

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **September 30, 2019**

() 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

23-1948942

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

451 Creamery Way, Exton, PA

19341

(Address of principal executive offices)

(Zip Code)

(610) 524-7272

Registrant's telephone number, including area code

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting Company

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

**APPLICABLE ONLY TO ISSUERS 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 Sections 12, 12 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by the courts.

The number of shares of the registrant's common stock outstanding as of September 30, 2019 was 10,094,322.

OMEGA FLEX, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2019

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PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements

OMEGA FLEX, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Amounts)

	September 30, 2019	December 31, 2018
	(unaudited)	
ASSETS		
Current Assets:		
Cash and Cash Equivalents	\$25,158	\$32,392
Accounts Receivable - less allowances of \$1,060 and \$985, respectively	16,814	16,451
Investments	22,865	14,944
Inventories-Net	10,466	7,976
Other Current Assets	2,692	1,859
Total Current Assets	77,995	73,622
Right-Of-Use Assets	680	---
Property and Equipment - Net	8,899	8,378
Goodwill - Net	3,526	3,526
Deferred Taxes	3	3
Other Long Term Assets	1,416	1,307
Total Assets	\$92,519	\$86,836
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts Payable	\$2,859	\$2,775
Accrued Compensation	3,159	5,295
Accrued Commissions and Sales Incentives	4,284	4,264
Dividends Payable	2,826	2,422
Taxes Payable	---	58
Lease Liability	305	---
Other Liabilities	6,590	3,591
Total Current Liabilities	20,023	18,405
Lease Liability, net of current portion	392	---
Deferred Taxes	319	566
Other Long Term Liabilities	1,813	1,544
Total Liabilities	22,547	20,515
Commitments and Contingencies (Note 5)		
Shareholders' Equity:		
Omega Flex, Inc. Shareholders' Equity:		
Common Stock – par value \$0.01 share: authorized 20,000,000 shares: 10,153,633 shares issued at September 30, 2019 and December 31, 2018, respectively, and 10,094,322 and 10,091,822 shares outstanding at September 30, 2019 and December 31, 2018, respectively	102	102
Treasury Stock	(1)	(1)
Paid-in Capital	11,025	10,808
Retained Earnings	59,769	56,110
Accumulated Other Comprehensive Loss	(1,141)	(950)
Total Omega Flex, Inc. Shareholders' Equity	69,754	66,069
Noncontrolling Interest	218	252
Total Shareholders' Equity	69,972	66,321
Total Liabilities and Shareholders' Equity	\$92,519	\$86,836

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

OMEGA FLEX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except per Share and Share Amounts)

	<u>For the three-months ended</u> <u>September 30,</u>		<u>For the nine-months ended</u> <u>September 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
	(Unaudited)			
Net Sales	\$ 28,030	\$ 27,199	\$ 81,627	\$ 79,443
Cost of Goods Sold	<u>10,326</u>	<u>10,652</u>	<u>30,241</u>	<u>31,649</u>
Gross Profit	17,704	16,547	51,386	47,794
Selling Expense	5,383	4,265	14,193	12,960
General and Administrative Expense	6,786	4,385	18,430	12,939
Engineering Expense	<u>1,162</u>	<u>1,221</u>	<u>3,655</u>	<u>3,361</u>
Operating Profit	4,373	6,676	15,108	18,534
Interest Income	229	130	685	275
Other Income (Expense)	<u>(55)</u>	<u>(40)</u>	<u>(50)</u>	<u>(80)</u>
Income Before Income Taxes	4,547	6,766	15,743	18,729
Income Tax Expense	<u>1,153</u>	<u>1,556</u>	<u>3,896</u>	<u>4,504</u>
Net Income	3,394	5,210	11,847	14,225
Less: Net Income attributable to the Noncontrolling Interest	<u>(26)</u>	<u>(34)</u>	<u>(114)</u>	<u>(110)</u>
Net Income attributable to Omega Flex, Inc.	<u>\$ 3,368</u>	<u>\$ 5,176</u>	<u>\$ 11,733</u>	<u>\$ 14,115</u>
Basic and Diluted Earnings per Common Share	<u>\$ 0.33</u>	<u>\$ 0.51</u>	<u>\$ 1.16</u>	<u>\$ 1.40</u>
Cash Dividends Declared per Common Share	<u>\$ 0.28</u>	<u>\$ 0.24</u>	<u>\$ 0.80</u>	<u>\$ 0.70</u>
Basic and Diluted Weighted-Average Shares Outstanding	<u>10,092,428</u>	<u>10,091,822</u>	<u>10,092,027</u>	<u>10,091,822</u>

