> fittings. The court has ruled that the competitor did infringe one or more of our patents, and that the patents were valid. The decision regarding validity of our patents is currently on appeal. See “Item 3 – Legal Proceedings” for a more detailed description of the litigation.

### ***Employees***

As of December 31, 2006, we had 115 employees. Most of our employees are located in our main facility in Exton, Pennsylvania, which is currently our main manufacturing facility, and which contains our engineering, finance, human resources and most sales personnel. Our factory workforce in Exton, Pennsylvania is not represented by a collective bargaining agent. We also maintain an office in Westfield, Massachusetts where seven employees in management and sales are primarily assigned. We sublease our Westfield offices from Mestek. A number of individual sales personnel are scattered across the United States. We also maintain a facility in Oxfordshire, England, and that facility has a total of seven people. The sales personnel in England handle all sales and service for our products in Europe and select accounts in Asia and the Middle East.

### ***Environmental***

Our manufacturing processes do not require the use of significant quantities of hazardous substances or materials, and therefore we are able to operate our Exton facility as a “small quantity generator” under the Resource Conservation and Recovery Act, 42 U.S.C. §§ 321 *et seq.* As a result, compliance with federal, state and local environmental laws do not pose a material burden on our business, and we are not required to expend any material amounts on capital expenditures for environmental control facilities for our manufacturing facility.

### ***Internet Website***

You may learn more about our company by visiting our website at [www.omegaflex.com](http://www.omegaflex.com). Among other things, you can access our filings with the Securities and Exchange Commission. These filings include annual reports (Form 10-K), quarterly reports (Form 10-Q), and current reports (Form 8-K), as well as Section 16 reports filed by our officers and directors (Forms 3, 4 and 5). All of these reports will be available on the website as soon as reasonably practicable after we file the reports with the SEC. You may also view on our website the following important corporate governance documents:

- Code of Business Ethics
- Corporate Governance Guidelines
- Charters for each of the Board committees
- Policy on receiving complaints regarding account or internal control issues

### **Item 1A – RISK FACTORS**

You should carefully consider the following risk factors and all the other information contained in this annual report and our other filings in evaluating our business and investment in our common stock. We have not disclosed general risk factors that may be applicable to any for-profit organization, such as general economic conditions, interest rates, labor supply and

technological changes. Investors are cautioned to take into consideration the specific risk factors we have disclosed below and general risk factors before making an investment decision.

### **Risk Relating to Our Business**

#### ***Certain of our competitors may have greater resources, or they may acquire greater resources.***

Some of our competitors have substantially more resources than are available to us as a stand-alone company. For example, in the corrugated stainless steel tubing market, two of our competitors are divisions of large corporations with revenues measured in the billions of dollars. These competitors may be able to devote substantially greater resources to the development, manufacture, distribution and sale of their products than would be available to us as a stand-alone company. One or more competitors may acquire several other competitors, or may be acquired by a larger entity, and through a combination of resources be able to devote additional resources to their businesses. These additional resources could be devoted to product development, reduced costs in an effort to obtain market share, greater flexibility in terms of profit margin as part of a larger business organization, increased investment in plant, machinery, distribution and sales concessions. As a stand-alone company, the resources that may be devoted by us to meet any potential developments by larger, well-financed competitors may be limited.

#### ***We are dependent on certain raw materials and supplies that could be subject to volatile price escalation.***

As a manufacturer of flexible metal hose, we must use certain raw materials in the manufacture of the hose. The primary raw material is stainless steel that is used in the forming of the hose, and various other steel products used in the wire braid overlay over some flexible metal hoses for additional strength and durability. We also use polyethylene in pellet form for the forming and extrusion of polyethylene jacket over corrugated stainless steel tubing for use in fuel gas applications, underground installations, and other installations that require that the metal hose be isolated from the environment. Finally, we also purchase our proprietary brass fittings used with the flexible metal hose that provide a mechanical means of attaching the hose to an assembly or junction. We attempt to limit the effects of volatile raw material prices, and to ensure adequate and timely supply of material, by committing to annual purchase contracts for the bulk of our steel and polyethylene requirements, and for our requirements for fittings. We also have qualified several vendors to produce or manufacture our critical purchase requirements. However, there is no assurance that these precautions would eliminate all or most of the adverse effects of a sudden increase in the cost of materials or key components, or that the loss of one or more of our sources would not lead to higher costs because of less competition.

#### ***We face intense competition in all of our markets.***

The markets for flexible metal hose are intensely competitive. There are a number of competitors in all markets in which we operate, and generally none of these markets have one dominant competitor – rather a large number of competitors exist, each having a proportion of the total market. One or more of our competitors may develop technologies and products that are more effective or which may cost less than our current or future products, or could potentially render our products noncompetitive or obsolete. Our prior success has been due to our ability to develop new products and product improvements, and establish and maintain an effective distribution network which to some extent came at the expense of several competing

manufacturers. There can be no assurance that our competitors will not be able to disrupt our distribution network by causing one or more of our sales representatives to drop our product lines.

***We may not retain our independent sales representatives, distributors and wholesalers.***

Almost all of our products and all of product lines are sold by outside sales organizations. These independent sales organizations include sales representatives, distributors and wholesalers, and generally are geographically dispersed in certain territorial markets across the United States, Canada and elsewhere. These outside sales organizations are independent of us, and are typically owned by the individual principals of such firms. We enter into agreements with such outside sales organizations for the exclusive representation or distribution of our products, but such agreements are generally for terms of one year or less. At the expiration of the agreement, the agent or distributor may elect to represent a different manufacturer. As a result, we have no ability to control which flexible metal hose manufacturer any such sales organization may represent or carry. The competition to retain quality outside sales organizations is also intense between manufacturers of flexible metal hose since it is these sales organizations that generally can direct the sales volume to distributors and, ultimately, contractors and installers in important markets across the country, and in other countries in which we operate. The failure to obtain the best outside sales organization within a particular geographic market can limit our ability to generate sales of our products. In addition, our relationships with such sales representatives, distributors and wholesalers were initiated while we were a subsidiary of Mestek, and the establishment of these relationships may have benefited from our association with Mestek. While we currently have a fully developed sales and distribution network of superior outside sales organizations, there can be no assurance that any one or more of the outside sales organizations will elect to remain with us.

***Our manufacturing plant may be damaged or destroyed.***

All of our manufacturing capacity is currently located in our facility in Exton, Pennsylvania. We do not have any other operational manufacturing capacity for flexible metal hose. We cannot replicate our manufacturing methods at a supplier's facility due to the confidential and proprietary nature of our manufacturing process. If the manufacturing portion of the Exton facility were destroyed or damaged in a significant manner, we would not be able to manufacture our flexible metal hose without delay or interruption. This could lead to a reduction in sales volume if customers were to purchase their requirements from our competitors, claims for breach of contract by certain customers with contracts for delivery of flexible metal hose by a certain date, and costs to replace our destroyed or damaged manufacturing capacity. The impact of any possible damage or destruction of our manufacturing facility may be offset to some extent by proceeds from our business interruption insurance policies. The fittings and accessories for the flexible metal hose are manufactured for us by several suppliers not located in Exton, Pennsylvania.

***Our historical financial information may not be indicative of our future results as an independent company.***

The historical financial information included in this annual report may not reflect what our results of operations, financial position and cash flows would have been had we been a separate publicly traded company during the periods presented and may not be indicative of our future results of operations, financial position and cash flows. We believe there are a number of reasons for this:

- As a subsidiary of Mestek, we received various services from Mestek and from outside vendors, and Mestek allocated expenses for these services and allocated a corporate charge to us. The amounts we paid for these services may have been more or less than the amounts that would have been incurred had we performed or acquired these services ourselves or that we have incurred as a separate company;
- Our historical financial information prior to the distribution does not reflect certain events and changes that occurred as a result of our Spin-Off from Mestek, including, the establishment of our capital structure, the incurrence of commercial bank debt and interest expense and changes in our expenses as a result of new treasury, employee benefit, tax and other functions that we have assumed.
- We incurred a significant expense in settling the Arkansas class action litigation. We believe that this settlement was an anomalous event, and is unlikely to be replicated on that scale within the foreseeable future.

For a further discussion of our financial information, see “Selected Historical Financial and Operating Data” and “Audited Financial Statements”.

***We are primarily dependant on one product line for most of our sales.***

Most of our sales are derived from the sale of TracPipe<sup>®</sup> flexible gas piping and to a lesser extent CounterStrike<sup>®</sup> flexible gas piping and accessories, including Autoflare<sup>®</sup> fittings. Sales of our flexible metal hose for other applications represent a small portion of our overall sales and income. Any event or circumstance that adversely affects our TracPipe<sup>®</sup> or CounterStrike<sup>®</sup> flexible gas piping could have a greater impact on our business and financial results than if our business were more evenly distributed across several different product lines. The effects of such an adverse event or circumstance would be magnified in terms of our company as a whole as compared to one or more competitors whose product lines may be more diversified, or who are not as reliant on the sales generated by their respective flexible gas piping products. Therefore, risks relating to our TracPipe<sup>®</sup> and CounterStrike<sup>®</sup> flexible gas piping business – in particular loss of distributors or sales channels, technological changes, changes in applicable code requirements, loss of our key personnel involved in the flexible gas piping product line, increases in commodity prices, particularly in stainless steel and polyethylene – could pose a significant risk to our company and its businesses.

***We are dependant on certain sales channels for a significant portion of our business.***

Of the various sales channels that we use to sell our TracPipe<sup>®</sup> flexible gas piping, a significant portion of such sales are made through our wholesale stocking distributors that include Ferguson Enterprises and several other distributors. These and other distributors purchase our TracPipe<sup>®</sup> flexible gas piping product and accessories, and stock the products in warehouses for resale, either to their own local branches or to end-users. Because of the breadth and penetration of the distribution networks, and the range of complementary products they offer for sale, these wholesale distributors are able to sell large amounts of our TracPipe<sup>®</sup> flexible gas piping products to end users across the United States and Canada. The decision by a major wholesaler distributor to stop distributing our TracPipe<sup>®</sup> product, and to distribute a competitive flexible gas piping product could significantly affect our revenues and possibly our earnings unless management took steps to replace such sales channel or otherwise act to maintain our margins.

***We do not have a recent record of operating as an independent company and our historical financial information may not be indicative of our future results as an independent company.***

We previously operated as an independent company from 1975 to 1996, when we were acquired by Mestek. At the time of the acquisition, we were a small privately held company, and our revenues were no more than \$7 million annually. While we were a part of Mestek, we operated as a part of its broader corporate organization, which provided various corporate services to us as part of the management fee charged by Mestek which we approved. Such corporate services including strategic corporate planning, legal services, finance services, insurance administration and coverage, tax accounting and planning, human resources and benefit plan sharing, environmental, health & safety services, and access to the Mestek credit facilities with Bank of America and its predecessors. Following the distribution, we have taken responsibility for these activities and our cost of performing these services or acquiring these services may be more than the corporate charge we previously received from Mestek.

***We may substantially increase our debt in the future.***

We are currently not carrying any long-term debt. We may consider establishing credit facilities to provide funds for purposes of working capital, capital purchases, research and development, potential acquisitions and business development. If we do use credit facilities, interest costs associated with any such borrowings and the terms of the loan generally may adversely affect our profitability.

***Our business may be subject to the supply and availability of fuel gas supplies.***

Our TracPipe<sup>®</sup> flexible gas piping products are used to convey fuel gas, primarily natural gas, but also propane, within a building from the exterior wall of the building to any gas-fired appliances within the building. Because the TracPipe<sup>®</sup> product is used in the transmission of fuel gas, the application of the product is limited to geographic areas where such fuel gas is available. Certain geographic areas of the United States and other countries do not have the infrastructure to make natural gas available. Other types of fuel gas may be used in areas where there are no natural gas pipelines, but these alternate fuel gas sources have other distribution issues that may constrict their availability. Our prospects for future growth of the TracPipe<sup>®</sup> product are largely limited to those areas that have natural gas transmission lines available for use in residences and commercial buildings.

***Our business may be subject to varying demands based on market interest rates.***

Our TracPipe<sup>®</sup> flexible gas piping is used in the construction industry, both in residential, commercial and industrial segments, for the piping of fuel gas within a building. The demand for new or remodeled construction in the construction industry – and in particular the residential construction industry – is susceptible to fluctuations in interest rates charged by banks and other financial institutions as well as consumer demand. The purchasers of new or remodeled construction generally finance the construction or acquisition of the residential, commercial or industrial buildings, and any increase in the interest rates on such financing will raise the acquisition cost of the potential purchaser. As costs increase, an increasing number of potential buyers may not be able to support the level of financing under a higher interest rate environment. Increased acquisition costs may lead to a decline in the demand for new or remodeled construction, and as a result may also lead to a reduced demand for our products used in construction industry.

***If we are not able to protect our intellectual property rights, we may not be able to compete as effectively.***

We possess a wide array of intellectual property rights, including patents, trademarks, copyrights, and applications for the above, as well trade secrets, manufacturing know-how, and other proprietary information. Certain of these intellectual property rights form the basis of our competitive advantage in the market place through a superior product design, a superior business process, superior manufacturing methods or other features that provide an advantage over our competitors. The intellectual property rights are sometimes subject to infringement or misappropriation by other organizations, and failing an amiable resolution, we may be forced to resort to legal proceedings to protect our rights in such intellectual property.

We are currently engaged in one case currently pending in the U.S. District Court in Massachusetts, where we have sued a flexible gas pipe competitor for infringement on one or more of our U.S. patents covering our AutoFlare<sup>®</sup> fittings. Although we have received a ruling from the court that our patents were infringed, and that our patents are valid, the decision on the validity of our patents is currently on appeal. The results we may obtain from resorting to any such legal proceedings are never assured, and it is possible that an adverse decision may be delivered in any particular proceeding. As a result, we may not be able to retain the exclusive rights to utilize and practice such intellectual property rights, and one or more of our competitors could utilize and practice such intellectual property rights. This development may lessen our competitive advantage vis-à-vis one or more competitors, and lead to a reduction in sales volume in one or more product lines, a reduction in profit margin in such product lines, or both. See Item 3 – Legal Proceedings for a more detailed description of the above described litigation.

***If we were to lose the services of one or more of our senior management team, we may not be able to execute our business strategy***

Our future success depends in a large part upon the continued service of key members of our senior management team. In particular, our President, Kevin R. Hoben, and our Executive Vice President, Mark F. Albino, are critical to our overall management, as well as the development of our products and our strategic direction. Both Mr. Hoben and Mr. Albino provide critical leadership and direction to our company especially in terms of market developments and new product applications, and other areas, and their unique abilities, experience and expertise cannot be easily duplicated or replaced. As we continue to grow, however, our entire management team becomes more attuned to the strategic vision created by our senior management. The loss of any of our senior management could seriously harm our business.

***Our business may be subject to cyclical demands.***

The demand for our products may be subject to cyclical demands in the markets in which we operate. Our customers who use our products in industrial and commercial applications are generally manufacturing capital equipment for their customers. Similarly, our TracPipe<sup>®</sup> flexible gas piping products are used primarily in residential construction, both in single-family buildings, and in larger multi-unit buildings. TracPipe<sup>®</sup> flexible gas piping is considered to be a relatively new product and is displacing black iron pipe at a steady rate. Should there be any

change in factors that affect the rate of new residential construction, our growth rate would no longer be augmented by the recent historical increases in new residential construction. To the extent that interest rates increase, in conjunction with an economic cycle or as part of the general economic conditions in the United States or abroad, the demand for our products in such applications may decrease as well.

***Our business may be subject to seasonal or weather related factors.***

The demand for our products may be affected by factors relating to seasonal demand for the product, or a decline in demand due to inclement weather. Our TracPipe<sup>®</sup> flexible gas piping products are installed in new or remodeled buildings, including homes, apartment buildings, office buildings, warehouses, and other commercial or industrial buildings. Generally, the rate of new or remodeled buildings in the United States and in the other geographic markets in which we are present decline in the winter months due to the inability to dig foundations, problems at the job site relating to snow, or generally due to low temperatures and stormy weather. As the rate of construction activity declines during the winter, the demand for our corrugated stainless steel tubing may also decrease or remain static. The decreases that may be inflicted due to seasonality and poor weather may be offset somewhat by the increase in the use of corrugated stainless steel tubing from contractors who previously used only the traditional black iron pipe. However, the market share for corrugated stainless steel tubing in the fuel gas application within the construction industry may reach a finite point, and there can be no assurance that the decline in demand for our products or a decline in the growth of our products will not occur.

***We are obligated to pay a significant settlement, which could affect our liquidity.***

The Company has recently settled a purported class action captioned *Lovelis, et al. v. Titeflex Corp., et al.*, that was brought in the Clark County Circuit Court, in Arkansas. The plaintiffs alleged that corrugated stainless steel tubing products, including our TracPipe<sup>®</sup> CSST and similar products manufactured by several other manufacturers (also named as defendants in the case), was defective against potential damage caused by the nearby lightning strikes. After litigating this case since 2004, we and the other defendants elected to settle the case to avoid further expense and the prospect of an adverse decision in a forum that was predisposed to the plaintiffs. We have estimated that the total cost of the settlement will be approximately \$8.8 million, with a majority of this sum (estimated at \$6.4 million) payable in 2007. This payment will seriously deplete our cash reserves and affect our liquidity position. As a result of the settlement and other significant payments in the first quarter of 2007 (customer rebates, accrued bonuses), we may be required to obtain a line of credit borrowing facility from a commercial bank. The interest costs associated with any such borrowings and the terms of the loan generally may adversely affect our profitability.

***The agreements we have entered into with Mestek in connection with the distribution restrict our operations.***

In connection with the distribution, we and Mestek entered into a number of agreements regarding the distribution from Mestek and our relationship with each other. Each of these agreements signed in the context of our relationship to Mestek as a subsidiary and our Spin-Off from Mestek and, accordingly, the terms and provisions of these agreements may be less favorable to us than terms and provisions we could have obtained in arm's-length negotiations with unaffiliated third parties. These agreements commit us to take actions, observe



commitments and accept terms and conditions that are or may be advantageous to Mestek but are or may be disadvantageous to us. The terms of these agreements included obligations and restrictive provisions, including, but not limited to:

- an agreement to indemnify Mestek, its affiliates, and each of their respective directors, officers, employees, agents and representatives from certain liabilities arising out of the litigation we are involved in and all liabilities that arise from our breach of, or performance under, the agreements we entered into with Mestek in connection with the distribution and for any of our liabilities;
- an agreement with regard to tax matters between ourselves and Mestek which restricts our ability to engage in certain strategic or capital raising transactions.

For a further discussion of our agreements with Mestek, see “Relationships Between Our Company and Mestek, Inc. – Agreements Between Us and Mestek.”

***Under some circumstances, we could be prevented from engaging in strategic or capital-raising transactions and we could be liable to Mestek for any resulting adverse tax consequences.***

It is possible that Mestek could recognize a large taxable gain if the IRS were to assert that the distribution is part of a plan or series of related transactions pursuant to which one or more persons acquire, directly or indirectly, stock representing a 50% or greater interest in either Mestek or Omega Flex. Any cumulative 50% change of ownership in either Mestek or Omega Flex within the four-year period beginning two years before the date of the Spin-Off will be presumed under applicable law to be part of such a plan. If this presumption applies, it would need to be rebutted to avoid a large taxable gain. A merger, recapitalization or acquisition, or issuance or redemption of our common stock after the Spin-Off could, in some circumstances, be counted toward the 50% change of ownership threshold. As a result, we may be unable to engage in strategic or capital raising transactions that shareholders might consider favorable, or to structure potential transactions in the manner most favorable to us. Further, our tax responsibility allocation agreement with Mestek precludes us from engaging in some of these transactions and requires us to indemnify Mestek for the adverse tax consequences resulting from these types of transactions.

***The concentration of ownership of our common stock may depress its market price.***

Approximately 68% of the issued and outstanding common stock is owned or controlled by four shareholders; John E. Reed, Stewart B. Reed, Kevin R. Hoben and Mark F. Albino. All of these shareholders are also our directors, and Mr. Hoben and Mr. Albino are also our officers. As a result, the shares held by these persons may be subject to certain restrictions on the transfer or sale of their shares, either under the restrictions relating to the maintenance of the distribution as a tax-free distribution under Section 355 of the Internal Revenue Code, or under Rule 144. Further, there is no indication that even without such restrictions, any one or more of the above shareholders would be inclined to sell their shares of our common stock on the listed national stock exchange. In such event, the inactivity of a large block of our common shares in the marketplace may have the tendency of reducing the volume of trading of the common stock on the NASDAQ Global Market, and which may also result in lower prices for the common stock because there is not a sufficient supply of shares to create a vibrant market for our shares on the NASDAQ Global Market.