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

OMEGA FLEX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	For the three-months ended		For the nine-months ended	
	September 30,		September 30,	
	2019	2018	2019	2018
	(Unaudited)			
Net Income	\$ 3,394	\$ 5,210	\$ 11,847	\$ 14,225
Other Comprehensive Income (Loss):				
Foreign Currency Translation Adjustment	(147)	(38)	(202)	29
Other Comprehensive Income (Loss)	(147)	(38)	(202)	29
Comprehensive Income	3,247	5,172	11,645	14,254
Less: Comprehensive Income Attributable to the Noncontrolling Interest	(18)	(32)	(103)	(110)
Total Comprehensive Income	\$ 3,229	\$ 5,140	\$ 11,542	\$ 14,144

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

OMEGA FLEX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In Thousands, Except Share Amounts)

For the three-months ended September 30, 2019

	Common Stock Outstanding	Common Stock	Treasury Stock	Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Shareholders' Equity
June 30, 2019	10,094,322	\$ 102	(\$ 1)	\$ 11,025	\$ 59,227	(\$ 1,002)	\$ 337	\$ 69,688
Net Income					3,368		26	3,394
Cumulative Translation Adjustment						(139)	(8)	(147)
Dividends Declared					(2,826)		(137)	(2,963)
September 30, 2019	10,094,322	\$ 102	(\$ 1)	\$ 11,025	\$ 59,769	(\$ 1,141)	\$ 218	\$ 69,972

For the three-months ended September 30, 2018

	Common Stock Outstanding	Common Stock	Treasury Stock	Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Shareholders' Equity
June 30, 2018	10,091,822	\$ 102	(\$ 1)	\$ 10,808	\$ 49,754	(\$ 843)	\$ 198	\$ 60,018
Net Income					5,176		34	5,210
Cumulative Translation Adjustment						(36)	(2)	(38)
Dividends Declared					(2,422)			(2,422)
September 30, 2018	10,091,822	\$ 102	(\$ 1)	\$ 10,808	\$ 52,508	(\$ 879)	\$ 230	\$ 62,768

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

OMEGA FLEX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(In Thousands, Except Share Amounts)

For the nine-months ended September 30, 2019

	Common Stock Outstanding	Common Stock	Treasury Stock	Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Shareholders' Equity
December 31, 2018	10,091,822	\$ 102	(\$ 1)	\$ 10,808	\$ 56,110	(\$ 950)	\$ 252	\$ 66,321
Net Income					11,733		114	11,847
Cumulative Translation Adjustment						(191)	(11)	(202)
Shares Reissued From Treasury Pursuant To Restricted Stock Unit Awards	2,500			217				217
Dividends Declared					(8,074)		(137)	(8,211)
September 30, 2019	<u>10,094,322</u>	<u>\$ 102</u>	<u>(\$ 1)</u>	<u>\$ 11,025</u>	<u>\$ 59,769</u>	<u>(\$ 1,141)</u>	<u>\$ 218</u>	<u>\$ 69,972</u>

For the nine-months ended September 30, 2018

	Common Stock Outstanding	Common Stock	Treasury Stock	Paid In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Shareholders' Equity
December 31, 2017	10,091,822	\$ 102	(\$ 1)	\$ 10,808	\$ 45,457	(\$ 908)	\$ 611	\$ 56,069
Net Income					14,115		110	14,225
Cumulative Translation Adjustment						29		29
Dividends Declared					(7,064)		(491)	(7,555)
September 30, 2018	<u>10,091,822</u>	<u>\$ 102</u>	<u>(\$ 1)</u>	<u>\$ 10,808</u>	<u>\$ 52,508</u>	<u>(\$ 879)</u>	<u>\$ 230</u>	<u>\$ 62,768</u>

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

OMEGA FLEX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands)

	For the nine-months ended	
	September 30,	
	2019	2018
	(unaudited)	
Cash Flows from Operating Activities:		
Net Income	\$11,847	\$14,225
Adjustments to Reconcile Net Income to		
Net Cash Provided by Operating Activities:		
Non-Cash Compensation	1,962	445
Depreciation and Amortization	493	361
Provision for Losses on Accounts Receivable, net of write-offs and recoveries	75	129
Deferred Taxes	(247)	139
Provision for Inventory Reserves	(5)	(134)
Changes in Assets and Liabilities:		
Accounts Receivable	(512)	(2,054)
Inventories	(2,534)	476
Other Assets	(944)	1,219
Accounts Payable	103	(28)
Accrued Compensation	(2,115)	(1,069)
Accrued Commissions and Sales Incentives	28	(214)
Lease Liability, Net	18	---
Other Liabilities	1,504	(1,779)
Net Cash Provided by Operating Activities	<u>9,673</u>	<u>11,716</u>
Cash Flows from Investing Activities:		
Purchase of Investments	(45,921)	(34,897)
Net Proceeds from Sale of Investments	38,000	---
Capital Expenditures	(1,022)	(1,046)
Net Cash Used in Investing Activities	<u>(8,943)</u>	<u>(35,943)</u>
Cash Flows from Financing Activities:		
Dividend Paid	(7,807)	(7,353)
Net Cash Used in Financing Activities	<u>(7,807)</u>	<u>(7,353)</u>
Net Decrease in Cash and Cash Equivalents	(7,077)	(31,580)
Translation effect on cash	(157)	87
Cash and Cash Equivalents – Beginning of Period	32,392	37,938
Cash and Cash Equivalents – End of Period	<u>\$25,158</u>	<u>\$ 6,445</u>
Supplemental Disclosure of Cash Flow Information:		
Cash paid for Income Taxes	<u>\$4,342</u>	<u>\$5,708</u>
Cash paid for Interest	<u>\$ ---</u>	<u>\$ ---</u>
Declared Dividends	<u>\$8,211</u>	<u>\$7,555</u>

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

OMEGA FLEX, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION AND DESCRIPTION OF BUSINESS

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Omega Flex, Inc. (Omega) and its subsidiaries (collectively the “Company”). The Company’s unaudited condensed consolidated financial statements for the quarter ended September 30, 2019 have been prepared in accordance with accounting principles generally accepted in the United States (GAAP), and with the instructions of Form 10-Q and Article 10 of Regulation S-X. Certain information and note disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to those rules and regulations, although the Company believes that the disclosures made are adequate to make the information not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company’s latest shareholders’ annual report (Form 10-K). All material inter-company accounts and transactions have been eliminated in consolidation. It is Management’s opinion that all adjustments necessary for a fair statement of the results for the interim periods have been made, and that all adjustments are of a normal recurring nature or a description is provided for any adjustments that are not of a normal recurring nature.

Description of Business

The Company’s business is controlled as a single operating segment that consists of the manufacture and sale of flexible metal hose (also described as corrugated tubing), as well as the sale of the Company’s related proprietary fittings and a vast array of accessories.