***Our charter documents or agreements may delay or prevent a change in control.***

The terms of the distribution from Mestek and the anti-takeover provisions of our articles of incorporation and by-laws, and the provisions of Pennsylvania law, could delay or prevent a change in control that may be favored by some of our shareholders. The provisions include without limitation a staggered board of directors, elimination of cumulative voting, requiring that only the Board may call a special shareholder meeting at which a fundamental transaction could be authorized, and the requirement of a super majority to approve certain changes to our articles of incorporation or by-laws. See “Description of Capital Stock” and “Anti-Takeover Provisions.” Any one or more acquisitions or issuance of our capital stock representing 50% or more of our then outstanding capital stock that may be related to the distribution could cause the distribution to be a taxable transaction to Mestek. As mentioned previously, any sale or issuance of shares within two years before or after the distribution are presumed to be a part of the distribution, unless we can rebut the presumption. We have agreed to indemnify Mestek for any tax that may be assessed due to actions by us that cause the distribution not to qualify as a tax-free transaction. Therefore, we have also agreed with Mestek that for a period of two years following the effective date of the distribution, we must obtain the approval of the Mestek Board of Directors before engaging in specified transactions that may involve the acquisition of our common stock or the issuance of our stock. These obligations may discourage, delay or prevent a change in control of us or to effect a transaction that may otherwise be in the best interests of our shareholders.

***Some of the requirements of Sarbanes-Oxley affect us as a small company disproportionately, and we may not be able to comply in a timely manner despite substantial effort and expense.***

The Sarbanes-Oxley Act of 2002 imposed many new requirements on public companies, the most significant of which involves the documentation, testing and reporting of the effectiveness of our internal control over financial reporting. Although we are not required to be in compliance with Section 404 of Sarbanes-Oxley relating to internal control over financial reporting until our annual report for the year ended December 2007, we will begin documenting and testing our internal controls in a way that we have never before been required to do. We expect this effort will involve substantial time and expense. Because we have limited resources we can devote to this effort, we cannot be sure that we will be able to complete the task in a timely manner or that our internal controls will meet the standards that are currently required.

**Item 1B – UNRESOLVED STAFF COMMENTS**

We do not have any unresolved comments from the staff of the Securities and Exchange Commission.

**Item 2 - PROPERTIES**

Our main facility is located in Exton, Pennsylvania about one hour west of Philadelphia and contains about 83,000 square feet of manufacturing and office space. We lease our Exton facility from Exton Ranch, Inc., our wholly owned subsidiary. We lease additional non-manufacturing space in Downingtown, Pennsylvania approximately 5 miles from the main plant. Almost all manufacturing of our flexible metal hose is done at the Exton facility. The corporate office of Omega Flex, Inc. in Westfield, Massachusetts is rented. In the United Kingdom we rent a facility in Banbury, which serves sales, warehousing and operational functions.

### **Item 3 - LEGAL PROCEEDINGS**

The Company is not presently involved in any litigation that it believes could materially and adversely affect its financial condition or results of operations, except as described in Item 7 – Management’s Discussion and Analysis of Financial Condition and Results of Operations- under the sub-caption “Commitments”.

We were involved in a putative class action litigation filed in the Clark County Circuit Court, in Arkansas, alleging that our corrugated stainless steel tubing product, TracPipe<sup>®</sup> and similar products manufactured by several other manufacturers (also named as defendants in the case) was defective against potential damage caused by the nearby lightning strikes. On September 5, 2006, we entered into a Stipulation and Settlement Agreement with the Class Representatives and Class Counsel, to settle and resolve the allegations brought forth in the lawsuit. We and the other defendants deny all of the allegations in the lawsuit, and deny any wrongdoing or legal liability, but agreed to settle this matter to avoid further cost and the uncertainty and risk of the outcome of further litigation. The Settlement Agreement provides (a) a release of all claims brought by Class Representatives for themselves and for the class against the defendants in the lawsuit, (b) notice to the class of the settlement and a remedial program for all class members, (c) certain marketing measures by the defendants, and (d) payment of attorneys’ fees to the Class Counsel. A copy of the Settlement Agreement has been filed as an exhibit to the Current Report on Form 8-K that we filed with the Securities and Exchange Commission on September 6, 2006, and is available on the SEC website at [www.sec.gov](http://www.sec.gov). The court gave final approval to the Settlement Agreement on February 1, 2007. The remedial program provided under the Settlement Agreement is currently processing claims from class members as provided under the Settlement Agreement. The deadline for submitting such claims is September 5, 2007.

We are currently engaged in a case to protect our intellectual property rights. We have sued a flexible gas pipe competitor for infringement on one or more of our U.S. patents covering our AutoFlare<sup>®</sup> fittings. We have alleged that the competitor has infringed on one or more of our patents covering the AutoFlare<sup>®</sup> fittings by including certain patented features in the competitor’s fitting, including a locator sleeve that makes it easier to align the connection. The trial court has ruled that the competitor did infringe on one or more of our AutoFlare<sup>®</sup> patents, and that the AutoFlare<sup>®</sup> patents are valid. The case is now scheduled for a trial to determine the amount of damages for the infringement, and a decision on the damages trial is expected in the 2<sup>nd</sup> quarter of 2007. However, the defendant has filed an appeal from the trial court ruling on the validity of one or more of our AutoFlare<sup>®</sup> patents, and that appeal is currently pending. A decision from the appellate court may be issued in the latter part of 2007, and an adverse ruling could reverse one or more parts of the trial court decision.

In another case that was pending in the Court of Common Pleas in Chester County, Pennsylvania, we sued a former employee and a flexible metal hose competitor to enjoin the disclosure of our trade secrets covering our proprietary rotary manufacturing process. In this case, a former long-term employee left our company to work for a competitor who is engaged in the flexible metal hose market. The former employee had been involved in the development and/or refinement of aspects of the rotary process manufacturing method, and had detailed knowledge of our trade secrets concerning this manufacturing method. We filed suit to enjoin any disclosure of our trade secrets by the former employee to his new employer, to enforce certain terms of an employment agreement previously signed by the former employee, and to

obtain damages for any unauthorized disclosure or misappropriation of our trade secrets. The case went to trial in March 2006, and the court issued its decision in July 2006, ruling that our proprietary rotary process for manufacturing corrugated stainless steel tubing was a “trade secret” under Pennsylvania law, and was to be accorded protection against unauthorized disclosure or misappropriation. The defendants were permanently enjoined from disclosing the trade secrets, or using the trade secrets in their business. At trial, we did not bring a claim for monetary damages, and no monetary damages were awarded by the court.

**Item 4 - SUBMISSION OF MATTER TO A VOTE OF THE SECURITY HOLDERS**

No matters were submitted to the security holders of the Company for a vote during the fourth quarter of 2006.

## PART II

### Item 5 - MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

#### Common Stock

Our common stock is listed on the NASDAQ Global Market, under the symbol OFLX. The number of shareholders of record as of March 30, 2007, based on inquiries of the registrant's transfer agent, was 828. For this purpose, shareholders whose shares are held by brokers on behalf of such shareholders (shares held in "street name") are not separately counted or included in that total.

We registered our common stock by a registration statement filed with the Securities and Exchange Commission, and this registration statement was effective on July 22, 2005. Consequently, our common stock was not publicly traded prior to that date, and so no information regarding the price range of our common stock for the time prior to the registration of our common stock is presented. The following table sets forth, for the periods indicated, the high and low closing sale prices for our common stock as reported by the NASDAQ Global Market.

#### PRICE RANGE

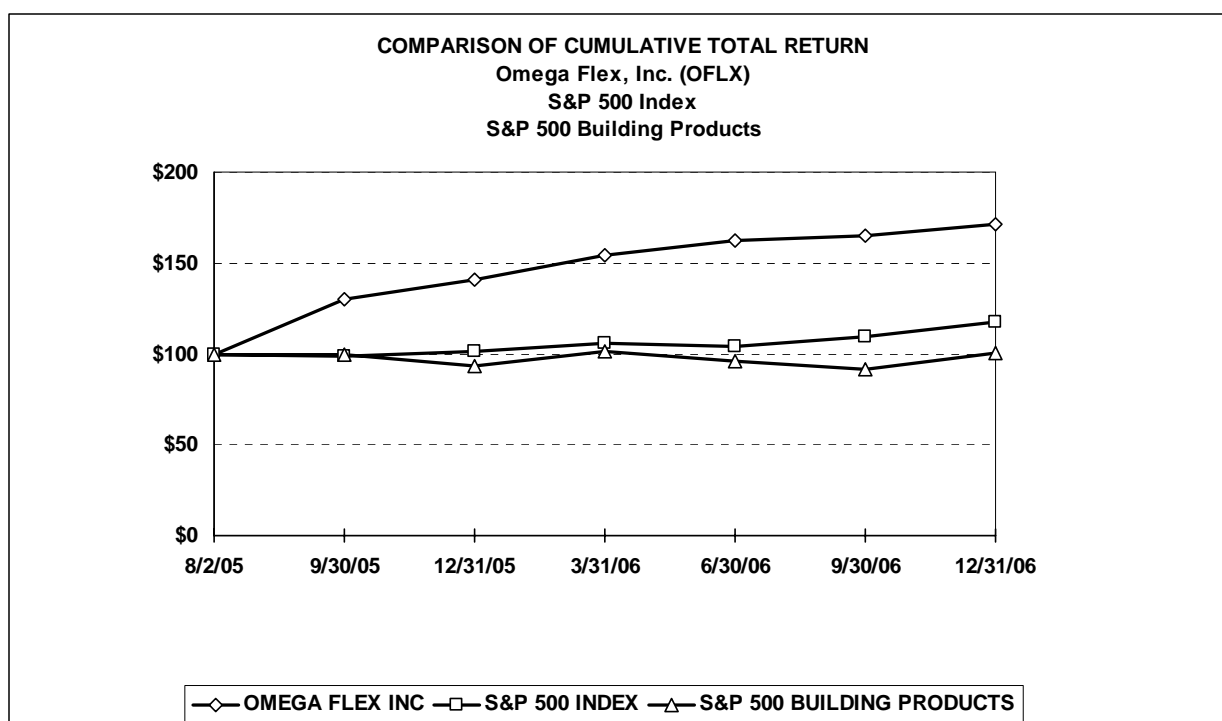
|                | <u>2006</u> |            | <u>2005</u> |                |
|----------------|-------------|------------|-------------|----------------|
|                | <u>high</u> | <u>low</u> | <u>high</u> | <u>low</u>     |
| First Quarter  | \$19.40     | \$15.05    |             | Not applicable |
| Second Quarter | \$20.05     | \$16.15    |             | Not applicable |
| Third Quarter  | \$25.43     | \$19.00    | \$19.55     | \$10.00        |
| Fourth Quarter | \$23.30     | \$18.27    | \$22.91     | \$12.70        |

We do not have any other securities, other than common stock, listed on a stock exchange or are publicly traded.

#### Shareholder Return Performance Presentation

*The Shareholder Return Performance Presentation shall not be deemed to be "soliciting material" or subject to Regulations 14A or 14C of the Securities and Exchange Commission or to the liabilities of Section 18 of the Securities and Exchange Act of 1934 (the "Exchange Act") and shall not be deemed incorporated by reference by any general statement incorporating by reference this annual report into any filing under the Securities Act of 1933 or under the Exchange Act, and shall not otherwise be deemed filed under such Acts.*

The following graph shows the changes on a cumulative basis in the total shareholder return on the Omega Flex common stock, and compares those changes in shareholder return with the total return on the S&P 500 Index and the total return on the S&P 500 Building Products Index. The graph begins with a base value of 100 on August 2, 2005, the date on which our common stock began trading on the NASDAQ Global Market, and shows the cumulative changes on a quarterly basis. The graph assumes \$100 was invested on August 2, 2005 in each of the three alternatives, and that all dividends have been reinvested.



| Company / Index           | Base Period | INDEXED RETURNS |          |         |         |         |          |
|---------------------------|-------------|-----------------|----------|---------|---------|---------|----------|
|                           |             | Quarter Ending  |          |         |         |         |          |
|                           | 8/2/05      | 9/30/05         | 12/31/05 | 3/31/06 | 6/30/06 | 9/30/06 | 12/31/06 |
| Omega Flex, Inc.          | 100         | 129.68          | 141.04   | 154.50  | 162.61  | 164.80  | 170.97   |
| S&P 500 Index             | 100         | 99.09           | 101.16   | 105.42  | 103.90  | 109.79  | 117.14   |
| S&P 500 Building Products | 100         | 99.40           | 93.41    | 100.99  | 96.25   | 91.32   | 100.22   |

## Dividends

We have paid three special dividends on our common stock, but two of these special dividends on our common stock were declared and paid prior to the date that our common stock was registered with the Securities and Exchange Commission and began trading on the NASDAQ Global Market in August, 2005

The first dividend was declared and paid to shareholders of record as of October 13, 2004, and the amount of the dividend was \$0.886 per share on a fully diluted basis and after giving effect to the forward split as part of the distribution, as described in Note 3 under the caption "Spin-Off". On January 12, 2005, the second dividend was paid to record shareholders as of January 1, 2005, and was \$0.92 per share on a fully diluted basis and after giving effect to the forward split as part of the distribution. The 2005 dividend totaling \$9,350,000 was recorded as a reduction to retained earnings for the portion related to Mestek, its 86% shareholder, and the remaining 14% portion relating to Mr. Hoben and Mr. Albino was recorded as a reduction to Common Stock Subject to Put Obligation in Current Liabilities, as described in Note 3.

On December 11, 2006, the Board of Directors authorized a special dividend of \$0.40 per share to all shareholders of record as of January 2, 2007, and payable as soon as practicable. The payment in the amount of \$4,061,453 was subsequently paid on January 16, 2007. Our future

decisions concerning the payment of dividends on our common stock will depend upon our results of operations, financial condition and capital expenditure plans, as well as such other factors as the Board of Directors, in its sole discretion, may consider relevant.

The Company adopted the Omega Flex, Inc. 2006 Phantom Stock Plan during 2006 as described in Note 13. There are no plans to institute any other such plan at this time.

### **Omega Flex Distribution**

On January 19, 2005, Mestek, Inc. announced that it would distribute its equity interest in Omega Flex, Inc., *pro rata*, to all of the Mestek shareholders as of June 23, 2005, (the "Distribution"). In conjunction with the Distribution, we filed a Form 10 registration under the Securities Exchange Act of 1934, and the registration statement was declared effective on July 22, 2005. Shares of our common stock began trading on the NASDAQ Global Market on August 1, 2005.

### **Item 6 - SELECTED FINANCIAL DATA**

Selected financial data for the Company for each of the last five years is shown in the following table, which is derived from and should be read in conjunction with the Consolidated Financial Statements included elsewhere in this report and in conjunction with information contained in the Company's Form 10 filing.

#### **SUMMARY OF FINANCIAL POSITION – as of December 31,**

(dollars in thousands except per share data)

|   | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
|---|-------------|-------------|-------------|-------------|-------------|
| Total assets                              | \$52,623    | \$41,714    | \$40,864    | \$34,432    | \$28,664    |
| Working capital                           | \$16,236    | \$17,125    | \$18,801    | \$16,314    | \$16,519    |
| Total long-term debt                      | ---         | \$3,225     | \$3,411     | ---         | ---         |
| Shareholders' equity                      | *\$27,646   | *\$25,986   | *\$23,996   | \$25,619    | \$21,227    |
| Shareholders' equity per common share (1) | \$2.72      | \$2.56      | \$2.36      | \$2.93      | \$2.43      |

\* See Note 7 relative to Dividends declared and or paid in 2006, 2005 and 2004.

#### **SUMMARY OF OPERATIONS -- for the years ended December 31,**

(dollars in thousands except per share data)

|                                   | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
|-----------------------------------|-------------|-------------|-------------|-------------|-------------|
| Revenues                          | \$73,574    | \$65,638    | \$48,248    | \$37,065    | \$35,026    |
| Net Income                        | \$5,164     | \$7,477     | \$6,001     | \$4,037     | \$3,563     |
| Earnings per common share:        |             |             |             |             |             |
| Basic Earnings per common share   | \$0.51      | \$0.74      | \$0.66      | \$0.46      | \$0.41      |
| Diluted Earnings Per common share | \$0.51      | \$0.74      | \$0.59      | \$0.40      | \$0.35      |

(1) As explained more fully in Note 3, On June 23, 2005 the Company authorized a split of its common shares at a ratio of 1 to 10,153.633 in connection with the Spin-Off of Omega Flex common shares to Mestek Shareholders. All references to shares and per share amounts in these financial statements have been retroactively restated to give effect to the stock split at the above

ratio.

## **Item 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*Certain statements set forth under this caption constitute "forward-looking statements." See "Cautionary Note Regarding Forward-Looking Statements" on page 3 of this annual report for additional factors relating to such statements.*

### **Overview**

As disclosed in Item 1 under the caption "Development of Business", the Company is a former subsidiary of Mestek, Inc. On July 29, 2005, Mestek, Inc. effected a distribution of its 86% ownership of the Company's common stock to the Mestek record shareholders. This distribution was preceded by the filing on July 22, 2005 of a definitive registration statement of the Company's common stock on Form 10 with the Securities and Exchange Commission. The Company's common shares began trading on the NASDAQ Global Market (formerly known as the NASDAQ National Market) under the trading symbol "OFLX" on August 1, 2005. Certain effects of the distribution are reflected in the changes of financial condition of the Company for the year ended December 31, 2005.

The Company is a leading manufacturer of flexible metal hose, and is currently engaged in a number of different markets, including construction, manufacturing, transportation, petrochemical, pharmaceutical and other industries.

The Company's business is controlled as a single operating segment that consists of the manufacture and sale of flexible metal hose and accessories. The Company's products are concentrated in residential and commercial construction, and general industrial markets. The Company's primary product line, TracPipe<sup>®</sup> flexible gas piping, is used for gas piping within residential and commercial buildings. Through its flexibility and ease of use with patented fittings distributed under the trademark AutoFlare<sup>®</sup>, the TracPipe<sup>®</sup> flexible gas piping allows users to substantially cut the time required to install the gas piping, as compared to traditional methods. All of the Company's hose products are manufactured at the Company's Exton, Pennsylvania facility. A majority of the Company's sales across all industries are generated through independent outside sales organizations such as sales representatives, wholesalers and distributors, or a combination of both. The Company has a broad distribution network in North America and to a lesser extent in other global markets.

## **NON-GAAP FINANCIAL MEASURES**

### **RETURN ON AVERAGE NET ASSETS EMPLOYED 2006, 2005, and 2004**

The following analysis of the Company's Results of Operations focuses on the relationship of "Core Operating Profits", a "non-GAAP financial measure", as defined below, to "Average Net Assets Employed", as defined below. Management believes this focus, which is essentially an "enterprise value" point of view, is more useful to investors as it isolates and relates the Company's ongoing pre-tax, pre-interest, operating earnings to the total capital invested, whether debt or equity capital.

The Company's Operating Profits in 2006, 2005 and 2004, as reflected in the



accompanying Consolidated Financial Statements, included Non-Cash Stock Based Compensation Charges of \$0, \$587,000 and \$844,000, respectively, that relate to the “put” rights of two of the Company’s principal executive officers (who are also shareholders of Omega Flex) which potentially obligated the Company to repurchase the officer’s option shares at book value. Effective with the date of Spin-Off, the put rights were cancelled and the balance of the Put Obligation, \$2,743,000, was converted to Paid-in Capital.

The Company’s Operating Profits for 2006, 2005 and 2004 as reflected in the accompanying Consolidated Financial Statements, also included \$10,499,000, \$2,106,000 and \$0, respectively, for legal expenses in connection with the Arkansas litigation matter in which the Company is engaged, as more fully discussed in Note 11 to the Financial Statements.

Core Operating Profits, as the term is used herein, is defined as Operating Profits determined in accordance with GAAP, as reflected in the accompanying Financial Statements, plus the aforementioned Non-Cash Stock Based Compensation Charges and Non-Recurring Legal Expenses.