The Company is a leading manufacturer of flexible metal hose, which is used in a variety of ways to carry gases and liquids within their particular applications. Some of the more prominent uses include carrying fuel gases within residential and commercial buildings, carrying gasoline and diesel gasoline products (both above and below the ground) in a double containment piping to contain any possible leaks, which is used in automotive and marina refueling, and fueling for back-up generation, using copper-alloy corrugating piping in medical or health care facilities to carry medical gases (oxygen, nitrogen, vacuum) or pure gases for pharmaceutical applications, and 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 facilities in Exton, Pennsylvania, in the United States, and in Banbury, Oxfordshire in the United Kingdom, and primarily sells its products through distributors, wholesalers and to original equipment manufacturers (“OEMs”) throughout North America and Europe, and to a lesser extent other global markets.

2. SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of 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 and related sales incentives, accounts receivable allowances, investment valuations, inventory valuations, goodwill valuation, product liability reserve, stock-based compensation valuations and accounting for income taxes. Actual amounts could differ significantly from these estimates.

Revenue Recognition

Effective January 1, 2018, the Company adopted the requirements of Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services.

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective approach). The Company selected the modified retrospective approach however there was no material impact which required a cumulative effect adjustment.

The principle of Topic 606 was achieved through applying the following five-step approach:

- *Identification of the contract, or contracts, with a customer* — a contract with a customer exists when the Company enters into an enforceable contract with a customer, typically a purchase order initiated by the customer, that defines each party’s rights regarding the goods to be transferred and identifies the payment terms related to these goods.
- *Identification of the performance obligations in the contract* — performance obligations promised in a contract are identified based on the goods that will be transferred to the customer that are distinct, whereby the customer can benefit from the goods on their own or together with other resources that are readily available from third parties or from us. Persuasive evidence of an arrangement for the sale of product must exist. The Company ships product in accordance with the purchase order and standard terms as reflected within the Company’s order acknowledgments and sales invoices.

- *Determination of the transaction price* —the transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods to the customer. This would be the agreed upon quantity and price per product type in accordance with the customer purchase order, which is aligned with the Company’s internally approved pricing guidelines.
- *Allocation of the transaction price to the performance obligations in the contract* — if the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. This applies to the Company as there is only one performance obligation to ship the goods.
- *Recognition of revenue when, or as, the Company satisfies a performance obligation* — the Company satisfies performance obligations at a point in time when control of the goods transfers to the customer. Determining the point in time when control transfers requires judgment. Indicators considered in determining whether the customer has obtained control of a good include:
 - The Company has a present right to payment
 - The customer has legal title to the goods
 - The Company has transferred physical possession of the goods
 - The customer has the significant risks and rewards of ownership of the goods
 - The customer has accepted the goods

It is important to note that the indicators are not a set of conditions that must be met before the Company can conclude that control of the goods has transferred to the customer. The indicators are a list of factors that are often present if a customer has control of the goods.

The Company has typical, unmodified FOB shipping point terms. As the seller, the Company can determine that the shipped goods meet the agreed-upon specifications in the contract or customer purchase order (e.g. items, quantities, and prices) with the buyer, so customer acceptance would be deemed a formality, as noted in Accounting Standards Codification (“ASC”) 606-10-55-86. As a result, the Company has a legal right to payment upon shipment of the goods.

Based upon the above, the Company has concluded that control substantively transfers to the customer upon shipment.

Other considerations of Topic 606 include the following:

- *Contract Costs* - costs to obtain a contract (e.g. customer purchase order) include sales commissions. Under Topic 606, these costs may be expensed as incurred for contracts with a duration of one year or less. The majority of the customer purchase orders are fulfilled (e.g. goods are shipped) within two days of receipt.
- *Warranties* - the Company does not offer customers to purchase a warranty separately. Therefore there is not a separate performance obligation. The Company does account for warranties as a cost accrual and the warranties do not include any additional distinct services other than the assurance that the goods comply with agreed-upon specifications. There is no impact of warranties under Topic 606 upon

the financial reporting of the Company.

- *Returned Goods* - from time to time, the Company provides authorization to customers to return goods. If deemed to be material, the Company would record a “right of return” asset for the cost of the returned goods which would reduce cost of sales.
- *Volume Rebates (Promotional Incentives)* - volume rebates are variable (dependent upon the volume of goods purchased by our eligible customers) and, under Topic 606, must be estimated and recognized as a reduction of revenue as performance obligations are satisfied (e.g. upon shipment of goods). Also under Topic 606, to ensure that revenue recognized would not be probable of a significant reversal, the four following factors are considered:
 - The amount of consideration is highly susceptible to factors outside the company’s influence.
 - The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
 - The Company’s experience with similar types of contracts is limited.
 - The contract has a large number and broad range of possible consideration amounts.

If it was concluded that the above factors were in place for the Company, it would support the probability of a significant reversal of revenue. However, as none of the four factors apply to the Company, promotional incentives are recorded as a reduction of revenue based upon estimates of the products expected to be sold.

Regarding disaggregated revenue disclosures, as previously noted, the Company’s business is controlled as a single operating segment that consists of the manufacture and sale of flexible metal hose. Most of the Company’s transactions are very similar in nature, contract, terms, timing, and transfer of control of goods. As indicated within Note 2, under the caption “Significant Concentration”, the majority of the Company’s sales were geographically contained within North America, with the remainder scattered internationally. All performance assessments and resource allocations are generally based upon the review of the results of the Company as a whole.

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. Carrying value approximates fair value. Cash and cash equivalents are deposited at various area banks, which at times may exceed federally insured limits. The Company monitors the viability of the banking institutions carrying its assets on a regular basis, and has the ability to transfer cash to various institutions during times of risk. The Company has not experienced any losses related to these cash balances, and believes its credit risk to be minimal.

Accounts Receivable and Provision for Doubtful Accounts

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 their inability to make payments, additional allowances may be required.

The allowance for doubtful accounts reflects the Company's 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. The reserve for future credits, discounts, and doubtful accounts was \$1,060,000 and \$985,000 as of September 30, 2019 and December 31, 2018, respectively. In regards to identifying uncollectible accounts, the Company reviews an aging report on a consistent basis to determine past due accounts, and utilizes a well-established credit rating agency. The Company charges off those accounts that are deemed uncollectible once all collection efforts have been exhausted.

Investments

The Company invests excess funds in liquid interest earning instruments including U.S. Treasury bills and bank time deposits. These investments are stated at fair value, which approximates amortized cost, and are classified as available-for-sale in accordance with ASC 320, *Investments – Debt and Equity Securities*. Investments were \$22,865,000 and \$14,944,000 as of September 30, 2019 and December 31, 2018, respectively. Maturities, from the date of purchase, were more than three months and less than one year.

Inventories

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

Property and Equipment

Property and equipment are initially recorded 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 other income or expense for the period. The cost of maintenance and repairs is expensed as incurred; significant improvements are capitalized.

Goodwill

In accordance with Financial Accounting Standards Board ("FASB") ASC Topic 350, *Intangibles – Goodwill and Other*, the Company performed an annual impairment test in

accordance with this guidance as of December 31, 2018. This analysis did not indicate any impairment of goodwill. There were no circumstances that indicate that goodwill might be impaired as of September 30, 2019.

Stock-Based Compensation Plans

In 2006, the Company adopted a Phantom Stock Plan (the “Plan”), which allows the Company to grant phantom stock units (“Units”) to certain key employees, officers or directors. The Units each represent a contractual right to payment of compensation in the future based upon the market value of the Company’s common stock. The Units follow a vesting schedule of three years from the grant date, and are then paid upon maturity. In accordance with FASB ASC Topic 718, *Compensation - Stock Compensation*, the Company uses the Black-Scholes option pricing model as its method for determining the fair value of the Units. Further details of the Plan are provided in Note 6.