“Core Operating Profits” as defined above represents a “non-GAAP financial measure” which is reconcilable with the “comparable GAAP financial measure”, Operating Profits, as follows:

|  | <u>2006</u>     | <u>2005</u>     | <u>2004</u>     |
|--|-----------------|-----------------|-----------------|
|  | (in thousands)  |                 |                 |
| Operating Profits (comparable GAAP financial measure)                    | \$7,178         | \$12,066        | \$9,206         |
| Plus: Non-Cash Stock Based Compensation and Non-Recurring Legal Expenses | <u>10,499</u>   | <u>2,693</u>    | <u>844</u>      |
| Core Operating Profits (non-GAAP financial measure)                      | <u>\$17,677</u> | <u>\$14,759</u> | <u>\$10,050</u> |
|  | =====           | =====           | =====           |

The Company’s Return on Average Net Assets Employed, defined as Core Operating Profits, over Average Net Assets Employed From Continuing Operations (Total Assets less Current and Non Current Liabilities-other than Current and Non Current Portions of Long-Term Debt-averaged over 12 months) for the years 2006, 2005, and 2004 was as follows:

|  | <u>2006</u>    | <u>2005</u> | <u>2004</u> |
|--|----------------|-------------|-------------|
|  | (in thousands) |             |             |
| Core Operating Profits (non-GAAP financial measure)    | \$17,677       | \$14,759    | \$10,050    |
| Average Net Assets Employed from Continuing Operations | \$30,183       | \$25,169    | \$15,873    |
| Return on Average Net Assets Employed-Annualized       | 58.6%          | 58.6%       | 63.3%       |
|  | =====          | =====       | =====       |

The slight dip in overall Return on Average Net Assets Employed from 63.3% in 2004 to 58.6% in 2006 is reflected in the following themes:

1. The Company’s Average Net Assets Employed (“ANAE”) increased 90% from 2004 to 2006. The increase in ANAE is principally due to the purchase of the Company’s manufacturing facility in April of 2004, which has a current carrying value of \$4.3 million. In addition, the Company had an increase in working capital driven by the sales increase of 52.5% over the same 3-year period, principally in the TracPipe<sup>®</sup> flexible gas piping product, as more fully described under “Results of Operations.”
2. Core operating profits increased 76% during the 3-year period largely offsetting the

increase in ANAE. This increase to core operating profits was principally derived from our ability to sustain higher levels of growth without adding commensurate continuing resource costs, increased levels of sales, enhanced purchasing efficiencies, and our ability to effectively gain productivity increases at the higher volumes.

3. Our abilities to effectively manage existing costs by gaining higher levels of manufacturing efficiencies, coupled with enhanced purchasing practices, also as more fully described under “Results of Operations” further diminished the effects of the increase in ANAE.

## **CHANGES IN FINANCIAL CONDITION**

On April 27, 2006, the Company paid the remaining outstanding principal balance (and accrued interest) of \$3,348,000 million on the mortgage note that was obtained from Sovereign Bank in 2004. The balance at December 31, 2005 was \$3,411,000.

On September 5, 2006 the Company entered into a Stipulation and Settlement Agreement with the Class Representatives and Class Counsel, to settle and resolve the allegations brought forth in the lawsuit titled *Lovelis, et al. v. Titeflex, Inc., et al.* in the Arkansas Circuit Court, Clark County. The Company estimates that the total amount of the liability relating to the settlement of the litigation will fall within a range of \$8.8 million and \$10.2 million. Accordingly, the Company recorded a pre-tax charge to operations of approximately \$8.8 million in the third quarter of 2006. This amount is based on currently available information and certain estimates and judgments, and is subject to revision as actual claims are received, and a claim history is established. The court gave final approval to the Settlement Agreement on February 1, 2007. Refer to Note 11 for a detailed description of the Settlement.

On December 11, 2006 the Board of Directors authorized a special dividend of \$0.40 per share to all Shareholders of record as of January 2, 2007, and payable as soon as practicable. The payment in the amount of \$4,061,453 was subsequently paid on January 16, 2007.

## **RESULTS OF OPERATIONS**

### **ANALYSIS: 2006 VS. 2005**

The Company reported comparative results from continuing operations for 2006 and 2005 as follows:

|   | <b><u>2006</u></b><br><b><u>(\$000)</u></b> | <b><u>2006</u></b><br><b><u>%</u></b> | <b><u>2005</u></b><br><b><u>(\$000)</u></b> | <b><u>2005</u></b><br><b><u>%</u></b> |
|---|---|---------------------------------------|---|---------------------------------------|
| Net Sales   | \$73,574                                    | 100.0%                                | \$65,638                                    | 100.0%                                |
| Gross Profit  | \$37,892                                    | 51.5%                                 | \$32,701                                    | 49.8%                                 |
| Core Operating Profits (a non-GAAP financial measure) | \$17,677                                    | 24.0%                                 | \$14,759                                    | 22.5%                                 |
| Average Net Assets Employed (ANAE)                    | \$30,183                                    |                                       | \$25,169                                    |                                       |
| Return on ANAE  | 58.6%                                       |                                       | 58.6%                                       |                                       |

The Company’s sales increased \$7,936,000 (12.1%) from \$65,638,000 in 2005 as

compared to \$73,574,000 in 2006 due to continued strong sales of the Company's flagship TracPipe® flexible gas piping product and its patented AutoFlare® connection system. TracPipe® is a corrugated stainless steel tubing product developed especially for use in the piping of fuel gas lines within residential and commercial buildings. Although sales in 2006 to established contractors in the residential construction sector may have been affected by the current weakening of the residential market, overall sales of TracPipe® flexible gas piping were sustained by conversion of competitive products in the Company's largest market (residential construction), and strategic initiatives resulting in accelerating sales in the commercial market. Of the \$7,936,000 increase in sales from 2005 to 2006, approximately two-thirds of such increases were a result of price increases to address rapidly increasing raw material costs with the remainder due to increases in sales volume.

The Company's gross profit margins increased from 49.8% in 2005 to 51.5% in 2006 indicative of management's ability to find manufacturing efficiencies and effectively price our products despite inflationary pressures effecting stainless steel and other commodities.

Selling Expenses. Selling expenses consist primarily of employee salaries and associated overhead costs, commissions, and the cost of marketing programs such as advertising, trade shows and related communication costs. Selling expense was \$11,493,000 and \$10,245,000 for 2006 and 2005, respectively. The \$1,248,000 increase in selling expenses is principally due to increased sales commissions as a result of higher volume. Staffing expenses and sales travel also contributed to the increase. Sales expense as a percentage of sales remained consistent at 15.6% for 2005 and 2006.

General and Administrative Expenses. General and administrative expenses consist primarily of employee salaries, benefits for administrative, executive and finance personnel, legal and accounting, and corporate general and administrative services. General and administrative expenses were \$6,833,000 and \$6,648,000 for 2006 and 2005, respectively, a slight increase of \$185,000. As a percentage of sales, general and administrative expenses decreased from 10.1% for 2005 to 9.3% for 2006.

Engineering Expense. Engineering expenses consist of development expenses associated with the development of new products and enhancements to existing products, and manufacturing engineering costs. Engineering expenses were \$1,889,000 and \$1,637,000 for 2006 and 2005 respectively. As a percentage of sales, engineering expenses were mostly in line at 2.6% in 2006 compared with 2.5% in 2005. The increase in engineering relates mostly to increased staffing expenses.

Legal Settlement and Related Costs. Legal charges related to the Arkansas litigation in 2006 and 2005, were \$10,499,000 and \$2,106,000, respectively. Further details are provided in Note 11, Commitments and Contingencies. We do not expect to incur at any time during the foreseeable future further charges for legal expenses or settlements on the scale recorded in 2006.

Reflecting the factors mentioned above, Operating Profit margins decreased \$4,888,000 from a profit of \$12,066,000 in 2005 to a profit of \$7,178,000 in 2006.

Core Operating Profits (a non-GAAP financial measure), as previously defined, has

increased \$2,918,000, or 19.8% when comparing 2006 operations to 2005. Core Operating Profit is reconcilable with Operating Profit (the most directly comparable GAAP financial measure) as follows:

|  | <u>2006</u>     | <u>2005</u>    |
|--|-----------------|----------------|
|  | (in thousands)  |                |
| Core Operating Profits (a non-GAAP financial measure)              | \$17,677        | \$14,759       |
| Non-Cash Stock Based Compensation and Non-Recurring Legal Expenses | <u>(10,499)</u> | <u>(2,693)</u> |
| Operating Profits (comparable GAAP financial measure)              | \$7,178         | \$12,066       |
|  | =====           | =====          |

Interest Income-Net. Interest income-net includes interest income on the note receivable from Mestek and interest income on our interest-bearing investments.

Other Income-Net. Other Income-net primarily consists of realized foreign currency exchange gains (losses) on Omega Flex Limited payments for accounts payable, interest and management fee to Omega Flex, Inc., its parent corporation.

Income Tax Expense. The Company's effective tax rate reflects the anticipated benefit of future deductions from payments relating to the Arkansas litigation.

#### **ANALYSIS: 2005 VS. 2004**

The Company reported comparative results from continuing operations for 2005 and 2004 as follows:

|   | <u>2005</u> | <u>2005</u> | <u>2004</u> | <u>2004</u> |
|---|-------------|-------------|-------------|-------------|
|   | (\$000)     | %           | (\$000)     | %           |
| Net Sales   | \$65,638    | 100.0%      | \$48,248    | 100.0%      |
| Gross Profit  | \$32,701    | 49.8%       | \$24,851    | 51.5%       |
| Core Operating Profits (a non-GAAP financial measure) | \$14,759    | 22.5%       | \$10,050    | 20.8%       |
| Average Net Assets Employed (ANAE)                    | \$25,169    |             | \$15,873    |             |
| Return on ANAE  | 58.6%       |             | 63.3%       |             |

The Company's net sales for 2005 of \$65,638,000 exceeded 2004 by \$17,390,000, or 36.0% due to strong sales of the Company's flagship TracPipe<sup>®</sup> flexible gas piping product and its patented connection system, which were sustained by continued relatively strong single family and multi-family residential construction activity driven by historically low interest rates. The increase from 2004 to 2005 reflects volume increases of \$11,290,000 and net price increases of \$6,100,000.

The Company's gross profit margins for 2005 of 49.8% were down slightly compared to 51.5% in 2004. The decrease is largely due to heavy inflationary pressures affecting stainless steel and other commodities and was softened by our abilities to stabilize costs for our raw materials in exchange for committed volume purchases, continued manufacturing efficiencies, improved inventory control procedures and our ability to recoup our costs in the market place. Our commitments were not expected to, nor did they, exceed our requirements for the year.

Selling Expenses. Selling expenses consist primarily of employee salaries and associated

overhead costs, the cost of marketing programs such as advertising, trade shows and related communication costs, commissions and freight costs. Sales expense increased \$1,453,000 to \$10,245,000 in 2005 from \$8,792,000 in 2004 reflecting the effect of increased costs due to volume, principally commissions and freight costs, additional sales personnel including employee-related expenses and advertising. As a percentage of revenues, these costs decreased to 15.6% in 2005 from 18.2% in 2004.

General and Administrative Expenses. General and administrative expenses consist primarily of employee salaries and benefits for administrative, executive, and finance and human resources personnel, legal and accounting expenses, and former parent company general and administrative services which terminated with the “Spin-Off”. General and administrative expenses increased \$1,157,000 to \$6,647,000 in 2005 from \$5,490,000 in 2004. The increase reflects the effect of increased insurance costs previously provided by the former parent, which terminated with the “Spin-Off”, management compensation, and computer expenses. As a percentage of revenues, these costs actually decreased to 10.1% in 2005 from 11.4% in 2004.

Engineering Expenses. Engineering expenses include development expenses associated with the development of new products and enhancements to existing products, and manufacturing engineering costs. Engineering expense increased \$274,000 to \$1,637,000 in 2005 from \$1,363,000 in 2004. As a percentage of continuing revenues, these costs were 2.5% in 2005 versus 2.8% in 2004, a 0.3 percentage point decrease. This reflected the effect of improved revenues offset by additional staff and increased spending for new product qualification expenses.

Legal Settlement and Related Costs. Legal charges related to the pending Arkansas litigation in 2005 and 2004, were \$2,106,000 and \$0, respectively. Further details are provided in Note 11, Commitments and Contingencies.

Reflecting the factors mentioned above, Operating Profit margins increased \$2,806,000 to a profit of \$12,066,000 in 2005 from a profit of \$9,206,000 in 2004.

Core Operating Profits (a non-GAAP financial measure), as previously defined, has increased \$4,709,000, or 46.9% when comparing 2005 operations to 2004. Core Operating Profit is reconcilable with Operating Profit (the most directly comparable GAAP financial measure) as follows:

|   | <u>2005</u>    | <u>2004</u>  |
|---|----------------|--------------|
|   | (in thousands) |              |
| Core Operating Profits (a non-GAAP financial measure)             | \$14,759       | \$10,050     |
| Non-Cash Stock Based Compensation and Non-Recurring Legal Charges | <u>(2,693)</u> | <u>(844)</u> |
| Operating Profits (comparable GAAP financial measure)             | \$12,066       | \$9,206      |
|   | =====          | =====        |

Interest Income-Net Interest income-net includes interest income on the note receivable from Mestek, Inc. which bears interest at 5.06% per annum, interest income from the Company’s newly-enacted investment account for the investment of excess cash, and interest expense associated with the commercial bank borrowings in April 2004 related to the purchase of the Company’s manufacturing facility. The mortgage note bears interest at LIBOR plus 1.75%. Interest income was \$333,000 for the year 2005 and \$457,000 for the year 2004. The inter-

company receivable from Mestek, Inc. decreased from \$16,572,000 in 2004 to \$3,250,000 for the year 2005, when it was converted to a formal interest-bearing Note Receivable, as discussed in Note 1 to the Financial Statements. Interest Expense was \$177,000 for 2005 and \$86,000 for 2004.

Income Tax Expense. For the year 2005, the Company's effective income tax rate varied slightly from the statutory rates for both federal and state taxes due primarily to limitations on deductions related to Incentive Stock Options. For the year 2004, the effective tax rate was equal to the statutory rate.

## **COMMITMENTS AND CONTINGENCIES**

### **Commitments:**

On September 5, 2006 the Company entered into a Stipulation and Settlement Agreement with the Class Representatives and Class Counsel, to settle and resolve the allegations brought forth in the lawsuit titled *Lovelis, et al. v. Titeflex, Inc., et al.* in the Arkansas Circuit Court, Clark County. All of the other defendants in the case also signed the Settlement Agreement. The lawsuit relates to allegations that the Company's CSST products posed an unreasonable risk of fire due to lightning strikes. Both the Company and the other defendants deny these allegations, and deny any wrongdoing or legal liability, but have agreed to settle this matter to avoid further cost and the uncertainty and risk of the outcome of further litigation.

The court gave final approval to the Settlement Agreement on February 1, 2007. The remedial program provided under the Settlement Agreement is currently processing claims from class members. The deadline for submitting any claims is September 5, 2007.

Under the Settlement Agreement, the Company has agreed to pay the value of each payment voucher redeemed by a class member for the installation of a lightning protection system or bonding and grounding of the Company's CSST product. The amount of the voucher is dependent on the geographical area in the United States where the building is located and the size of the heated or air-conditioned area of the building, as set forth in the Settlement Agreement. The Company has also agreed to pay a fixed amount of administrative expenses in providing notice to the class, and establishing and operating a claim system under which class members may obtain information, submit claims, and have claims processed. Finally, the Company has agreed to pay attorneys' fees to the Class Counsel to resolve this matter.

The Company cannot determine the exact amount for which it may be liable for the costs of the payment vouchers tendered under the claim program because of the number of unknown variables associated with this liability, including; the number of buildings in the United States that contain the Company's CSST product; the number of payment vouchers that are properly and timely submitted by claimants; the extent to which vouchers are for lightning protection systems or for bonding and grounding; the geographical location of the building within the United States; and the size of the building in which the CSST is located. However, the Company estimates that the total amount of the liability relating to the settlement of the litigation will fall within a range of \$8.8 million and \$10.2 million. Accordingly, the Company recorded a pre-tax charge to operations of approximately \$8.8 million in the third quarter of 2006. This amount is based on currently available information and certain estimates and judgments, and is subject to revision as actual claims are received, and a claim history is established.

The Company is obligated under Indemnity Agreements executed on behalf of 16 of the

Company's officers and directors. Under the terms of the Agreement, the Company is contingently liable for costs which may be incurred by the officers and directors in connection with claims arising by reason of these individuals' roles as officers and directors.

As of December 31, 2005, the Company was a guarantor of the debt of its wholly-owned subsidiary, Exton Ranch, Inc., related to the mortgage note established on April 16, 2004 with Sovereign Bank for the purchase of the Company's main operating facility in Exton, Pennsylvania. However, on April 27, 2006, the Company paid the entire outstanding principal balance (and accrued interest) of the \$3.348 million mortgage note that was obtained from Sovereign Bank in 2004.

The Company has entered into salary continuation agreements with two employees which provide for monthly payments to each of the employee or his designated beneficiary upon the employee's retirement or death. The payment benefits range from \$1,000 per month to \$3,000 per month with the term of such payments limited to 15 years after the employee's retirement at age 65. The agreements also provide for survivorship benefits if the employee dies before attaining age 65; and severance payments if the employee is terminated without cause, the amount of which is dependent on the length of company service at the date of termination. The net present value of the retirement payments is included in Other Long-term Liabilities. The Company has obtained and is the beneficiary of two whole life insurance policies in respect of the two employees, and the cash surrender value of such policies (included in Other Assets) exceeds the net present value of the Company's obligations for the retirement payments at December 31, 2006.

### **Contingencies:**

The Company retains significant obligations under its commercial insurance policies for losses occurring in the policy years in which it was a subsidiary of Mestek, Inc. For the policy year ending October 1, 2004, the Company retained liability for the first \$2,000,000 per occurrence of commercial general liability claims (including product liability claims), subject to an agreed aggregate. For losses occurring in the policy year ended October 31, 2003, the Company retained liability for the first \$500,000 per occurrence of commercial general liability claims (including product liability claims), subject to an agreed aggregate. In addition, for 2004 and 2003 the Company retained liability for the first \$250,000 per occurrence of workers compensation coverage, subject to an agreed aggregate. However, for policy years beginning on July 22, 2005 (the effective date of the Spin-Off), the Company retained liability for the first \$25,000 per occurrence of commercial liability claims (including products liability claims), subject to an agreed aggregate, and the Company is currently insured on a 'first dollar' basis for workers' compensation subject to statutory limits. The Company maintains reserves for its obligations under these various policies based on claim experience and the reserves established by the insurers in relation to these claims. The reserve balances at December 31, 2006 and December 31, 2005 were not material in amount.

Prior to the Spin-Off, the Company self-insured a substantial portion of the health benefits provided for its employees and maintained reserves in this regard and relied upon a recognized actuarial consulting firm to help it set and maintain these reserves. After the Spin-Off, the Company's liability is limited to \$30,000 per case and an aggregate of \$600,000 annually.

The Company was obligated as a guarantor with respect to the debt of Mestek, Inc. under Mestek's primary commercial bank line of credit. As of the effective date of the Spin-Off (as disclosed in Note 3), the guaranty was cancelled and is no longer in effect.

The Company has disclosed the estimated contingency related to the Settlement Agreement reached on February 1, 2007 in the "Commitments" caption above.

### **Warranty Commitments:**

Gas transmission products such as those made by the Company carry potentially serious personal injury risks in the event of failures in the field. As a result, the Company has extensive internal testing and other quality control procedures and historically the Company has not had a meaningful failure rate in the field due to the extensive nature of these quality controls. Due to the Company's quality systems, the warranty expense is *de minimis*, and accordingly, the Company does not maintain a warranty reserve beyond a nominal amount.

### **FUTURE IMPACT OF KNOWN TRENDS OR UNCERTAINTIES**

The Company's operations are sensitive to a number of market factors, any one of which could materially adversely affect its results of operations in any given year:

Construction Activity—The Company is directly impacted by the level of single family and multi-family residential housing starts and, to a lesser extent, commercial construction starts. Historically low interest rates had contributed to strong residential construction activity in recent years. Significant increases in interest rates or reductions in residential construction activity for other reasons in future periods, however, could be expected to adversely affect the Company's revenues, possibly materially.

Technological Changes—Although the HVAC industry has historically been impacted by technology changes in a relatively incremental manner, it cannot be discounted that radical changes—such as might be suggested by fuel cell technology, burner technology and/or other developing technologies which might impact the use of natural gas—could materially adversely affect the Company's results of operations and/or financial position in the future.

Weather Conditions—The Company's flagship TracPipe® product is used in residential and commercial heating applications. As such, the demand for its products is impacted by weather as it affects the level of construction. Furthermore, severe climatic changes, such as those suggested by the "global warming" phenomenon, could over time adversely affect the demand for heating products and adversely affect the Company's results of operations and financial position.

Purchasing Practices—It has been the Company's policy in recent years to aggregate purchase volumes for high value commodities with fewer vendors to achieve maximum cost reductions while maintaining quality and service. This policy has been effective in reducing costs but has introduced additional risk which could potentially result in short-term supply disruptions or cost increases from time to time in the future.