Product Liability Reserves

Product liability reserves mostly represent the estimated unpaid amounts under the Company’s insurance policies with respect to existing claims. The Company uses the most current available data to estimate claims. As explained more fully under Note 5, Commitments and Contingencies, for various product liability claims covered under the Company’s general liability insurance policies, the Company must pay certain defense and settlement costs within its deductible or self-insured retention limits, ranging primarily from \$25,000 to \$1,000,000 per claim, depending on the terms of the policy in the applicable policy year, up to an aggregate amount. The Company is vigorously defending against all known claims.

Leases

Effective January 1, 2019, the Company adopted the requirements of FASB ASU 2016-02, *Leases* (Topic 842) which defines a lease as any contract that conveys the right to use a specific asset for a period of time in exchange for consideration. Leases are classified as a finance lease, formerly called a capital lease, if any of the following criteria are met:

1. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
2. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
3. The lease term is for the major part of the remaining economic life of the underlying asset.
4. The present value of the sum of lease payments and any residual value guaranteed by the lessee equals or exceeds substantially all of the fair value of the underlying asset.
5. The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

For any leases that do not meet the criteria identified above for finance leases, the Company treats such leases as operating leases. As of September 30, 2019, each of the Company’s leases are classified as operating leases.

Under the new guidance, both finance and operating leases are reflected on the balance sheet as lease or “right-of-use” assets and lease liabilities. It should be noted that under previous guidance operating leases (non-capital leases) were not required to be recorded as an asset on the balance sheet.

There are some exceptions, which the Company has elected in its accounting policies. For leases with terms of twelve months or less, or below the Company’s general capitalization policy threshold, the Company elects an accounting policy to not recognize lease assets and lease liabilities for all asset classes. The Company recognizes lease expense for such leases generally on a straight-line basis over the lease term.

The Company determines if a contract is a lease at the inception of the arrangement. The Company reviews all options to extend, terminate, or purchase its right-of-use assets at the inception of the lease and accounts for these options when they are reasonably certain to be exercised. Certain leases contain non-lease components, such as common area maintenance, which are generally accounted for separately. In general, the Company will assess if non-lease components are fixed and determinable, or variable, when determining if the component should be included in the lease liability. For purposes of calculating the present value of the lease obligations, the Company utilizes the implicit interest rate within the lease agreement when known and/or determinable, and otherwise utilizes its incremental borrowing rate at the time of the lease agreement.

As permitted under ASU 2018-11, the Company elected the optional transition method to adopt the new leases standard. Under this new transition method, the Company initially applied the new leases standard at the adoption date of January 1, 2019 and would have recognized a cumulative-effect adjustment, if appropriate, to the opening balance of retained earnings in the period of adoption. No cumulative-effect adjustment was recognized. The Company’s reporting for the comparative periods prior to 2019 in the financial statements are presented in accordance with existing GAAP in effect for 2018 and earlier (ASC Topic 840, *Leases*).

The impact of the adoption of this new standard resulted in an increase to the Company’s operating lease assets and liabilities on January 1, 2019 of approximately \$800,000. The implementation did not have a material impact on the Company’s consolidated statements of income and statements of cash flows.

Fair Value of Financial and Nonfinancial Instruments

The Company measures financial instruments in accordance with FASB ASC Topic 820, *Fair Value Measurements and Disclosures*. The accounting standard defines fair value, establishes a framework for measuring fair value under GAAP, and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard creates a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into

three broad levels as follows: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs that reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability. The Company relies upon Level 1 inputs in determining the fair value of investments and the fair value of the Company's reporting unit in its annual impairment test as described in the FASB ASC Topic 350, *Intangibles - Goodwill and Other*.

Earnings per Common Share

Basic earnings per share have been computed using the weighted-average number of common shares outstanding. For the periods presented, there are no dilutive securities. Consequently, basic and diluted earnings per share are the same.