Supply Disruptions and Commodity Risks—The Company uses a variety of materials in



the manufacture of its products, including stainless steel, polyethylene and brass for its AutoFlare<sup>®</sup> connectors. In connection with the purchase of commodities, principally stainless steel for manufacturing requirements, the Company typically enters into one year purchase commitments which include a designated fixed price range. These agreements require the Company to accept delivery of the commodity in the quantities committed, at the agreed upon prices. Transactions required for these commodities in excess of the one year commitments are conducted at current market prices at the Company's discretion. In addition to the raw material cost strategy described above, the Company enters into fixed pricing agreements for the fabrication charges necessary to convert these commodities into useable product. Management believes at present that it has adequate sources of supply for its raw materials and components (subject to the risks described above under Purchasing Practices) and has historically not had significant difficulty in obtaining the raw materials, component parts or finished goods from its suppliers. The Company is not dependent for any commodity on a single supplier, the loss of which would have a material adverse effect on its business.

Interest Rate Sensitivity—The Company currently has no borrowing with any lending institutions and therefore has very little risk related to interest rate volatility. Interest rates are nonetheless significant to the Company as a participant in the residential construction industry. (See Construction Activity, above.)

Retention of Qualified Personnel – The Company does not operate with multiple levels of management. It is relatively “flat” organizationally, which does subject the Company to the risks associated with the loss of critical managers for whatever reason. From time to time, there may be a shortage of skilled labor, which may make it more difficult and expensive for the Company to attract and retain qualified employees. The Company is dependent upon the relatively unique talents and managerial skills of a small number of key executives.

## **CRITICAL ACCOUNTING POLICIES AND USE OF ESTIMATES**

Financial Reporting Release No. 60, released by the Securities and Exchange Commission, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 2 of the Notes to the Consolidated Financial Statements include a summary of the significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. The following is a brief discussion of the Company's more significant accounting policies.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition, accounts receivable valuations, inventory valuations, goodwill and intangible asset valuations, product liability costs, workers compensation claims reserves, health care claims reserves, and accounting for income taxes. Actual amounts could differ significantly from these estimates.

Our critical accounting policies and significant estimates and assumptions are described in more detail as follows:

### **Revenue Recognition**

The Company's revenue recognition activities relate almost entirely to the manufacture and sale of its flexible metal hose and related products. Under generally accepted accounting principles, revenues are considered to have been earned when the Company has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. With respect to sales of the Company's products, the following criteria represent preconditions to the recognition of revenue:

- \* persuasive evidence of an arrangement must exist;
- \* delivery has occurred or services rendered;
- \* the sales price to the customer is fixed or determinable; and
- \* collection is reasonably assured.

### **Accounts Receivable**

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance for uncollectible amounts is based primarily on specific analysis of accounts in the receivable portfolio and historical write-off experience. While management believes the allowance to be adequate, if the financial condition of the Company's customers were to deteriorate, resulting in impairment of their ability to make payments, additional allowances may be required.

### **Inventory**

The Company values its inventory at the lower of cost to purchase and/or manufacture the inventory, determined on the first-in, first-out ("FIFO") method, or the current estimated market value of the inventory. The Company periodically reviews inventory quantities on hand and records a provision for excess and/or obsolete inventory based primarily on its historical usage, as well as estimated forecast of product demand. A significant decrease in demand for the Company's products or technological changes in the industries in which the Company operates could result in an increase of excess or obsolete inventory quantities on hand, requiring adjustments to the value of the Company's inventories.

### **Goodwill and Intangible Assets**

In accordance with FAS 142, the Company ceased recording amortization of goodwill and intangible assets with indefinite lives effective January 1, 2002. The Company performed annual valuation exercises in accordance with FAS 142 as of December 31, 2005 and December 31, 2006 which analyses indicated in all cases no impairment of goodwill.

### **Product Liability Reserves**

As explained more fully under Contingencies, the Company retains liability for the first \$25,000 of product liability claims. To date, the Company has not experienced a meaningful product failure rate.

### **Workers Compensation Claims Reserves**

Prior to the Spin-Off, the Company provided workers compensation coverage principally through commercial insurance carriers using “high deductible” programs, which required the Company to reserve for and pay a high proportion of its workers compensation claims payable and relied upon the expertise of its insurance carriers and its own historical experience in setting the reserves related to these claims. Two such workers compensation claims are still outstanding from the pre-Spin-Off period for which the company remains liable for amounts up to the deductible. The Company maintains a reserve for these amounts. In all two cases the remaining potential liability is minimal, as these cases are reaching the maximum deductible.

After the Spin-Off, the Company is insured on a ‘first dollar’ basis.

### **Health Care Claim Reserves**

Prior to the Spin-Off, the Company self-insured a substantial portion of the health benefits provided for its employees and maintained reserves in this regard and relied upon a recognized actuarial consulting firm to help it set and maintain these reserves. After the Spin-Off, the Company’s liability is limited to \$30,000 per case and an aggregate of \$600,000 annually.

### **Accounting for Income Taxes**

Up to the date of the Spin-Off, the Company elected to file its federal income tax return as part of the Mestek, Inc. parent company, consolidated return. Mestek and Omega accounted for Omega’s federal tax liabilities on the “separate company basis” method in accordance with FAS 109, Accounting for Income Taxes. Under this method Omega recorded tax expense and related deferred taxes and tax benefits in a manner comparable to that which it would record if it were not affiliated with Mestek.

The Company filed a separate Federal income tax return for the five months of 2005 in which it was a separate and public company and expects to file a separate Federal income tax return for 2006 in its entirety.

By agreement, the Company will be responsible for and hold Mestek harmless from, any liability for its income taxes for all taxable periods, whether before or after the Spin-Off.

The preparation of the Company’s Consolidated Financial Statements requires it to estimate its income taxes in each of the jurisdictions in which it operates, including those outside the United States which may be subject to certain risks that ordinarily would not be expected in the United States. The income tax accounting process involves estimating its actual current exposure together with assessing temporary differences resulting from differing treatment of items such as depreciation, stock based compensation, and legal settlements for tax and accounting purposes. These differences result in the recognition of deferred tax assets and liabilities. The Company must then record a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. Significant management judgment is required in determining the Company’s provision for income taxes, its deferred tax assets and liabilities and any valuation allowance recorded against deferred tax assets. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, it could materially impact its financial position and results of operations.

## **Related Party Service Fees**

The Company historically paid fees to Mestek, its 86% shareholder prior to the Spin-Off, for various services including legal, treasury, tax, employee benefits, insurance, executive oversight and other services. The Company's historical financial statements reflect these fees which have approximated 1% of net sales in recent years. The fees charged represented estimates of the value of the services provided. After the Spin-Off, the Company now manages these costs independently. Going forward, the cost to procure these services on a stand-alone basis may differ materially from the fee charged by Mestek.

## **IMPACT OF INFLATION**

Stainless steel and other related commodities represent a significant portion of the Company's prime costs. As such, the Company's margins are vulnerable to inflationary pressures which affect the commodity markets from time to time. Margins were not significantly impacted by such commodity cost increases in 2006 due to the timely implementation of price increases to our customers and to effective purchasing strategies, as explained above. If the rate of inflation continues to climb in 2007, with concurrent interest rate increases, the Company expects that the construction markets and the commodity markets in which it operates could be adversely impacted, thus potentially impacting the Company's results of operations.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Twelve Months ended December 31, 2006**

As of December 31, 2006, we had \$17.4 million in consolidated cash, cash equivalents and short-term investments, which is \$7.5 million more than at December 31, 2005, which was \$9.9 million. As described in Note 3 to the Consolidated Financial Statements, prior to the Spin-Off, the Company relied on its parent, Mestek for its working capital purposes and therefore kept minimal balances on hand.

### **Operating Activities**

Cash provided by operations for 2006 was \$11.8 million compared with \$10.7 million provided in 2005.

### **Investing Activities**

Capital spending for 2006 was \$1.4 million compared to 2005 which was \$0.7 million. Capital expenditures in 2006 were mostly associated with the installation of equipment in our United Kingdom facility. In 2005, capital expenditures were related to the acquisition and improvement of additional manufacturing space at the Exton facility, and manufacturing equipment.

### **Financing**

Cash used in financing activities amounted to \$3.4 million versus \$0.2 million used in 2005.

On April 27, 2006, the Company's subsidiary Exton Ranch, Inc. paid the entire

outstanding principal balance (and accrued interest) of the \$3.348 million Mortgage Note that was obtained from Sovereign Bank in 2004 to purchase the Company's main facility in Exton, Pennsylvania.

As of December 31, 2006 the Company has accumulated approximately \$17,424,000 in cash and cash equivalents which are invested in short-term investment facilities. The Company believes its liquidity position as of December 31, 2006 is fully adequate to meet foreseeable future needs and that the Company will possess adequate cash reserves to meet its day-to-day needs including any acquisitions or capital expenditures it can reasonably foresee at this time.

The Company currently has no commercial bank line of credit for working capital purposes; however, the Company believes it would be able to obtain sufficient lines of credit at reasonable interest rates if it elects to do so.

Significant cash outlays during the first quarter of 2007 include the payment of the special dividend of \$4.061 million addressed in detail in Note 7, and payment related to the legal settlement discussed in Note 11 of \$6.000 million.

Prior to the Spin-Off, the Company was obligated as a guarantor with respect to the debt of Mestek, Inc., its previous parent (as described in Note 11) under its primary commercial bank line of credit. As of the effective date of the distribution of the Company's common stock by Mestek, Inc. to its shareholders, the guaranty was cancelled and is no longer in effect.

#### **RECENT ACCOUNTING PRONOUNCEMENTS**

In September 2006, the SEC issued Staff Accounting Bulletin 108 ("SAB 108"), which expresses the Staff's views regarding the process of quantifying financial statement misstatements. The bulletin was effective at fiscal year end 2006. The implementation of this bulletin had no impact on the Company's results of operations, cash flows or financial position.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 will be applied prospectively and will be effective for periods beginning after November 15, 2007. The Company is currently evaluating the effect, if any, of SFAS 157 on the Company's consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* ("FIN 48"). IN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on recognition, classification, treatment of interest and penalties, and disclosure of such positions. FIN 48 will be applied prospectively and will be effective for fiscal years beginning after December 31, 2006. The Company will adopt the provisions of FIN 48 in the first quarter of 2007 as required. The adoption of FIN 48 is not expected to have a material effect on the Company's consolidated financial statements.

#### **TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS AND OFF-BALANCE**

## **SHEET ARRANGEMENTS**

### **Contractual Obligation and Commercial Commitments**

The Company's primary contractual obligations as of December 31, 2006 are summarized in the following table and are more fully explained in Notes to the Consolidated Financial Statements.

| <b>Contractual Obligations</b>     | <b>Payments Due by Period</b> |                         |                     |                     |                       |
|------------------------------------|-------------------------------|-------------------------|---------------------|---------------------|-----------------------|
|                                    | <b>(in thousands)</b>         |                         |                     |                     |                       |
|                                    | <b><u>Total</u></b>           | <b><u>Less than</u></b> | <b><u>1 -3</u></b>  | <b><u>4 -5</u></b>  | <b><u>After 5</u></b> |
|                                    |                               | <b><u>1-year</u></b>    | <b><u>years</u></b> | <b><u>years</u></b> | <b><u>year</u></b>    |
| Short Term Debt                    | \$0                           | \$0                     | \$0                 | \$0                 | \$0                   |
| Long-Term Debt                     | 0                             | 0                       | 0                   | 0                   | 0                     |
| Operating Lease Obligations        | 2,377                         | 430                     | 847                 | 882                 | 218                   |
| Purchase Obligations               | 24,737                        | 24,737                  | 0                   | 0                   | 0                     |
| Other Long-Term Liabilities        | <u>720</u>                    | <u>12</u>               | <u>24</u>           | <u>24</u>           | <u>660</u>            |
| Total Contractual Cash Obligations | <u>\$27,834</u>               | <u>\$25,179</u>         | <u>\$871</u>        | <u>\$906</u>        | <u>\$878</u>          |
|                                    | =====                         | =====                   | =====               | =====               | =====                 |

### **Off-Balance Sheet Obligations or Arrangements**

The Company is not a party to any off-balance sheet obligations or arrangements.

## **Item 7A - QUANTITATIVE AND QUALITATIVE MARKET RISKS**

The Company does not engage in the purchase or trading of market risk sensitive instruments. The Company does not presently have any positions with respect to hedge transactions such as forward contracts relating to currency fluctuations. No market risk sensitive instruments are held for speculative or trading purposes.

## **Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

### **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Omega Flex, Inc.

We have audited the consolidated balance sheets of Omega Flex, Inc. and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

/s/ Vitale Caturano & Company, Ltd.

Boston, Massachusetts  
March 28, 2007

**OMEGA FLEX, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**As of December 31,**  
**(Dollars in thousands)**

|  | <u>2006</u>     | <u>2005</u>     |
|--|-----------------|-----------------|
| <b>ASSETS</b>  |                 |                 |
| <b>Current Assets</b>  |                 |                 |
| Cash and Cash Equivalents  | \$17,424        | \$9,882         |
| Accounts Receivable - less allowances of \$79 and \$33,<br>respectively  | 9,745           | 11,938          |
| Inventories  | 8,149           | 6,228           |
| Deferred Taxes   | 2,847           | 252             |
| Other Current Assets   | <u>529</u>      | <u>457</u>      |
| Total Current Assets   | 38,694          | 28,757          |
| Property and Equipment – net   | 6,705           | 5,749           |
| Goodwill - net   | 3,526           | 3,526           |
| Note Receivable from former Parent Company   | 3,250           | 3,250           |
| Other Long Term Assets   | <u>448</u>      | <u>432</u>      |
| Total Assets   | <u>\$52,623</u> | <u>\$41,714</u> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                 |                 |
| <b>Current Liabilities:</b>  |                 |                 |
| Current Portion of Long-Term Debt  | \$---           | \$186           |
| Accounts Payable   | 1,236           | 1,554           |
| Accrued Compensation   | 2,362           | 2,631           |
| Accrued Commissions and Sales Incentives   | 4,859           | 5,937           |
| Accrued Legal Settlement and Related Costs   | 6,456           | 85              |
| Dividends Payable  | 4,061           | ---             |
| Taxes Payable  | 1,967           | 376             |
| Other Accrued Liabilities  | <u>1,517</u>    | <u>863</u>      |
| Total Current Liabilities  | 22,458          | 11,632          |
| Long-Term Debt   | ---             | 3,225           |
| Deferred Taxes   | 146             | 639             |
| Long-Term portion of Accrued Legal Settlement  | 2,000           | ---             |
| Other Liabilities  | <u>318</u>      | <u>209</u>      |
| Total Liabilities  | <u>24,922</u>   | <u>15,705</u>   |
| Minority Interests   | <u>55</u>       | <u>23</u>       |
| <b>Shareholders' Equity:</b>   |                 |                 |
| Common Stock – par value \$0.01 share: authorized 20,000,000 –<br>shares: 10,153,633 shares issued and outstanding | 102             | 102             |
| Paid in Capital  | 11,739          | 11,739          |
| Retained Earnings  | 14,976          | 13,873          |
| Accumulated Other Comprehensive Income (Loss)  | <u>829</u>      | <u>272</u>      |
| Total Shareholders' Equity   | <u>27,646</u>   | <u>25,986</u>   |
| Total Liabilities and Shareholders' Equity   | <u>\$52,623</u> | <u>\$41,714</u> |

See Accompanying Notes to Consolidated Financial Statements.



**OMEGA FLEX, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**For the years ended December 31,**

|   | <u>2006</u>  | <u>2005</u>    | <u>2004</u>    |
|---|--|----------------|----------------|
|   | (Amounts in thousands, except earnings per Common) |                |                |
| Net Sales                                   | \$73,574   | \$65,638       | \$48,248       |
| Cost of Goods Sold                          | <u>35,682</u>                                      | <u>32,937</u>  | <u>23,397</u>  |
| Gross Profit                                | 37,892   | 32,701         | 24,851         |
| Selling Expense                             | 11,493   | 10,245         | 8,792          |
| General and Administrative Expense          | 6,833  | 6,647          | 5,490          |
| Engineering Expense                         | 1,889  | 1,637          | 1,363          |
| Legal Settlement and Related Costs          | <u>10,499</u>                                      | <u>2,106</u>   | <u>---</u>     |
| Operating Profit                            | 7,178  | 12,066         | 9,206          |
| Interest Income, Net                        | 562  | 157            | 371            |
| Other Income, Net                           | <u>486</u>   | <u>198</u>     | <u>134</u>     |
| Income Before Income Taxes                  | 8,226  | 12,421         | 9,711          |
| Income Tax Expense                          | <u>3,062</u>                                       | <u>4,944</u>   | <u>3,710</u>   |
| Net Income                                  | <u>\$5,164</u>                                     | <u>\$7,477</u> | <u>\$6,001</u> |
| Basic Earnings per Common Share             | <u>\$0.51</u>                                      | <u>\$0.74</u>  | <u>\$0.66</u>  |
| Basic Weighted Average Shares Outstanding   | <u>10,154</u>                                      | <u>10,154</u>  | <u>9,034</u>   |
| Diluted Earnings per Common Share           | <u>\$0.51</u>                                      | <u>\$0.74</u>  | <u>\$0.59</u>  |
| Diluted Weighted Average Shares Outstanding | <u>10,154</u>                                      | <u>10,154</u>  | <u>10,154</u>  |

See Accompanying Notes to Consolidated Financial Statements.

**OMEGA FLEX, INC.**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)  
For the years ended December 31, 2006, 2005, and 2004**

| <b>(Dollars in Thousands)</b>               | <b>Common<br/>Stock<br/>Outstanding</b> | <b>Common<br/>Stock</b> | <b>Paid In<br/>Capital</b> | <b>Retained<br/>Earnings</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income (Loss)</b> | <b>Total</b>    |
|---|---|-------------------------|----------------------------|------------------------------|--|-----------------|
| Balance - December 31, 2003                 | 8,732,125                               | \$88                    | \$9,010                    | \$16,176                     | \$345  | \$25,619        |
| Net Income                                  |   |                         |                            | 6,001                        |  | 6,001           |
| Cumulative Translation Adjustment           |   |                         |                            |                              | 116  | <u>116</u>      |
| Net Comprehensive Income                    |   |                         |                            |                              |  | 6,117           |
| Common Shares issued (Note 13)              | 1,421,508                               | 14                      | (14)                       |                              |  |                 |
| Dividends Paid                              |   |                         |                            | (7,740)                      |  | (7,740)         |
| Balance - December 31, 2004                 | <u>10,153,633</u>                       | <u>\$102</u>            | <u>\$8,996</u>             | <u>\$14,437</u>              | <u>\$461</u>   | <u>\$23,996</u> |
| Net Income                                  |   |                         |                            | 7,477                        |  | 7,477           |
| Cumulative Translation Adjustment           |   |                         |                            |                              | (189)  | <u>(189)</u>    |
| Net Comprehensive Income                    |   |                         |                            |                              |  | 7,288           |
| Reclass Put Liability to Paid in<br>Capital |   |                         | 2,743                      |                              |  | 2,743           |
| Dividends Paid                              |   |                         |                            | (8,041)                      |  | (8,041)         |
| Balance -December 31, 2005                  | <u>10,153,633</u>                       | <u>\$102</u>            | <u>\$11,739</u>            | <u>\$13,873</u>              | <u>\$272</u>   | <u>\$25,986</u> |
| Net Income                                  |   |                         |                            | 5,164                        |  | 5,164           |
| Cumulative Translation Adjustment           |   |                         |                            |                              | 557  | <u>557</u>      |
| Net Comprehensive Income                    |   |                         |                            |                              |  | 5,721           |
| Dividends Accrued                           |   |                         |                            | (4,061)                      |  | (4,061)         |
| Balance -December 31, 2006                  | <u>10,153,633</u>                       | <u>\$102</u>            | <u>\$11,739</u>            | <u>\$14,976</u>              | <u>\$829</u>   | <u>\$27,646</u> |
|   | =====                                   | ===                     | =====                      | =====                        | ===  | =====           |

See Accompanying Notes to Consolidated Financial Statements

**OMEGA FLEX, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**For the years ended December 31,**

|  | <u>2006</u>            | <u>2005</u>     | <u>2004</u>    |
|--|------------------------|-----------------|----------------|
|  | (Dollars in thousands) |                 |                |
| Cash Flows from Operating Activities:  |                        |                 |                |
| Net Income   | \$5,164                | \$7,477         | \$6,001        |
| Adjustments to Reconcile Net Income to<br>Net Cash Provided by Operating Activities: |                        |                 |                |
| Depreciation and Amortization  | 417                    | 665             | 665            |
| Non-Cash Compensation Expense  | ---                    | 587             | 844            |
| Provision for Losses on Accounts<br>Receivable, net of write-offs and recoveries     | 46                     | 4               | ---            |
| Change in Minority Interests   | 32                     | 19              | (4)            |
| Changes in Assets and Liabilities:   |                        |                 |                |
| Accounts Receivable  | 2,147                  | (3,162)         | (3,435)        |
| Inventory  | (1,921)                | (796)           | (531)          |
| Accounts Payable   | (318)                  | (293)           | 695            |
| Accrued Compensation   | (269)                  | 695             | 534            |
| Receivable from Former Parent Company  | ---                    | 5,281           | (10,253)       |
| Accrued Legal Settlement & Related Costs   | 8,371                  | 85              | ---            |
| Other Liabilities  | 783                    | 1,038           | 2,288          |
| Other Assets   | <u>(2,683)</u>         | <u>(906)</u>    | <u>(234)</u>   |
| Net Cash Provided by (Used In) Operating Activities                                  | <u>11,769</u>          | <u>10,694</u>   | <u>(3,430)</u> |
| Cash Flows from Investing Activities:  |                        |                 |                |
| Capital Expenditures   | <u>(1,373)</u>         | <u>(717)</u>    | <u>(267)</u>   |
| Net Cash Used In Investing Activities  | <u>(1,373)</u>         | <u>(717)</u>    | <u>(267)</u>   |
| Cash Flows from Financing Activities:  |                        |                 |                |
| Principal Payments Under Long Term Debt Obligations                                  | (3,411)                | (186)           | (123)          |
| Proceeds from Issuance of Long Term Debt   | ---                    | ---             | 3,720          |
| Net Cash Provided by (Used In) Financing Activities                                  | <u>(3,411)</u>         | <u>(186)</u>    | <u>3,597</u>   |
| Net Increase (Decrease) in Cash and Cash Equivalents                                 | 6,985                  | 9,791           | (100)          |
| Translation effect on cash   | 557                    | (189)           | 116            |
| Cash and Cash Equivalents - Beginning of Period                                      | <u>9,882</u>           | <u>280</u>      | <u>264</u>     |
| Cash and Cash Equivalents - End of Period  | <u>\$17,424</u>        | <u>\$9,882</u>  | <u>\$280</u>   |
| Schedule of Non-cash Financing Activities  |                        |                 |                |
| Dividend To Mestek treated as reduction of receivable                                | \$---                  | \$8,041         | \$7,740        |
| Reclass of Put Obligation to Equity  | ---                    | 2,743           | ---            |
| Accrual of Dividend  | 4,061                  | ---             | ---            |
|  | <u>\$4,061</u>         | <u>\$10,784</u> | <u>\$7,740</u> |

See Accompanying Notes to Consolidated Financial Statements.

**OMEGA FLEX, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION AND CONSOLIDATION**

**Description of Business**

The accompanying consolidated financial statements include the accounts of Omega Flex, Inc. (Omega) and its subsidiaries (collectively the “Company”). The Company’s audited consolidated financial statements for the year ended December 31, 2006 have been prepared in accordance with generally accepted accounting principles, and with the instructions of Form 10-K and Article 10 of Regulation S-X. Operations at Omegaflex Limited, our United Kingdom subsidiary, are consolidated on a one month lag. All material inter-company accounts and transactions have been eliminated in consolidation.

The Company is a leading manufacturer of flexible metal hose, which is used in a variety of applications to carry gases and liquids within their particular applications. These applications include carrying liquefied gases in certain processing applications, fuel gases within residential and commercial buildings and vibration absorbers in high vibration applications. Our industrial flexible metal piping is used to carry other types of gases and fluids in a number of industrial applications where the customer requires the piping to have both a degree of flexibility and/or an ability to carry corrosive compounds or mixtures, or to carry at both very high and very low (cryogenic) temperatures.

The Company manufactures flexible metal hose at its facility in Exton, Pennsylvania, and sells its product through distributors, wholesalers and to original equipment manufacturers (“OEMs”) throughout North America, and in certain European markets.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition, accounts receivable valuations, inventory valuations, goodwill and intangible asset valuations, and accounting for income taxes. Actual amounts could differ significantly from these estimates.

**Revenue Recognition**

The Company’s revenue recognition activities relate almost entirely to the manufacture and sale of flexible metal hose and pipe. Under generally accepted accounting principles, revenues are considered to have been earned when the Company has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. The following criteria represent preconditions to the recognition of revenue:

- Persuasive evidence of an arrangement for the sale of product or services must exist.

- Delivery has occurred or services rendered.
- The sales price to the customer is fixed or determinable.
- Collection is reasonably assured.

The Company generally recognizes revenue upon shipment in accordance with the above principles.

### **Cash Equivalents**

The Company considers all highly liquid investments with an original maturity of 90 days or less at the time of purchase to be cash equivalents. Cash equivalents include investments in an institutional money market fund, which invests in U.S. Treasury bills, notes and bonds, and/or repurchase agreements, backed by such obligations. Cash and cash equivalents are deposited at various area banks, which at times may exceed federally insured limits. The Company has not experienced any losses related to these balances, and management believes its credit risk to be minimal.

### **Inventories**

Inventories are valued at the lower of cost or market. Cost of inventories are determined by the first-in, first-out (FIFO) method. The Company considers inventory quantities beyond two-years' usage, measured on a historical usage basis, to be excess inventory and reduces the gross carrying value of inventory accordingly.

### **Property and Equipment**

Property and equipment are carried at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets or, for leasehold improvements, the life of the lease, if shorter. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in income for the period. The cost of maintenance and repairs is charged to income as incurred; significant improvements are capitalized.

### **Excess of Cost Over Net Assets of Acquired Companies (Goodwill)**

In accordance with FAS 142, the Company ceased recording amortization of goodwill and intangible assets with indefinite lives effective January 1, 2002. The Company performed annual valuation exercises in accordance with FAS 142 as of December 31, 2005 and December 31, 2006 which analyses indicated in all cases no impairment of goodwill.

### **Advertising Expense**

Advertising costs are charged to operations as incurred. Such charges aggregated \$464,000, \$403,000, and \$493,000, for the years ended December 31, 2006, 2005, and 2004, respectively.

### **Research and Development Expense**

Research and development expenses are charged to operations as incurred. Such charges aggregated \$703,000, \$554,000, and \$505,000, for the years ended December 31, 2006, 2005, and 2004, respectively and are included in Engineering expense in the accompanying financial statements.

### **Shipping Costs**

Shipping costs are included in selling expense on the Statement of Operations. The expense relating to shipping was \$2,066,000 in 2006, \$1,832,000 in 2005 and \$1,368,000 in 2004.

### **Provision for Doubtful Accounts**

The allowance for doubtful accounts reflects our best estimate of probable losses inherent in the accounts receivable balance. The Company determines the allowance based on any known collection issues, historical experience, and other currently available evidence. Due to a viable customer base and strong credit policies the Company had recognized only nominal expenses with regard to uncollectible accounts for the years ended December 31, 2006, 2005 and 2004. In regards to identifying uncollectible accounts, the Company reviews an Aging report on a consistent basis to determine past due accounts and charges off those accounts that are deemed uncollectible once all collection efforts have been exhausted.

### **Earnings per Common Share**

Basic earnings per share have been computed using the weighted average number of common shares outstanding. Basic and diluted weighted average shares outstanding have been adjusted for all periods to give retroactive effect to the stock split which was completed on June 23, 2005, as more fully described in Note 3.

### **Stock Based Compensation**

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123 (Revised 2004), *Share-Based Payment*, (“SFAS 123R”), using the statement’s modified prospective application method. Prior to January 1, 2006, the Company followed SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by SFAS No. 148, *Accounting for Stock based Compensation Transition and Disclosure, an amendment to FASB Statement No. 123*, which required entities to recognize as expense over the vesting period the fair value of stock-based awards on the date of grant or measurement date.

On November 10, 2005, the Financial Accounting Standards Board (“FASB”) issued FASB Staff Position SFAS 123R-3 “Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards”. The Company has elected to adopt the alternative transition method provided the FASB Staff Position for calculating the tax effects (if any) of stock-based compensation expense pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee stock-based compensation, and to determine the subsequent impact to the additional paid-in capital pool and the consolidated statements of operations and cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R.

Under the provisions of SFAS 123R, the Company recognizes the estimated fair value of stock based compensation in the consolidated statement of operations over the requisite service period of each option granted. Under the modified prospective application method of SFAS 123R, the Company applies the provisions of SFAS 123R to all awards granted or modified after January 1, 2006, as well as any unvested awards outstanding on January 1, 2006. The Company had no stock options outstanding at December 31, 2005 and made no option grants in the year ended December 31, 2006 and 2005.

During 2006, the Company established the Omega Flex, Inc. 2006 Phantom Stock Plan as described in detail in Note 13 under the caption "Stock Based Plans". In accordance with SFAS 123R, the Company recorded compensation expense of approximately \$1,000 in 2006 related to the Phantom Stock Plan.

### **Currency Translation**

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at exchange rates prevailing on the balance sheet date. The Statement of Operations is translated at average exchange rates. Net foreign currency transactions are reported in the results of operations in U.S. dollars at average exchange rates. Adjustments resulting from the translation of financial statements are excluded from the determination of income and are accumulated in a separate component of shareholders' equity.

### **Income Taxes**

The Company elected in prior years and up to the date of the Spin-Off as described in Note 3 below to file its federal income tax return as part of the Mestek, Inc. consolidated return. Mestek and the Company account for the Company's federal tax liabilities on the "separate company basis" method in accordance with SFAS No. 109, "Accounting for Income Taxes". Under this method the Company recorded tax expense and related deferred taxes and tax benefits in a manner comparable to that which it would have recorded if it were not affiliated with Mestek.

The Company filed a separate Federal income tax return for the five months of 2005 in which it was a separate company, and expects to file a separate Federal income tax return for 2006 in its entirety.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities from a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is provided for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize the benefit, or that future deductibility is uncertain.

### **Other Comprehensive (Loss) Income**

For the years ended December 31, 2006, 2005, and 2004, respectively, the components of Other Comprehensive (Loss) Income consisted solely of foreign currency translation adjustments.

### **Significant Customer**

One customer accounted for approximately 18% of Sales in 2006 and 14% of Accounts Receivable at December 31, 2006. One customer represented 16% and 14% of Sales in 2005 and 2004, respectively, and 16% of Accounts Receivable at December 31, 2005.

### **New Accounting Pronouncements**

In September 2006, the SEC issued Staff Accounting Bulletin 108 ("SAB 108"), which expresses the Staff's views regarding the process of quantifying financial statement misstatements. The bulletin was effective at fiscal year end 2006. The implementation of this bulletin had no impact on the Company's results of operations, cash flows or financial position.

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 will be applied prospectively and will be effective for periods beginning after November 15, 2007. The Company is currently evaluating the effect, if any, of SFAS 157 on the Company's consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on recognition, classification, treatment of interest and penalties, and disclosure of such positions. FIN 48 will be applied prospectively and will be effective for fiscal years beginning after December 31, 2006. The Company will adopt the provisions of FIN 48 in the first quarter of 2007 as required. The adoption of FIN 48 is not expected to have a material effect on the Company's consolidated financial statements.

### **3. DISTRIBUTION FROM MESTEK, INC. (Spin-Off)**

On January 19, 2005, Mestek, Inc. (Mestek) and the Company announced that Mestek intended to distribute its 86% equity interest in the Company in a Spin-Off, *pro rata*, to all of Mestek's public shareholders as of a record date, which was subsequently established at June 23, 2005 (the "Spin-Off"). The Spin-Off was preceded by an amendment on April 19, 2005 to the Company's articles of incorporation to authorize a maximum of 20 million shares of common stock. The board of directors declared a share split on the Company's common stock on June 23, 2005 that resulted in a share split of 1 to 10,153.633 in order to effect a 1 for 1 share distribution under the Spin-Off. All references to shares and per share amounts in these Financial Statements have been retroactively restated to give effect to the stock split at the 1 to 10,153.633 ratio. In conjunction with the Spin-Off, the Company filed several preliminary registration statements on Form 10 with the Securities and Exchange Commission under the Securities Exchange Act of 1934. On July 22, 2005, the Company filed its definitive registration statement on Form 10 with the Securities and Exchange Commission and completed the Spin-Off on July 29, 2005. The Company's common shares began trading on the NASDAQ Global Market under the trading symbol "OFLX" on August 1, 2005.

In connection with the Spin-Off, the Company executed certain agreements governing its relationship with Mestek subsequent to the date of the Spin-Off. These include:



- A Separation and Distribution Agreement which relates to the events surrounding the distribution of Omega common shares to Mestek shareholders and certain aspects of the relationship between the companies thereafter.
- A Tax Responsibility Allocation Agreement which relates to the allocation of tax liabilities between Mestek and the Company subsequent to the Spin-Off.
- An Indemnification and Insurance Matters Agreement which provides for mutual indemnification relating to the respective company's liabilities and definitions relating to insurance rights and obligations.
- A Transitional Services Agreement by which Mestek will continue to provide to the Company certain corporate services, including legal, financial and tax services, in exchange for a fixed annual fee of approximately \$70,000.
- A Confidential Nondisclosure Agreement which imposes certain duties of confidentiality on the Company and Mestek.

All of the above agreements are described in greater detail in the Form 10 filing which has been made with the Securities and Exchange Commission by the Company in connection with the Spin-Off.

On January 12, 2005, the Company paid a dividend of \$9,350,000 to its shareholders of record as of January 1, 2005. Consistent with their shareholdings, 10% of the dividend was received by Kevin Hoben, President and Chief Executive Officer, 4% by Mark Albino, Executive Vice President and Chief Operating Officer (both treated as a reduction of the accrued put obligation), and 86%, or \$8,041,000 was received by Mestek, and charged against Retained Earnings. On July 1, 2005 and in anticipation of the Spin-Off, the Company stopped lending its daily cash receipts to Mestek, Inc., its 86% shareholder, in order to accumulate cash reserves necessary for working capital purposes prior to the effective date of the Spin-Off. At the effective date of the Spin-Off, Mestek remained indebted to the Company in the amount of \$3,250,000 which was converted on the effective date of the Spin-Off to a 3-year note receivable from Mestek bearing interest at 100 basis points above the then prevailing 3-year US Treasury note yield at approximately 5%. The interest income recorded on the note was approximately \$164,000, \$69,000 and \$0 for the years 2006, 2005 and 2004, respectively.

#### 4. INVENTORIES

Inventories consisted of the following at December 31:

|                      | <u>2006</u>    | <u>2005</u>  |
|----------------------|----------------|--------------|
|                      | (in thousands) |              |
| Finished Goods       | \$5,940        | \$4,280      |
| Raw Materials        | <u>2,209</u>   | <u>1,948</u> |
| Total Inventory, Net | \$8,149        | \$6,228      |
|                      | =====          | =====        |

## 5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31:

|                          | <u>2006</u>    | <u>2005</u>    | <b>Depreciation and<br/>Amortization Est.<br/><u>Useful Lives</u></b> |
|--------------------------|----------------|----------------|---|
|                          | (in thousands) |                |   |
| Land                     | \$538          | \$538          |   |
| Buildings                | 4,141          | 4,141          | 39 Years  |
| Leasehold Improvements   | 39             | 39             | 3-10 Years  |
| Equipment                | <u>7,476</u>   | <u>6,104</u>   | 3-10 Years  |
|                          | 12,194         | 10,822         |   |
| Accumulated Depreciation | <u>(5,489)</u> | <u>(5,073)</u> |   |
|                          | <u>\$6,705</u> | <u>\$5,749</u> |   |

The above amounts include approximately \$1,161,000 at December 31, 2006 and \$0 at December 31, 2005 in assets that had not yet been placed in service by the Company. No depreciation was recorded in the related periods for these assets.

Depreciation and amortization expense was approximately \$417,000, \$665,000, and \$665,000, for the years ended December 31, 2006, 2005, and 2004, respectively.

## 6. DEBT

### Long-term Debt:

Long-term debt consisted of the following at December 31, 2006 and December 31, 2005

|                         | <u>2006</u>    | <u>2005</u>    |
|-------------------------|----------------|----------------|
|                         | (in thousands) |                |
| Mortgage Note           | \$---          | \$3,411        |
| Less Current Maturities | <u>---</u>     | <u>(186)</u>   |
|                         | <u>\$---</u>   | <u>\$3,225</u> |

On April 27, 2006, the Company's subsidiary Exton Ranch, Inc. paid the entire outstanding principal balance (and accrued interest) of the \$3.348 million Mortgage Note that was obtained from Sovereign Bank in 2004 to purchase the Company's main facility in Exton, Pennsylvania.

Cash paid for interest was \$78,000, \$177,000, and \$79,000, during the years ended December 31, 2006, 2005, and 2004, respectively.

## 7. SHAREHOLDERS' EQUITY

As of December 31, 2004, the Company had authorized common stock of 1,000 shares with par value of \$60 per share. As of December 31, 2004, Mestek, Inc. owned 860 shares of the Company's common stock, or 86%, and Kevin R. Hoben and Mark F. Albino, the President and

Executive Vice President of the Company respectively, collectively owned the remaining 14% of the Company's common stock. As explained more fully in Note 3 on June 23, 2005 the Company authorized a split of its common shares at a ratio of 1 to 10,153.633 in connection with the planned Spin-Off of Omega Flex common shares to Mestek Stockholders. All references to shares and per share amounts in these Financial Statements have been retroactively restated to give effect to the stock split at the above ratio.

The Company has paid three dividends on its common stock. On December 12, 2006, the Company issued a press release announcing that on December 11, 2006 the Board of Directors authorized a special dividend of \$0.40 per share to all Shareholders of record as of January 2, 2007, and payable as soon as practicable. The payment in the amount of \$4,061,453 was subsequently paid on January 16, 2007.

The other two special dividends on its common stock were declared and paid prior to the date that our common stock was registered with the Securities and Exchange Commission and began trading on the NASDAQ Global Market in August, 2005. The first dividend was declared and paid to shareholders of record as of October 13, 2004, and the amount of the dividend was \$0.886 per share on a fully diluted basis and after giving effect to the forward split as part of the distribution, as described in Note 3 under the caption "Spin-Off". On January 12, 2005, the second dividend was paid to record shareholders as of January 1, 2005, and was \$0.92 per share on a fully diluted basis and after giving effect to the forward split as part of the distribution. The 2005 dividend totaling \$9,350,000 was recorded as a reduction to retained earnings for the portion related to Mestek, its 86% shareholder, and the remaining 14% portion relating to Mr. Hoben and Mr. Albino was recorded as a reduction to Common Stock Subject to Put Obligation in Current Liabilities, as described in Note 3. Our future decisions concerning the payment of dividends on our common stock will depend upon our results of operations, financial condition and capital expenditure plans, as well as such other factors as the Board of Directors, in its sole discretion, may consider relevant.

## 8. INCOME TAXES

Income tax expense consisted of the following:

|                     | <u>2006</u>    | <u>2005</u><br>(in thousands) | <u>2004</u>    |
|---------------------|----------------|-------------------------------|----------------|
| Federal Income Tax: |                |                               |                |
| Current             | \$5,282        | \$4,148                       | \$3,274        |
| Deferred            | (2,830)        | 28                            | 31             |
| State Income Tax:   |                |                               |                |
| Current             | 813            | 651                           | 449            |
| Deferred            | (429)          | 3                             | (2)            |
| Foreign Income Tax: |                |                               |                |
| Current             | ---            | ---                           | ---            |
| Deferred            | 226            | 114                           | (42)           |
| Income Tax Expense  | <u>\$3,062</u> | <u>\$4,944</u>                | <u>\$3,710</u> |

Profit before Income Taxes included foreign income (losses) of \$812,000, \$323,000, and (\$168,000) in 2006, 2005, and 2004, respectively.