Currency Translation

Assets and liabilities denominated in foreign currencies, most of which relate to the Company's United Kingdom subsidiary whose functional currency is British pound sterling, are translated into U.S. dollars at exchange rates prevailing on the balance sheet dates. The statements of income are translated into U.S. dollars at average exchange rates for the period. 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. Exchange gains and losses resulting from foreign currency transactions are included in the statements of income (other expense) in the period in which they occur.

Income Taxes

The Company accounts for tax liabilities in accordance with the FASB ASC Topic 740, *Income Taxes*. Under this method the Company records tax expense, related deferred taxes and tax benefits, and uncertainties in tax positions.

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.

The FASB ASC Topic 740, *Income Taxes*, clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. This guidance prescribes a recognition threshold of more-likely-than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements.

The Company follows the provisions of ASC 740-10 relative to accounting for uncertainties in tax positions. These provisions provide guidance on the recognition, de-recognition and measurement of potential tax benefits associated with tax positions.

The Company reflected the effects of the Tax Cuts and Jobs Act (the “Act”) in its financial statements during the 2017 enactment period. This included the effects of the change in the US Corporate tax rate from 35% to 21% on deferred tax assets and liabilities, and a provision related to previously deferred taxes on earnings of the Company’s foreign subsidiary. The Company’s tax expense for the periods ended September 30, 2019 and 2018 included the continuing effect of the reduction in the U.S. federal tax rate from 35% to 21%, effective for those respective tax years. The Company’s tax provision also reflects other changes as a result of the Act, including the impact of the Global Intangible Low Taxed Income (“GILTI”) provisions, and changes effecting the deductibility of certain executive compensation.

Other Comprehensive Income

For the three and nine months ended September 30, 2019 and 2018, respectively, the components of other comprehensive income consisted solely of foreign currency translation adjustments.

Significant Concentration

The Company has one significant customer which represented more than 10% of the Company’s Accounts Receivable at September 30, 2019 and December 31, 2018. That same customer represented more than 10% of the Company’s total Net Sales for the nine months ended September 30, 2019 and 2018. Geographically, the Company has a significant amount of sales in the United States versus internationally. These concentrations are consistent with those discussed in detail in the Company’s December 31, 2018 Form 10-K.

Subsequent Events

The Company evaluates all events or transactions through the date of the related filing that may have a material impact on its condensed consolidated financial statements. Refer to Note 10 of the condensed consolidated financial statements.

Recent Accounting Pronouncements

In January 2017, the FASB amended ASC Topic 350, *Intangibles – Goodwill and Other* (issued under ASU 2017-04, “Simplifying the Test for Goodwill Impairment”). This amendment simplifies the test for goodwill impairment by only requiring an entity to perform an annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount that the carrying amount exceeds the reporting unit’s fair value. Any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendment requires adoption on January 1, 2020. The Company does not expect that the adoption of ASU 2017-04 will have a material impact on its consolidated financial statements.

3. INVENTORIES

Inventories, net of reserves of \$351,000 and \$363,000 at September 30, 2019 and December 31, 2018, respectively, consisted of the following:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
	(dollars in thousands)	
Finished Goods	\$5,094	\$4,756
Raw Materials	<u>5,372</u>	<u>3,220</u>
Inventories - Net	<u>\$10,466</u>	<u>\$7,976</u>

4. LINE OF CREDIT

On December 1, 2017, the Company agreed to a new Amended and Restated Revolving Line of Credit Note and Third Amendment to the Loan Agreement with Santander Bank, N.A. (the "Bank"). The Company established a line of credit facility in the maximum amount of \$15,000,000, maturing on December 1, 2022, with funds available for working capital purposes and other cash needs. The loan is unsecured. The loan agreement provides for the payment of any borrowings under the agreement at an interest rate range of either LIBOR plus 0.75% to plus 1.75% (for borrowings with a fixed term of 30, 60, or 90 days), or, Prime Rate up to Prime Rate plus 0.50% (for borrowings with no fixed term other than the December 1, 2022 maturity date), depending upon the Company's then existing financial ratios. Currently, the Company's ratio would allow for the most favorable rate under the agreement's range, which would be a rate of 2.77%. The Company is also required to pay on a quarterly basis an unused facility fee of 10 basis points of the average unused balance of the note. The Company may terminate the line at any time during the five year term, as long as there are no amounts outstanding.