Total income tax expense differed from “statutory” income tax expense, computed by applying the U.S. federal income tax rate of 35% to earnings before income tax, as follows:

|  | <u>2006</u>    | <u>2005</u><br>(in thousands) | <u>2004</u>    |
|--|----------------|-------------------------------|----------------|
| Computed “statutory” income tax expense              | \$2,879        | \$4,347                       | \$3,399        |
| State income tax, net of federal tax benefit         | 229            | 425                           | 292            |
| Foreign tax rate differential                        | (58)           | (32)                          | 17             |
| Non-Cash Compensation Expense – permanent difference | ---            | 205                           | (11)           |
| Other - net  | <u>12</u>      | <u>(1)</u>                    | <u>13</u>      |
| Income Tax Expense                                   | <u>\$3,062</u> | <u>\$4,944</u>                | <u>\$3,710</u> |
|  | =====          | =====                         | =====          |

A deferred income tax (expense) benefit results from temporary timing differences in the recognition of income and expense for income tax and financial reporting purposes. The components of and changes in the net deferred tax assets (liabilities) which give rise to this deferred income tax (expense) benefit for the years ended December 31, 2006 and 2005 are as follows:

|                                  | <b>December 31,</b> |                |
|----------------------------------|---------------------|----------------|
|                                  | <u>2006</u>         | <u>2005</u>    |
|                                  | (in thousands)      |                |
| <u>Current Deferred Taxes:</u>   |                     |                |
| Compensated Assets               | \$101               | \$69           |
| Inventory Valuation              | 312                 | 265            |
| Accounts Receivable Valuation    | 27                  | 65             |
| Legal Reserves                   | 2,458               | 0              |
| Other                            | 124                 | 25             |
| Prepaid Expenses                 | <u>(175)</u>        | <u>(172)</u>   |
| Total Current                    | <u>\$2,847</u>      | <u>\$252</u>   |
|                                  | =====               | =====          |
| <u>Long Term Deferred Taxes:</u> |                     |                |
| Legal Reserves                   | \$765               | \$0            |
| Foreign Tax Operating Loss       | 24                  | 195            |
| Depreciation and Amortization    | <u>(935)</u>        | <u>(834)</u>   |
| Total Long Term                  | <u>(\$146)</u>      | <u>(\$639)</u> |
|                                  | =====               | =====          |
| Total Deferred                   | \$2,701             | (\$387)        |
|                                  | =====               | =====          |

At December 31, 2006, the Company has a United Kingdom tax operating loss carry-forward of approximately \$50,000, which may offset income in future years.

Management believes it is more likely than not that the Company will have sufficient taxable income when these timing differences are reversed and that the deferred tax asset will be realized and accordingly no valuation allowance is deemed necessary.

Cash paid for taxes in 2006 amounted to \$4.474 million.

## 9. LEASES

In the United Kingdom the Company leases a facility in Banbury, which serves sales, warehousing and operational functions. The lease in Banbury was effective April 1, 2006 and

has a 6.5 year term with an option to renew. Prior to that, the Company leased office space in High Wycombe near London.

The Company subleases office space in Westfield, MA from a related party, Mestek, Inc., for approximately \$1,000 a month, and warehouse space in Downingtown, PA on a month-to-month basis from Schorn & Company.

Rent expense for operating leases was approximately \$380,000, \$60,000 and \$54,000, for the years ended December 31, 2006, 2005, and 2004, respectively.

Future minimum lease payments under non-cancelable leases as of December 31, 2006 are as follows:

| <b>Year Ending December 31,</b> | <b>Operating Leases</b><br>(in thousands) |
|---------------------------------|---|
| 2007                            | \$430                                     |
| 2008                            | 420                                       |
| 2009                            | 427                                       |
| 2010                            | 435                                       |
| 2011                            | 447                                       |
| Thereafter                      | <u>218</u>                                |
| Total Minimum Lease Payments    | <u>\$2,377</u>                            |

## **10. EMPLOYEE BENEFIT PLANS**

### **Defined Contribution and 401-K Plans**

The Company maintains a qualified non-contributory profit-sharing plan covering all eligible employees. Contributions to the plan charged to expense were approximately \$199,000, \$172,000 and \$168,000, for the years ended December 31, 2006, 2005, and 2004, respectively.

Contributions to the Plan are defined as three percent (3%) of gross wages up to the current Old Age, Survivors, and Disability (OASDI) limit and six percent (6%) of the excess over the OASDI limit, subject to the maximum allowed under the Employee Retirement Income Security Act (ERISA). The plan's vesting terms fully vest participants over six years.

The Company also maintains a savings & retirement plan qualified under Internal Revenue Code Section 401(k) for all employees. Employees are eligible to participate in the Plan the first day of the month following date of hire. Participants may elect to have up to fifty percent (50%) of their compensation withheld, up to the maximum allowed by the Internal Revenue Code. After completing (1) year of service, the Company contributes an additional amount equal to 25% of all employee contributions, up to a maximum of 6% of an employee's gross wages. Contributions are funded on a current basis. Contributions to the Plan charged to expense for the years ended December 31, 2006, 2005, and 2004 were approximately \$61,000, \$70,000, and \$43,000, respectively. The Company contribution vesting terms fully vest participants over six years.

Prior to the “Omega Flex Spin-Off” transaction described in Note 3, the Company’s “profit sharing” and “401K” plans were maintained through its former parent, Mestek, Inc. with substantially equivalent benefits.

## 11. COMMITMENTS AND CONTINGENCIES

### Commitments:

On September 5, 2006 the Company entered into a Stipulation and Settlement Agreement with the Class Representatives and Class Counsel, to settle and resolve the allegations brought forth in the lawsuit titled *Lovelis, et al. v. Titeflex Corp., Inc., et al.* in the Arkansas Circuit Court, Clark County. All of the other defendants in the case also signed the Settlement Agreement. The lawsuit relates to allegations that the Company’s CSST products posed an unreasonable risk of fire due to lightning strikes. Both the Company and the other defendants deny these allegations, and deny any wrongdoing or legal liability, but have agreed to settle this matter to avoid further cost and the uncertainty and risk of the outcome of further litigation.

The court gave final approval to the Settlement Agreement on February 1, 2007. The remedial program provided under the Settlement Agreement is currently processing claims from class members. The deadline for submitting any claims is September 5, 2007.

Under the Settlement Agreement, the Company has agreed to pay the value of each payment voucher redeemed by a class member for the installation of a lightning protection system or bonding and grounding of the Company’s CSST product. The amount of the voucher is dependent on the geographical area in the United States where the building is located and the size of the heated or air-conditioned area of the building, as set forth in the Settlement Agreement. The Company has also agreed to pay a fixed amount of administrative expenses in providing notice to the class, and establishing and operating a claim system under which class members may obtain information, submit claims, and have claims processed. Finally, the Company has agreed to pay attorneys’ fees to the Class Counsel to resolve this matter.

The Company cannot determine the exact amount for which it may be liable for the costs of the payment vouchers tendered under the claim program because of the number of unknown variables associated with this liability, including; the number of buildings in the United States that contain the Company’s CSST product; the number of payment vouchers that are properly and timely submitted by claimants; the extent to which vouchers are for lightning protection systems or for bonding and grounding; the geographical location of the building within the United States; and the size of the building in which the CSST is located. However, the Company estimates that the total amount of the liability relating to the settlement of the litigation will fall within a range of \$8.8 million and \$10.2 million with \$6.8 million allocated as a Short-Term Liability and \$2.0 million recorded as Long-Term. Accordingly, the Company recorded a pre-tax charge to operations of approximately \$8.8 million in the third quarter of 2006. This amount is based on currently available information and certain estimates and judgments, and is subject to revision as actual claims are received, and a claim history is established.

The Company is obligated under Indemnity Agreements executed on behalf of 16 of the Company’s officers and directors. Under the terms of the Agreement, the Company is contingently liable for costs which may be incurred by the officers and directors in connection with claims arising by reason of these individuals’ roles as officers and directors.

The Company has entered into salary continuation agreements with two employees which provide for monthly payments to each of the employee or his designated beneficiary upon the employee's retirement or death. The payment benefits range from \$1,000 per month to \$3,000 per month with the term of such payments limited to 15 years after the employee's retirement at age 65. The agreements also provide for survivorship benefits if the employee dies before attaining age 65; and severance payments if the employee is terminated without cause, the amount of which is dependent on the length of company service at the date of termination. The net present value of the retirement payments is included in Other Long-Term Liabilities, which amount to \$268,000 and \$257,000 for 2006 and 2005, respectively. The Company has obtained and is the beneficiary of two whole life insurance policies in respect of the two employees, and the cash surrender value of such policies (included in Other Assets) amount to \$448,000 and \$382,000 for 2006 and 2005, respectively.

### **Contingencies:**

The Company retains significant obligations under its commercial insurance policies for losses occurring in the policy years in which it was a subsidiary of Mestek, Inc. For the policy year ending October 1, 2004, the Company retained liability for the first \$2,000,000 per occurrence of commercial general liability claims (including product liability claims), subject to an agreed aggregate. In addition, for 2004 the Company retained liability for the first \$250,000 per occurrence of workers compensation coverage, subject to an agreed aggregate. However, for policy years beginning on July 22, 2005 (the effective date of the Spin-Off), the Company retained liability for the first \$25,000 per occurrence of commercial liability claims (including products liability claims), subject to an agreed aggregate, and the Company is currently insured on a 'first dollar' basis for workers' compensation subject to statutory limits. The Company maintains reserves for its obligations under these various policies based on claim experience and the reserves established by the insurers in relation to these claims. The reserve balances at December 31, 2006 and December 31, 2005 were not material in amount.

Prior to the Spin-Off, the Company self-insured a substantial portion of the health benefits provided for its employees and maintained reserves in this regard and relied upon a recognized actuarial consulting firm to help it set and maintain these reserves. After the Spin-Off, the Company's liability is limited to \$30,000 per case and an aggregate of \$600,000 annually.

The Company was obligated as a guarantor with respect to the debt of Mestek, Inc. under Mestek's primary commercial bank line of credit. As of the effective date of the Spin-Off (as disclosed in Note 3), the guaranty was cancelled and is no longer in effect.

The Company has disclosed the estimated contingency related to the Settlement Agreement reached on February 1, 2007 in the "Commitments" caption above.

### **Warranty Commitments:**

Gas transmission products such as those made by the Company carry potentially serious personal injury risks in the event of failures in the field. As a result, the Company has extensive internal testing and other quality control procedures and historically the Company has not had a meaningful failure rate in the field due to the extensive nature of these quality controls. Due to the Company's quality systems, the warranty expense is *de minimis*, and accordingly, the Company does not maintain a warranty reserve beyond a nominal amount.

## 12. MINORITY INTERESTS

Five percent of the Company's Omega Flex Limited subsidiary is held by an unrelated third party, which is represented as Minority Interests in the Company's financial statements.

## 13. STOCK BASED PLANS

### Phantom Stock Plan

**Plan Description.** On December 11, 2006, the Company adopted the Omega Flex, Inc. 2006 Phantom Stock Plan (the "Plan"). The Plan authorizes the grant of up to one million units of phantom stock to employees, officers or directors of the Company and of any of its subsidiaries. The phantom stock units ("Units") each represent a contractual right to payment of compensation in the future based on the market value of the Company's common stock. The Units are not shares of the Company's common stock, and a recipient of the Units does not receive any of the following:

- ownership interest in the Company
- shareholder voting rights
- dividends or distributions
- other incidents of ownership to the Company's common stock

The Units are granted to participants upon the recommendation of the Company's CEO, and the approval of the compensation committee. Each of the Units that are granted to a participant will be initially valued by the compensation committee, and at a minimum, the Unit's value will be in an amount equal to the closing price of the Company's common stock on the grant date. The Units have a vesting schedule, with a maximum vesting schedule of 3 years after the grant date. Upon vesting, the Units represent a contractual right to the payment of the value of the Unit. The Units will be paid on their maturity date, which is a maximum of one year after all of the Units granted in a particular award have fully vested. The amount to be paid to the participant on the maturity date is dependant on the type of Unit granted to the participant. The Units may be *Full Value* in which the value of each Unit at the maturity date will equal the closing price of the Company's common stock as of the maturity date; or *Appreciation Only*, in which the value of each Unit at the maturity date will equal to the closing price of the Company's common stock at the maturity date *minus* the closing price of the Company's common stock at the grant date.

In certain circumstances, the Units may be immediately vested upon the participant's death or disability. All Units granted to a participant are forfeited if the participant is terminated from his relationship with the Company or its subsidiary for "cause," which is defined under the Plan. If a participant's employment or relationship with the Company is terminated for reasons other than for "cause," then any vested Units will be paid to the participant upon termination. However, Units granted to certain "specified employees" as defined in Section 409A of the Internal Revenue Code will be paid approximately 181 days after that termination.

**Grants of Phantom Stock Units.** On December 11, 2006, the Company granted 2,420 Units with a face value of \$50,000 (fair value at the grant date of approximately \$46,000) to an executive officer. The grant price was equal to the closing price of the Company's common stock at the grant date. Since the Plan came into existence in 2006, there are no outstanding Units relating to the years ended December 31, 2005 or 2004.



The Company uses the Black-Scholes option pricing model as its method for determining fair value of the Units. The Company uses the straight-line method of attributing the value of the stock-based compensation expense relating to the Units. The compensation expense from the Units is recognized over the service or vesting period of each grant or award.

Statement 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates in order to derive the Company's best estimate of awards ultimately to vest. Forfeitures represent only the unvested portion of a surrendered Unit and are typically estimated based on historical experience. Based on an analysis of the Company's historical data, which has never experienced forfeitures related to any stock based plan, the Company applied a 0% forfeiture rate to Plan Units outstanding in determining its Plan Unit compensation expense for December 31, 2006. The Company believes this is a reasonable forfeiture rate.

The fair value of the Units granted during the year ended December 31, 2006 using the Black-Scholes option-pricing model uses the following assumptions:

| <u>Year Ended</u><br><u>December 31,</u> | <u>Expected Term</u> | <u>Expected</u><br><u>Volatility Factor</u> | <u>Expected</u><br><u>Dividend Amount</u> | <u>Risk-Free</u><br><u>Interest Rate</u> |
|--|----------------------|---|---|--|
| 2006                                     | 4.5                  | 96.46%                                      | 1.93%                                     | 4.5%                                     |

The Company has elected to use the "Simplified" method for calculating the Expected Term in accordance with SAB 107, and has opted to use the Expected Dividend Amount rather than an Expected Dividend Yield.

The effect on the years ended December 31, 2005 and 2004 was zero and therefore those years do not reflect any compensation expense.

The following table summarizes information about the Units outstanding at December 31, 2006:

|  | <u>Units</u> | <u>Weighted</u><br><u>Average</u><br><u>Grant Date</u><br><u>Fair Value</u> |
|--|--------------|---|
| Number of Phantom Stock Unit Awards:       |              |   |
| Outstanding at December 31, 2005           | ---          | \$---   |
| Granted                                    | 2,420        | \$18.94   |
| Vested                                     | (--)         | (\$--)  |
| Forfeited                                  | (--)         | (\$--)  |
| Canceled                                   | (--)         | (\$--)  |
| Outstanding at December 31, 2006           | 2,420        | \$18.94   |
| Phantom Stock Unit Awards Expected to Vest | 2,420        | \$18.94   |

At December 31, 2006 none of the Units have vested. Those Units granted in 2006 are expected to vest in three years, subject to earlier termination or forfeiture.

As of December 31, 2006, the unrecognized compensation costs related to Plan Units vesting will be primarily recognized over a period of approximately 3 years.

| <u>Fiscal year ending</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>Total</u> |
|---------------------------|-------------|-------------|-------------|--------------|
| Compensation Expense      | \$15,300    | \$15,300    | \$14,000    | \$44,600     |

The Units outstanding and exercisable at December 31, 2006 were in the following exercise price ranges:

| Range of Exercise Price | Number of Units Outstanding | <u>Units Outstanding</u>                    |                                 |                           | Number of Units Exercisable | <u>Units Exercisable</u>                    |                                 |                           |
|-------------------------|-----------------------------|---|---------------------------------|---------------------------|-----------------------------|---|---------------------------------|---------------------------|
|                         |                             | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Aggregate Intrinsic Value |                             | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Aggregate Intrinsic Value |
| \$20.66                 | 2,420                       | 2.95  | \$18.94                         | \$46,000                  | ---                         | 2.95  | 18.94                           | ---                       |

### **Stock Option Plan**

The Company adopted a stock option plan (the “Plan”), effective July 1, 1996 which provided for the granting of both Incentive and Non-Qualified Stock Options (as those terms are defined in the Internal Revenue Code) of up to (pre-split) 200 shares of stock to certain employees of the Company for the purchase of the Company’s common stock at fair market value as of the date of grant. The Plan was approved by Mestek, Inc., then the Company’s sole shareholder. Options to purchase an aggregate of (pre-split) 140 shares of the common stock of the Company, representing a 14% equity share were granted to two executives, Kevin Hoben, President and Mark Albino, Executive Vice President, effective July 1, 1996. The options vested over a five-year period commencing May 1, 1999 and ending on May 1, 2004. All of the options granted were exercised on October 13, 2004, in connection with which the Company received the \$1,260,000 exercise price. Through a separate agreement, the option holders (now shareholders in the Company) had a put right after exercise which allowed them to sell their shares to the Company at an amount based upon book value and the Company had a corresponding call option at an amount based upon book value. In accordance with APB 25, the Company has reflected pre-tax charges to earnings for the year ended December 31, 2006, 2005 and 2004, of \$0, \$587,000 and \$844,000, respectively, for the compensation value in those periods of the options granted. These charges, which reflected the potential obligations of the Company relative to the put rights, were credited to Common Stock Subject to Put Obligation. In July 2005 in coordination with the “Spin-Off” described in Note 3 the Company and Mr. Hoben and Mr. Albino mutually terminated their respective call and put rights at which time the Company reclassified the remaining liability (approximately \$2,743,000) to the put rights to Paid In Capital. No stock options were issued, exercised or outstanding at or after December 31, 2005.

## **14. CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS**

### **Mestek, Inc.**

The Company historically had related party transactions with Mestek, Inc., its 86% shareholder and parent prior to the Spin-Off. The Company relied on Mestek for various services including legal, treasury, tax, employee benefits, insurance, executive oversight and corporate office space. The Company’s Financial Statements include charges for these services of \$63,000 in 2006, \$291,000 for 2005 and \$563,000 in 2004. The charges represent estimates of the value of the services provided. Effective with the date of the “Spin-Off”, these costs include only costs

related to financial services, taxation and building rental. See Note 3 for a more comprehensive discussion of the Company's relationship with Mestek subsequent to the "Spin-Off" of Omega Flex stock to Mestek shareholders.

## 15. SELECTED QUARTERLY INFORMATION (UNAUDITED)

The table below sets forth selected quarterly information for each full quarter of 2006 and 2005.

(Dollars in thousands except per common share amounts)

| <b>2006</b>       | <b><u>1st</u><br/><u>Quarter</u></b> | <b><u>2nd</u><br/><u>Quarter</u></b> | <b><u>3rd</u><br/><u>Quarter</u></b> | <b><u>4th</u><br/><u>Quarter</u></b> |
|-------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Total Revenues    | \$17,315                             | \$17,908                             | \$19,283                             | \$19,068                             |
| Gross Profit      | \$9,064                              | \$9,287                              | \$9,934                              | \$9,607                              |
| Net Income (Loss) | \$2,241                              | \$2,302                              | (\$2,319)                            | \$2,940                              |
| Per Common Share: |                                      |                                      |                                      |                                      |
| Basic             | \$0.22                               | \$0.23                               | (\$0.23)                             | \$0.29                               |
| Diluted           | \$0.22                               | \$0.23                               | (\$0.23)                             | \$0.29                               |
| <br>              |                                      |                                      |                                      |                                      |
| <b>2005</b>       | <b><u>1st</u><br/><u>Quarter</u></b> | <b><u>2nd</u><br/><u>Quarter</u></b> | <b><u>3rd</u><br/><u>Quarter</u></b> | <b><u>4th</u><br/><u>Quarter</u></b> |
| Total Revenues    | \$13,268                             | \$15,265                             | \$17,116                             | \$19,989                             |
| Gross Profit      | \$6,790                              | \$7,553                              | \$8,515                              | \$9,843                              |
| Net Income        | \$1,388                              | \$1,680                              | \$1,940                              | \$2,469                              |
| Per Common Share: |                                      |                                      |                                      |                                      |
| Basic             | \$0.14                               | \$0.17                               | \$0.19                               | \$0.24                               |
| Diluted           | \$0.14                               | \$0.17                               | \$0.19                               | \$0.24                               |

### **Item 9 – CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING FINANCIAL DISCLOSURE**

None

### **Item 9A – CONTROLS AND PROCEDURES**

(a) Evaluation of Disclosure Controls and Procedures.

At the end of the fiscal fourth quarter, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The Company's disclosure controls and procedures are designed to ensure that the Company records, processes, summarizes and reports in a timely manner the information the Company must disclose in its reports filed under the Securities Exchange Act. Company management, including the chief executive officer and chief financial officer, have conducted an evaluation of the effectiveness of the design and operation of the Company's Disclosure Controls and procedures as defined in the Rule 13a-15(e) of Securities Exchange Act of 1934. Based on that evaluation, the chief executive officer and chief financial officer have concluded that, as of the date of their evaluation, the Company's disclosure controls

and procedures are effective to provide reasonable assurance of achieving the purposes described in Rule 13a-15(e), and no changes are required at this time.

(b) Changes in Internal Controls.

There was no change in the Corporation's "internal control over financial reporting" (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) identified in connection with the evaluation required by Rule 13a-15(d) of the Securities Exchange Act of 1934 that occurred during the fourth quarter of the fiscal year covered by this Annual Report on Form 10-K that has materially affected or is reasonably likely to materially affect the Corporations' internal control over financial reporting subsequent to the date the chief executive officer and chief financial officer completed their evaluation.

**Item 9B – OTHER INFORMATION**

All matters required to be disclosed on Form 8-K during our fiscal 2006 fourth quarter have been previously disclosed on a Form 8-K filed with the Securities and Exchange Commission.

### **PART III**

With respect to items 10 through 14, the Company will file with the Securities and Exchange Commission, within 120 days of the close of its fiscal year, a definitive proxy statement pursuant to Regulation 14A.

#### **Item 10 - DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information regarding directors of the Company will be set forth in the Company's proxy statement relating to the annual meeting of shareholders to be held June 5, 2007, under the caption "Current Directors and Nominees for Election – Background Information", and to the extent required and except as set forth therein, is incorporated herein by reference.

Information regarding executive officers of the Company will be set forth under the caption "Executive Officers" in the Company's proxy statement, and to the extent required and except as set forth therein, incorporated herein by reference.

Information regarding the Company's Audit Committee and its "Audit Committee Financial Expert" will be set forth in the Company's proxy statement also, under the caption "Board Committees", incorporated herein by reference. Information concerning section 16(a) Beneficial Ownership Reporting Compliance will be set forth in the Company's proxy statement also, under the Caption "Compliance with Section 16(a) of the Securities Exchange Act" incorporated herein by reference.

The Company has adopted a Code Of Business Ethics ("Code") applicable to its principal executive officer, principal financial and accounting officers, its directors and all other employees generally. A copy of the Code will be set forth as an appendix in the Company's Proxy Statement and also may be found at the Company's website [www.omegaflex.com](http://www.omegaflex.com). Any changes to or waivers from this Code will be disclosed on the Company's website as well as in appropriate filings with the Securities and Exchange Commission.

#### **Item 11 - EXECUTIVE COMPENSATION**

Information regarding executive compensation will be set forth in the Company's proxy statement relating to the annual meeting of shareholders to be held June 5, 2007, and under the caption "Executive Compensation" to the extent required and except as set forth therein, is incorporated herein by reference.

The report of the Compensation Committee of the Board of Directors of the Company shall not be deemed incorporated by reference by any general statement incorporating by reference the proxy statement into any filing under the Securities Exchange Act of 1934, and shall not otherwise be deemed filed under such Act.

#### **Item 12 - SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

Information regarding security ownership of certain beneficial owners and management as well as information regarding equity compensation plans and individual equity contracts or

arrangements will be set forth in the Company's proxy statement relating to the annual meeting of shareholders to be held June 5, 2007, under the caption "Security Ownership of Certain Beneficial Owners and Management", and to the extent required and except as set forth therein, is incorporated herein by reference.

### **Item 13 - CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Information regarding certain relationships and related transactions will be set forth in the Company's proxy statement relating to the annual meeting of shareholders to be held June 5, 2007, under the caption "Certain Relationships and Related Transactions" and to the extent required and except as set forth therein, is incorporated herein by reference.

### **Item 14 – PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information regarding financial accounting fees and services will be set forth in the Company's proxy statement relating to the annual meeting of shareholders to be held June 5, 2007, under the caption "Principal Accounting Fees and Services", and to the extent required, and except as set forth therein, is incorporated herein by reference.

## **PART IV**

### **Item 15 - EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES, AND REPORTS ON FORM 8-K**

- (a) The following documents are filed as part of this Form 10-K:
1. All financial statements. See Index to Consolidated Financial Statements on page 60 of this Form 10-K.
  2. Financial Statement Schedules. None Required.
  3. Exhibits. See Index to Exhibits.

## INDEX

|  | <b><u>Pages of<br/>this report</u></b> |
|--|--|
| Reports of Independent Registered Public Accounting Firms  | Page 39                                |
| Financial Statements:  |  |
| (a)(1) Consolidated Balance Sheets as of December 31, 2006 and 2005  | Page 40                                |
| Consolidated Statements of Operations for the Years<br>Ended December 31, 2006, 2005, and 2004                                 | Page 41                                |
| Consolidated Statements of Shareholders' Equity and Comprehensive<br>Loss for the Years Ended December 31, 2006, 2005 and 2004 | Page 42                                |
| Consolidated Statements of Cash Flows for the Years<br>Ended December 31, 2006, 2005, and 2004                                 | Page 43                                |
| Notes to the Consolidated Financial Statements   | Pages 44 through 59                    |
| (a)(2) Financial Statement Schedules   |  |

All other financial statement schedules required by Item 14(a)(2) have been omitted because they are inapplicable or because the required information has been included in the Consolidated Financial Statements or notes thereto.

### (a)(3) Exhibits

The Exhibit Index is set forth on Pages 64 and 65. No annual report to security holders as of December 31, 2006 has been sent to security holders and no proxy statement, form of proxy or other proxy soliciting material has been sent by the registrant to more than ten of the registrant's security holders with respect to any annual or other meeting of security holders held or to be held in 2006. Such annual report to security holders, proxy statement or form of proxy will be furnished to security holders subsequent to the filing of this Annual Report on Form 10-K.

## EXHIBIT INDEX

Those documents followed by a parenthetical notation are incorporated herein by reference to previous filings with the Securities and Exchange Commission as set forth below.

| <b>Exhibit No.</b><br>***** | <b>Description</b><br>*****   | <b>Reference<br/>Key</b><br>***** |
|-----------------------------|---|-----------------------------------|
| 3.1                         | Articles of Incorporation of Omega Flex, Inc., as amended   | (A)                               |
| 3.2                         | Amended and Restated By-laws of Omega Flex, Inc.  | (A)                               |
| 10.1                        | Indemnity and Insurance Matters Agreement dated July 29, 2005 between Omega Flex, Inc. and Mestek, Inc.   | (A)                               |
| 10.2                        | Form of Indemnification Agreements entered into between Omega Flex, Inc. and its Directors and Officers and the Directors of its wholly-owned subsidiaries incorporated by reference as provided herein, except as set forth in the attached schedule | (A)                               |
| 10.3                        | Schedule of Directors/Officers with Indemnification Agreement   | (A)                               |
| 10.4                        | Tax Responsibility Allocation Agreement dated July 29, 2005 between Omega Flex, Inc. and Mestek, Inc.   | (A)                               |
| 10.5                        | Employment Agreement dated April 15, 1996 between Omega Flex, Inc. and Kevin R. Hoben   | (A)                               |
| 10.6                        | Employment Agreement dated April 22, 1996 between Omega Flex, Inc. and Mark F. Albino   | (A)                               |
| 10.7                        | Separation and Distribution Agreement dated July 29, 2005 between Omega Flex, Inc. and Mestek, Inc.   | (A)                               |
| 10.8                        | Transitional Services Agreement dated July 29, 2005 between Omega Flex, Inc. and Mestek, Inc.   | (B)                               |
| 10.9                        | Shareholders Agreement dated July 1, 1996   | (B)                               |
| 10.10                       | Promissory Note dated July 29, 2005 by Mestek, Inc. payable to Omega Flex, Inc. in the principal amount of \$3,249,615.63.  | (B)                               |
| 10.11                       | Executive Salary Continuation Agreement   | (C)                               |



|       |  |     |
|-------|--|-----|
| 10.12 | Employment Agreement dated March 22, 2006 between Omega Flex, Inc. and Duane E. Shooltz.   | (D) |
| 10.13 | Phantom Stock Plan dated December 11, 2006.  |     |
| 10.14 | Form of Phantom Stock Agreement entered into between Omega Flex, Inc. and its directors, officers and employees, except as set forth in the attached schedule. |     |
| 10.15 | Schedule of Phantom Stock Agreements between Omega Flex, Inc. and its directors and executive officers.  |     |
| 14.1  | Code of Business Ethics  | (A) |
| 21.1  | List of Subsidiaries   | (A) |
| 23.1  | Consent of Vitale, Caturano & Company, Ltd.  |     |
| 31.1  | CEO Certification  |     |
| 31.2  | CFO Certification  |     |
| 32.1  | 906 CEO and CFO Certifications   |     |
| 99.1  | Information Statement  | (A) |
| 99.2  | Corporate Governance Guidelines  | (A) |

#### Reference Key

- (A) Filed as an Exhibit to the Registration Statement on Form 10-12G filed on June 22, 2005.
- (B) Filed as an Exhibit to the Registration Statement on Form 10-12G/A filed on July 19, 2005.
- (C) Filed as an Exhibit to the Annual Report on Form 10-K filed March 31, 2006.
- (D) Filed as an Exhibit to the Quarterly Report on Form 10-Q filed May 15, 2006.

Each management contract or compensatory plan or arrangement to be filed as an exhibit to this report pursuant to item 15 is listed in Exhibit numbers 10.1, 10.2 and 10.5.



**Omega Flex, Inc.**  
**2006 Phantom Stock Plan**

451 Creamery Way, Exton, Pennsylvania, 19341 · Tel: (610) 524-7272 · Fax: (610) 524 8983·

**Omega Flex, Inc.**  
**2006 PHANTOM STOCK PLAN**

**ARTICLE 1 – PURPOSE**

The purpose of Omega Flex, Inc. 2006 Phantom Stock Plan is to retain the services of a select group of employees as well as the services of certain directors of Omega Flex, Inc. and its subsidiaries to motivate them to contribute to the growth and profits of the Company. This Plan is intended to comply with the provisions of Section 409A of the Internal Revenue Code of 1986, as amended, and shall be interpreted in a manner consistent with that intention.

**ARTICLE 2 – DEFINITIONS**

As used herein, the following terms shall have the meaning specified below unless the context clearly indicates to the contrary:

"Beneficiary" shall mean any person or persons (including, without limitation, the trustees of any testamentary or *inter vivos* trust), as designated from time to time in writing pursuant to Article 5, to whom any benefits may be payable upon the death of a Participant.

"Cause" shall mean any of the following acts or omissions on the part of the Participant:

- (i) dishonesty or fraud resulting in damage to the business of the Company;
- (ii) embezzlement or theft of assets of the Company;
- (iii) breach of the representations, warranties or obligations of Participant in any employment, or other agreement between the Company and any such Participant;
- (iv) conviction or plea of guilty or *nolo contendere* to a felony resulting in damage to the business of the Company; or
- (v) failure by any Participant to perform the Participant's employment, other duties to the best of the Participant's abilities, or willful failure to carry out the lawful and proper directions of the President or the Board of Directors of the Company.

"Committee" shall mean the Compensation Committee of the Board of Directors of Omega Flex, Inc.

"Code" shall mean the Internal Revenue Code of 1986, as amended.

"Company" shall mean Omega Flex, Inc., including any Subsidiary thereof, and any successor or successors thereto.

"Disabled" shall mean that a Participant is entitled to disability benefits under the Company's group disability insurance plan (or would be so entitled if the Participant was a participant in such plan).

"Grant Date" shall mean the effective date on which the Committee grants Phantom Stock to a Participant.

"Grant Price" shall mean the price of a unit of Phantom Stock as determined by the Committee on the Grant Date. This amount shall be provided for in the Plan Agreement.

"Maturity Date" shall mean the date on which a Participant's vested Phantom Stock grants are deemed to mature, which shall be the date set forth in the Plan Agreement; provided however that in no event shall the Maturity Date be a date prior to the date when all of the Phantom Stock units granted in the Plan Agreement are scheduled to become fully vested.

"Maturity Price" shall mean, except as otherwise provided in Section 4.3(b), the Value of a unit of Phantom Stock on the Maturity Date.

"Omega Common Stock" shall mean the common stock of Omega Flex, Inc.

"Participant" shall mean an officer, employee or director who has been selected by the Committee to participate in the Plan and who executes and returns to the Committee the Plan Agreement. Any officer, employee or director of a Subsidiary shall also be eligible to participate in the Plan, subject to the selection and approval by the Company's management and the Committee.

"Phantom Stock" shall mean units designated by the Company which represent a contractual right to payment of certain compensation in the future based on the value of the shares of the of Omega Common Stock. Phantom Stock units are not shares of the Omega Common Stock or the assets of Omega Flex, Inc., nor does the Phantom Stock provide any rights to obtain ownership of any shares of the Omega Common Stock, or to exercise any rights incident to ownership of the Omega Common Stock.

"Phantom Stock - Appreciation Only" shall mean a contractual right to receive the appreciation in the Value of a unit of Phantom Stock pursuant to the Plan and the applicable Plan Agreement.

"Phantom Stock – Full Value" shall mean a form of Phantom Stock wherein the Participant receives a contractual right to receive the entire Value of a unit of Phantom Stock pursuant to the Plan.

"Plan" shall mean Omega Flex, Inc. 2006 Phantom Stock Plan.

"Plan Agreement" shall mean one or more written agreements, as may be amended from time to time, which is entered into by and between the Company and a Participant. The terms of any Plan Agreement may not vary any of the terms set forth in the Plan.

"Service" shall mean the performance of services for the Company as an employee, director, and/or consultant, as determined by the Committee in its sole discretion. If a Participant transfers between the Company and another affiliated entity, then the Committee, in its sole discretion, shall decide whether Service has been terminated; provided that no termination of Service will be deemed to have occurred unless it constitutes a "separation from service" within the meaning of Code Section 409A and regulations thereunder.

"Subsidiary" shall mean any corporation, company, partnership or other business organization in which Omega Flex, Inc. has a direct or indirect controlling equity interest.

"Value" of a unit of Phantom Stock for any given date shall be equal to the closing price on that date of the Omega Common Stock as listed on a national exchange or quoted on a national automated quotation system. If the Omega Common Stock is not listed on a national exchange or national automated quotation system, then the "Value" of a unit of Phantom Stock shall be determined by the Committee and the Participants shall not have any right to challenge the Committee's determination.

### **ARTICLE 3 – ELIGIBILITY, GRANT AND VESTING**

3.1 Eligibility/Grant. Participation in the Plan shall be limited to a select group of officers, employees, and directors, of the Company. The Company's President may recommend to the Committee officers or employees of the Company, and the Compensation Committee may recommend to the Board one or more directors of the Company, that may participate in the Plan. The grant of Phantom Stock to any recommended individual employee will be at the sole and exclusive discretion of the Compensation Committee, and the grant of Phantom Stock to any recommended director will be at the sole and exclusive discretion of the Board of Directors. The recommendation that all members of the Board of Directors participate in the Plan will not be deemed to constitute a conflict of interest prohibiting any director to vote upon such recommendation.

3.2 Phantom Stock Units. The Committee authorizes the issuance of 1,000,000 Phantom Stock units under this Plan, subject to adjustment as provided in Section 0. Previously issued Phantom Stock units which are forfeited under the terms of this Plan shall be added back to the number of authorized but unissued Phantom Stock units, and may be subsequently granted to a Participant under this Plan.

3.3 Plan Agreement. Each Participant who receives Phantom Stock shall receive a Plan Agreement. As a condition to the effectiveness of the grant, the Participant shall acknowledge and agree to be bound by the terms, conditions, and restrictions of the Plan by signing a copy of the Plan Agreement. The Participant shall be entitled to benefits, if any, in accordance with the Participant's Plan Agreement and this Plan. In the event of any conflict between the terms of this Plan and a Plan Agreement, the terms of this Plan shall be controlling. The Plan Agreement will set forth the following terms of the grant:

(a) The number of Phantom Stock units, and whether the Phantom Stock units are Appreciation Only or Full Value;

(b) the Grant Date;

(c) the Grant Price; and

(d) the vesting schedule.

3.4 Grant Price. Each Agreement shall state the Grant Price of the Phantom Stock unit. The Grant Price shall be fixed by the Committee in the exercise of its sole discretion, but in no event shall the Grant Price be less than the closing price of a share of the Company's common stock at the Grant Date, or if there is no closing price available on the Grant Date, then the closing price of the Company's common stock on the first day immediately prior to the Grant Date for which the closing price is available.

3.5 Vesting. The Participant shall have no rights to any payments with respect to the Participant's Phantom Stock until the units of the Phantom Stock have vested. The vesting schedule for each grant of Phantom Stock shall be specified by the Committee at the time of grant and will be set forth in the Participant's Plan Agreement. Except as provided in Section 0, any grants of Phantom Stock shall be conditioned upon the continuous Service of the Participant during the vesting period, and if the Participant's Service is terminated during the vesting period, the Participant's unvested Phantom Stock units shall terminate and become forfeited on such date. If no vesting schedule is specified at the time of grant, the Phantom Stock shall vest according to the following schedule:

| <u>Number of Years<br/>Following Grant Date</u> | <u>Percentage of Phantom Stock<br/>to Vest</u> |
|---|--|
| 1   | 33%  |
| 2   | and an additional 33%                          |
| 3   | and an additional 34%                          |

3.6 Acceleration of Vesting. The Participant's Phantom Stock units shall be fully vested if the Participant's Service with the Company is terminated by reason of the Participant's death or Disability, provided, that the Participant's Service with the Company was continuous for 1 year prior to such death or Disability. The Participant's vested Phantom Stock units shall be paid as set forth in Section 0, below.

3.7 Rights as a Shareholder. With respect to any issued Phantom Stock units, a Participant shall have no rights as a shareholder of Omega Flex, Inc. (whether in terms of voting at meetings of the shareholders, or sharing in the payment of any dividend or distribution), nor shall a Participant obtain any rights to acquire shares of the Omega Common Stock in the future. Except as provided in Section 0, no rights shall accrue to a Participant and no adjustments shall be made to the Participant's outstanding Phantom Stock units on account of dividends (ordinary or extraordinary, whether in cash, securities or other property) or distributions or other rights declared on, or created in, the Omega Common Stock.

#### ARTICLE 4 – BENEFITS

4.1 Entitlement to Benefits (Maturity). The Participant's vested Phantom Stock units shall mature on the Maturity Date. If no Maturity Date is specified in the Plan Agreement, then the Maturity Date shall be on the date that is one year after the date on which all of the Phantom Stock units granted under a Plan Agreement are scheduled to be fully vested. The Company shall pay to the Participant the amount provided for in Section 4.3 below for such vested Phantom Stock units within 60 days of the earlier to occur of: (i) the Maturity Date; or (ii) the date on which the Participant's Service terminates for any reason other than Cause; provided, if the Participant is a "specified employee" (as described in Section 409A of the Code and Treasury regulations promulgated thereunder), then the Company shall pay to the Participant the amount provided for in Section 4.3 below (determined as of the date of termination) for the vested Phantom Stock units on the date 6 months and one day after the Participant's Service terminates (or, if earlier, the date of the Participant's death). Any unvested Phantom Stock units shall terminate and become forfeited on the date of the Participant's termination of Service with the Company in accordance with Section 3.5.

4.2 Termination of Service for Cause. If the Company terminates the Participant's Service for Cause, then all vested and unvested Phantom Stock units shall terminate and become forfeited as of the date of termination of Service and the Participant shall not be entitled to receive any amount for such Phantom Stock units. Prior to the forfeiture of any vested Phantom Stock units due to a termination for Cause for reasons set forth in clause (v) of Article 2, the circumstances and rationale for such termination shall be submitted by the Company to the Committee for review and approval at the discretion of the Committee. Such review by the Committee shall only be for the purposes of relating to the Plan, and shall not affect the employment or service relationship between the Company and any Participant.

4.3 Payment Amount. (a) For each vested Phantom Stock unit that is outstanding on the Maturity Date, the Participant shall be entitled to receive an amount based on the following formulas:

(i) *Appreciation Only Shares*: Vested Phantom Stock units multiplied by the Maturity Price as of the Maturity Date, less the Grant Price of the Phantom Stock units.

(ii) *Full Value Shares*: Vested Phantom Stock units multiplied by the Maturity Price as of the Maturity Date.

(b) For each vested Phantom Stock unit that is outstanding on the date of Participant's termination of Service with the Company for reasons other than for Cause, the Maturity Price of such Phantom Stock units shall be the closing price of the Omega Common Stock on the date of Participant's termination of Service, or if the closing price is not available on that date, the latest date prior to Participant's termination of Service for which the closing price is available.

(c) In accordance with Section 6.13, any payments made with respect to Phantom Stock units shall be subject to withholding as may be required by applicable law or regulation, or the Company's employee benefit plans.



## **ARTICLE 5 – BENEFICIARY**

5.1 Designation. At the time participation in the Plan commences, or at any later date, each Participant shall designate on a form satisfactory to the Committee one or more Beneficiaries to receive any benefits which may become payable hereunder in the event of his or her death (Beneficiary Designation). A Participant may change any such Beneficiary at any time prior to his or her death upon written notice to the Committee.

5.2 Multiple Beneficiary Designations. If the Participant shall have made more than one Beneficiary Designation, the Beneficiary Designation most recently filed with the Committee prior to the time of the Participant's death shall govern.

5.3 Participant's Obligation. All Participants and Beneficiaries shall have the obligation to keep the Committee informed of their current address until such time as all benefits due have been paid.

5.4 No Beneficiary Designation. If any amounts under the Plan become payable following a Participant's death at a time when no Beneficiary Designation is applicable or when no Beneficiary is in existence, such payments shall be made in a lump sum to such Participant's surviving spouse, or if none, such amounts shall be paid to such Participant's estate.

## **ARTICLE 6 – MISCELLANEOUS**

6.1 Amendment and Termination. The Committee reserves the right to amend or to terminate this Plan and Plan Agreements at any time; provided, however, that no such action shall reduce the benefits that the Participant earned prior to the date of any such amendment or termination.

Notwithstanding any other provision of the Plan or any Plan Agreement to the contrary, the Committee may, in good faith, amend the Plan or any Plan Agreement without Participant consent to the extent necessary, appropriate or desirable to comply with the requirements under Section 409A of the Code or to prevent the Participant from being subject to any additional tax or penalty under Section 409A of the Code, while maintaining to the maximum extent practicable the original intent of the Plan and the Plan Agreement. Notwithstanding the foregoing, neither the Company nor the Committee shall be liable to any Participant if such Participant's Phantom Stock units are subject to Section 409A of the Code, or the Participant otherwise is subject to any additional tax or penalty under Section 409A of the Code.

6.2 Rights to Terminate Service. Nothing in the Plan or in any Plan Agreement shall confer upon any Participant the right to continue in the Service of the Company or affect any right the Company may have to terminate the Service of such person.

6.3 Benefits not Transferable. Except as otherwise provided in Section 4.3(c), the rights and benefits under this Plan shall not be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge or encumbrance by any Participant or Beneficiary. Benefits under this Plan shall not be subject to or liable for the debts, contracts, liabilities, engagements or torts of any Participant or any Beneficiary, nor may the same be subject to attachment or seizure by any creditor of any Participant or any Beneficiary under any circumstances. Upon any attempt to transfer, assign, pledge, hypothecate or otherwise dispose of any Phantom Stock units or of any right or privilege conferred by this Plan contrary to the provisions hereof, or upon the

sale, levy or any attachment or similar process upon the rights and privileges conferred by this Plan, such Phantom Stock units shall thereupon terminate and become forfeited.

6.4 Source of Funds. Amounts payable to a Participant under this Plan shall be from the general funds of the Company. No special or separate fund shall be established, and no other segregation of assets shall be made to assure payout of benefits under the Plan. No Participant shall have any interest in any property or assets of the Company and the rights of Participants to unpaid amounts under the Plan shall be solely those of an unsecured creditor of the Company.

6.5 Plan Administration. The Plan shall be administered by, and in the sole discretion of, the Committee. The Committee may delegate all or some of its responsibilities under the Plan to one or more individuals, who may not be Participants under the Plan. The Committee may establish such rules and regulations as it deems necessary or desirable, make amendments in a manner consistent with Section 6.1 above, interpret the Plan and Plan Agreements, make factual findings and determinations, and otherwise make all determinations and take such action in connection with the Plan as it, in its sole discretion, deems appropriate. The decisions of the Committee shall be final, conclusive and binding upon all parties and the Committee shall not be liable for any action or determination made in good faith with respect to the Plan or any Plan Agreement. The Committee and each person to whom duties and responsibilities have been delegated shall be indemnified and held harmless by the Company against all claims, demands, damages, costs, liabilities, fines, and penalties, and all expenses reasonably incurred by or imposed upon such individuals (including but not limited to reasonable attorneys' fees) which arise as a result of actions or failure to act in connection with the operation and administration of the Plan.

#### 6.6 Determination of Benefits

(a) General. The Committee may require any person claiming benefits under the Plan (“Claimant”) to submit an application therefor in writing to the Claims Administrator, together with such other documents and information as the Committee may require.

(b) Claims. Claims for benefits, benefit determinations, appeals and reviews of any adverse benefit determination and all associated notifications shall, at a minimum, comply with Section 503 of ERISA and the applicable provisions of 29 C.F.R. § 2560.503-1 (“ERISA Regulations”).

(c) Claims Administrator. The Claims Administrator shall be designated by the Committee. The Committee reserves the right to change the Claims Administrator from time to time and to designate a special Claims Administrator when deemed necessary to avoid a conflict of interest.

(d) Notification of Benefit Determination. The Claims Administrator will notify the Claimant of a benefit determination in writing within a reasonable time. Notification that a claim is wholly or partially denied will normally be given no later than 90 days after receipt of the claim. The notice shall (1) specify the reasons for the adverse decision, (2) refer to the specific provisions of the Plan on which the decision is based, (3) describe any additional material necessary to complete the claim and the reasons that such material is necessary, (4) describe the appeal and review procedures and the applicable time limits, and (5) inform the Claimant of the right to bring the matter to binding arbitration in accordance with Section 6.9 following review. Should special circumstances require an extension of time for processing the

claim, written notice of the extension shall be furnished to the Claimant prior to the expiration of the initial ninety-day period. The notice shall indicate the special circumstances requiring an extension of time and the date by which a final decision is expected to be rendered. In no event shall the period of the extension exceed ninety days from the end of the initial ninety-day period. Claims not acted upon within the time prescribed herein shall be deemed denied for purposes of proceeding to the review stage.

(e) Review. A Claimant is entitled to have an adverse benefit determination reviewed by the Committee or its designee (the “Named Fiduciary”). The request for review must be in writing and filed with the Claims Administrator no later than 60 days following the Claimant’s receipt of the adverse determination. The Claimant may submit written comments and other information and documents relating to the claim, and have reasonable access to and receive copies of all documents and information relevant to the claim. The Claimant may request a hearing. The Claims Administrator will promptly forward the request for review and the claim file to the Named Fiduciary. The decision of the Named Fiduciary shall be made promptly, and not later than sixty days after the Named Fiduciary’s receipt of a request for review, unless special circumstances require an extension of time for processing. In such a case, a decision shall be rendered as soon as possible, but not later than one hundred twenty days after receipt of the request for review.

(f) Named Fiduciary. The Named Fiduciary shall not be the Claims Administrator nor subordinate to the Claims Administrator. The Committee reserves the right to change the Named Fiduciary from time to time, and to designate a special Named Fiduciary for appeals when deemed necessary.

(g) Review Procedure. The Named Fiduciary has the discretion to decide all questions regarding relevance and reasonable access. In addition, the Named Fiduciary has the discretion as to whether a hearing shall be held. The Named Fiduciary will afford no deference to the Claims Administrator’s decision, and will insure a full and fair review *de novo*.

(h) Notification of Benefit Determination on Review. The Named Fiduciary’s decision will be in writing and sent to the Claims Administrator. The Claims Administrator will then notify the Claimant either by hand delivery or by first class mail within a reasonable time, and normally not later than 60 days after receipt of the claim for review. If the Named Fiduciary issues an adverse benefit decision to the Claimant, the decision shall (1) specify the reasons for the decision, (2) refer to specific plan provisions on which the decision was based, (3) inform the Claimant of the right to review all information reviewed by the Named Fiduciary, even information not relied on in making the decision, and (4) inform the Claimant of the right to bring the matter to binding arbitration in accordance with Section 6.9].

(i) Exhaustion of Remedies. No legal action for benefits under the Plan may be brought unless and until the Claimant has exhausted his remedies under this Section 6.6.

## 6.7 Capital Structure Adjustments.

(a) In the event of a change in the form of entity, recapitalization, reorganization, merger, consolidation, separation, financing, or like change in the organizational or capital structure of the Company, the Committee shall make such changes to the Plan and/or Plan Agreement(s) as the Committee deems appropriate. These changes may include, but are not

limited to, changes to the definition of "Value" and "Company", or changes to the number of Phantom Stock units granted to any one or more Participants. The Committee's determination shall be final, binding, and conclusive. The Committee shall interpret this section in a manner it believes (in its discretion) to be consistent with the intent to place Participants in substantially the same economic position as they would have had in the absence of such an organizational or capital structure change.

(b) The Plan shall not affect, in any way, the right or power of the Company to make adjustments, re-classifications, reorganizations, or changes of its capital or business structures, to make distributions to its shareholders, or to merge or to consolidate or to dissolve, liquidate or sell, or transfer all or part of its business or assets.

6.8 Satisfaction of Claims. Any payment to a Participant or Beneficiary or the legal representative of either, in accordance with the terms of this Plan and the applicable Plan Agreement shall to the extent thereof be in full satisfaction of all claims such person may have against the Company. The Committee may require such payee, as a condition to such payment, to execute a receipt and release therefore in such form as shall be determined by the Committee.

6.9 Governing Law/Arbitration. The Plan shall be construed, administered, and governed in all respects in accordance with the laws of the Commonwealth of Pennsylvania, without regard to its conflict of laws or choice of law provisions or principles. In the event any claim or controversy arises under or concerning any provision of this Plan, such claim or controversy shall be settled by binding arbitration. The arbitration proceedings will be conducted in Philadelphia, Pennsylvania in accordance with the Employment Dispute Resolution Rules of the American Arbitration Association then in effect. Each Participant and the Company mutually agree that notwithstanding the rules of the arbitral body, that (a) any arbitration shall be presided over by a neutral arbitrator who shall have been admitted to the practice of law, and be in good standing or on retirement status in any one state of the United States, (b) the arbitrator shall base his/her decision on the facts as presented into evidence, and in accordance with the laws of the jurisdiction chosen by the parties under this Plan, (c) the arbitrator shall prepare a written memorandum of decision setting forth the findings of fact and conclusions of law, and (d) in the course of performing his/her duties hereunder and in rendering his/her decision, the arbitrator shall have no power or authority to add to, delete from, or otherwise modify this Plan, or any term, condition, covenant, representation, warranty, or provision contained herein. The decision of the arbitrator shall be final, and judgment may be entered upon it in accordance with the applicable law in any court having jurisdiction. Any claim for relief made under this Plan shall be made within one (1) year from the date upon which the party claiming relief knew or should have known of the cause of action constituting such claim. The arbitrator may award monetary damages to the prevailing party only for actual damages, but may not award punitive, consequential, special or incidental damages as between the parties.

6.10 Captions. The captions of this Plan are descriptive only and do not affect the intent or interpretation of the Plan.

6.11 Severability. The invalidity or unenforceability of any provision or portion thereof of this Plan shall not affect the validity or enforceability of any other provision or portion thereof.

6.12 Notices. Any notice required or permitted to be given hereunder shall be in writing sent by either personal delivery, overnight delivery, or United States, registered or

certified mail, return receipt requested, all of which shall be properly addressed with postage or delivery charges prepaid, to the Committee or Participant or Beneficiary at their respective addresses listed below, or at such other addresses as either the Company or Participant or Beneficiary may hereafter designate to the other in writing:

To the Committee:   Omega Flex, Inc.  
                          c/o Legal Department  
                          451 Creamery Way  
                          Exton, PA 19341

To Participant:       See Plan Agreement

Notices sent by personal delivery shall be deemed given upon actual receipt. Notices sent by overnight delivery shall be deemed given on the next business day. Notices sent via United States registered or certified mail shall be deemed given two business days from mailing.

6.13 Withholding. Payments made under this Plan constitute compensation and the Company shall deduct from all such payments an amount sufficient to satisfy any federal, state, local and/or employment tax withholding requirements and may withhold any other sums as required by the Company's employee benefit plans.

6.14 Effective Date and Term. This Plan shall be effective as of April 1, 2006 (the "Effective Date") and shall continue until terminated by the Committee.

**IN WITNESS WHEREOF**, the Company has caused this Plan to be executed by its duly authorized officer as of the Effective Date.

**OMEGA FLEX, INC.**

By: \_\_\_\_\_

Title: \_\_\_\_\_

PHANTOM STOCK AGREEMENT

THIS PHANTOM STOCK AGREEMENT effective this 11<sup>th</sup> day of December, 2006 is between OMEGA FLEX, INC, a Pennsylvania corporation ("Company"), and \_\_\_\_\_ ("Recipient").

BACKGROUND

A. Pursuant to the Company's 2006 Phantom Stock Plan dated as of April 1, 2006 (the "Plan"), the Compensation Committee of the Company's Board of Directors (the "Committee") is authorized to grant phantom stock units ("Phantom Stock Units") to directors, officers and other key employees of the Corporation.

B. The Board regards Recipient as a key contributor to the Company and, in order to provide additional incentive to Recipient to further his efforts for Company, the Committee has directed that there be granted to Recipient Phantom Stock Units set forth below, upon the terms and conditions set forth in the Plan and this Agreement.

AGREEMENTS

In consideration of the mutual promises and covenants herein contained, the parties hereto hereby agree as follows:

1. Basic Terms. Pursuant to the terms and conditions of the Plan and of this Agreement, Company hereby grants to Recipient units of Phantom Stock as defined under the Plan as follows:

**Type:** \_\_\_\_\_  
**Number:** \_\_\_\_\_  
**Grant Date:** \_\_\_\_\_  
**Grant Price:** \_\_\_\_\_  
**Maturity Date:** \_\_\_\_\_

**Vesting Schedule:**

| <u>Number of Years<br/>After Grant Date</u> | <u>Percentage of Phantom<br/>Stock Units to Vest</u> |
|---|--|
| 1   | _____  |
| 2   | _____  |
| 3   | _____  |

2. No Rights; Capital Stock. Recipient shall not have any rights as a shareholder of Omega Flex, Inc. with respect to any Phantom Stock units granted to Recipient under this Agreement. No adjustments shall be made to the grant of Phantom Stock made under this Agreement for any dividends or distributions or other rights relating to the Omega Common Stock, regardless of whether the record date for such dividends or distributions or other rights is prior to the complete vesting of the Phantom Stock units or the Maturity Date.

3. No Rights; Employment. The grant of the Phantom Stock units, execution of this Agreement or the vesting of any Phantom Stock units shall not confer upon Recipient any right to, or guaranty of, continued employment with Company or membership on the Board of Company or any of its subsidiaries, nor in any way limit the right of Company or such subsidiaries to terminate at any time the employment of or relationship with the Recipient.

4. Non-transferability of Phantom Stock. The Phantom Stock units granted under this Agreement shall not be transferable by Recipient or by operation of law, other than by will or by the laws of descent and distribution applicable to a deceased Recipient and then only to the extent provided in the Plan or in this Agreement. More particularly, but without limiting the generality of the foregoing, the Phantom Stock units may not be assigned, transferred (except as provided in the preceding sentence), pledged, or hypothecated in any way, shall not be transferred by operation of law, and shall not be subject to execution, attachment or similar process. Any attempted assignment, transfer, pledge, hypothecation, or other disposition of the Phantom Stock contrary to the provisions hereof, and the levy of any execution, attachment, or similar process upon the Phantom Stock, shall be a breach of this Agreement will automatically forfeit any Phantom Stock units then outstanding.

5. Beneficiary Designation. The names of each Beneficiary, if any, their relationship to the Recipient, and their respective interests in the Phantom Stock units, are set forth in Exhibit A attached hereto.

6. Notices. All notices to Recipient or other persons then entitled to exercise the Option shall be delivered at the address below or such other address as shall be specified in writing by Recipient or such other person. All notices to Company shall be delivered to the attention of its Secretary at its principal offices.

7. Governing Law. The Option shall be construed under and governed by the laws of the Commonwealth of Pennsylvania as to all matters, including, but not limited to, matters of validity, construction, effect and performance.

8. Arbitration. The Recipient acknowledges that the Plan provides for mandatory arbitration of any disputes arising under the Plan and this Agreement, or either of them, and the Recipient agrees to be bound by the arbitration provisions of the Plan.

THE PARTIES UNDERSTAND THAT BY AGREEING TO ARBITRATE CLAIMS OR CONTROVERSIES ARISING UNDER OR CONCERNING ANY PROVISION OF THE PLAN AND THIS AGREEMENT, OR EITHER OF THEM, THEY ARE WAIVING THE RIGHT TO BRING AN ACTION IN A COURT OF LAW, EITHER STATE OF FEDERAL, AND ARE WAIVING THE RIGHT TO HAVE CLAIMS AND DAMAGES (IF ANY) DETERMINED BY A JURY.

9. Entire Agreement, Amendment. This Agreement and the Plan contain the entire agreement between the parties hereto relating to the subject matter hereof and shall not be modified or amended in any way except in a writing signed by all of the parties hereto. All terms which are not defined in this Agreement shall bear the meaning ascribed to such terms in the Plan. This Agreement is made pursuant to and in accordance with the Plan, and in the event of any conflict or discrepancy between the terms of this Agreement and the terms of the Plan, the terms of the Plan shall have precedence over any conflicting or discrepant terms in this Agreement.

**COMPANY:**  
OMEGA FLEX, INC.

By \_\_\_\_\_  
Name: \_\_\_\_\_

**RECIPIENT:**

\_\_\_\_\_  
Name: \_\_\_\_\_  
Address: \_\_\_\_\_  
\_\_\_\_\_



**EXHIBIT A**

Designation of Beneficiary

The undersigned, \_\_\_\_\_, hereby designates  
\_\_\_\_\_, as my beneficiary under the Phantom Stock Agreement  
dated December 11, 2006, between the undersigned and Omega Flex, Inc., until such time as  
the undersigned shall change such designation in writing provided to Omega Flex, Inc.

\_\_\_\_\_  
\_\_\_\_\_

Commonwealth of \_\_\_\_\_ }  
County of \_\_\_\_\_ } ss.

On this \_\_\_\_ day of December, 2006, before me, the undersigned notary public, personally  
appeared \_\_\_\_\_, proved to me through satisfactory evidence of identification, which  
were \_\_\_\_\_, to be the person whose name is signed on the preceding or  
attached document, and acknowledged to me that [he] [she] signed it voluntarily for its stated  
purpose.

\_\_\_\_\_  
\_\_\_\_\_, Notary Public  
My commission expires \_\_\_\_\_

**OMEGA FLEX, INC.**

Phantom Stock Agreements  
Schedule of Directors and Officers

As of December 31, 2006

| <u>Director/Officer</u> | <u>Type</u> | <u>Number</u> | <u>Grant Date</u> | <u>Grant Price</u> | <u>Maturity Date</u> | <u>Vesting Schedule</u> |
|-------------------------|-------------|---------------|-------------------|--------------------|----------------------|-------------------------|
| Duane E. Sholtz         | Full Value  | 2,420         | 12/11/2006        | \$ 20.66           | 12/11/2010           | 3 years                 |

Consent of Independent Registered Public Accounting Firm

We hereby consent to the incorporation by reference of our report dated March 28, 2007, accompanying the December 31, 2006 consolidated financial statements included in the Annual Report of Omega Flex, Inc and subsidiaries on Form 10-K for the year ended December 31, 2006 in this Registration Statement of Omega Flex, Inc. and subsidiaries on Form S-8 (333-135515).

VITALE, CATURANO & COMPANY, LTD.

Boston, Massachusetts  
March 29, 2007

I, Kevin R. Hoben, Chief Executive Officer, Omega Flex, Inc., certify that:

1. I have reviewed this Annual Report on Form 10-K for year ended December 31, 2006, of Omega Flex, Inc. (the "registrant");

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses (if any) in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: April 2, 2007

/s/ Kevin R. Hoben

Kevin R. Hoben  
Chief Executive Officer

I, E. Lynn Wilkinson, Chief Financial Officer of Omega Flex, Inc., certify that:

1. I have reviewed this Annual Report on Form 10-K for the year ended December 31, 2006, of Omega Flex, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting.
5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses (if any) in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: April 2, 2007

/s/ E. Lynn Wilkinson

E. Lynn Wilkinson  
Chief Financial Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF  
THE SARBANES-OXLEY ACT OF 2002**

Each of the undersigned hereby certifies, for the purposes of 18 U.S.C. Section 1350, in his capacity as an officer of Omega Flex, Inc. (the "Company"), that, to his knowledge:

(a) the Annual Report on Form 10-K of the Company for the year ended December 31, 2006, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

(b) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: April 2, 2007

/s/ Kevin R. Hoben\_\_\_\_\_

Kevin R. Hoben  
Chief Executive Officer

/s/ E. Lynn Wilkinson\_\_\_\_\_

E. Lynn Wilkinson  
Chief Financial Officer

This certification is not deemed to be "filed" for purposes of section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section. This certification is not deemed to be incorporated by reference into any filing under the Securities Act of 1933 or Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates it by reference.