As of September 30, 2019 and December 31, 2018, the Company had no outstanding borrowings on its line of credit, and was in compliance with all debt covenants.

5. COMMITMENTS AND CONTINGENCIES

Commitments:

Under a number of indemnity agreements between the Company and each of its officers and directors, the Company has agreed to indemnify each of its officers and directors against any liability asserted against them in their capacity as an officer or director, or both. The Company's indemnity obligations under the indemnity agreements are subject to certain conditions and limitations set forth in each of the agreements. 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 obtained directors' and officers' insurance policies to fund certain obligations under the indemnity agreements.

The Company has salary continuation agreements with one current employee, and one

former employee who retired at the end of 2010. These agreements provide for monthly payments to each of the employees or their 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. 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 associated with these agreements is \$495,000 at September 30, 2019, of which \$483,000 is included in Other Long Term Liabilities, and the remaining current portion of \$12,000 is included in Other Liabilities, associated with the retired employee previously noted who is now receiving benefit payments. The December 31, 2018 liability of \$462,000 had \$450,000 reported in Other Long Term Liabilities, and a current portion of \$12,000 in Other Liabilities.

The Company has obtained and is the beneficiary of three life insurance policies with respect to the two employees discussed above, and one other employee policy. The cash surrender value of such policies (included in Other Long Term Assets) amounts to \$1,376,000 at September 30, 2019 and \$1,296,000 at December 31, 2018.

As disclosed in detail in Note 7 and in the Company's December 31, 2018 Form 10-K, Note 8, under the caption "Leases", the Company has several lease obligations in place that will be paid out over time. Most notably, the Company leases a facility in Banbury, England that serves the manufacturing, warehousing and distribution functions.

Contingencies:

In the ordinary and normal conduct of the Company's business, it is subject to periodic lawsuits, investigations and claims (collectively, the "Claims"). Most of the Claims, including a putative class-action claim, relate to potential lightning damage to the Company's flexible gas piping products, which impact legal and product liability related expenses. The Company does not believe the Claims have legal merit, and therefore has commenced a vigorous defense in response to the Claims. It is possible that the Company may incur increased litigation costs in the future due to a variety of factors, including a higher number of Claims, higher legal costs, and higher insurance deductibles or retentions.

In 2010, the Company took its first Claim to trial in Pennsylvania, and the jury returned a verdict that the Company was not negligent in designing and selling the TracPipe[®] product, but also returned a verdict for plaintiff on strict liability. The Company appealed that portion of the verdict, and in December 2014, the Supreme Court of Pennsylvania ruled in favor of the Company, and returned the case to the trial court for further hearings. The cash bond of \$1,600,000, which was previously included in Other Long Term Assets and posted as security for a subsequent appeal, was returned to the Company in May 2018. This case was finally settled and closed on August 7, 2018.

In March 2017, a putative class action case was re-filed against the Company and other parties in Missouri state court after the predecessor case was dismissed without prejudice by the

federal court. The Company successfully removed the case to federal court and is currently vigorously defending the case.

The Company has in place commercial general liability insurance policies that cover most Claims, which are subject to deductibles or retentions, ranging primarily from \$25,000 to \$1,000,000 per claim (depending on the terms of the policy and the applicable policy year), up to an aggregate amount. Litigation is subject to many uncertainties and management is unable to predict the outcome of the pending suits and claims. The potential liability for a given claim could range from zero to a maximum of \$1,000,000, depending upon the circumstances, and insurance deductible or retention in place for the respective claim year. The aggregate maximum exposure for all current open Claims, excluding the putative class action case, as of September 30, 2019 is estimated to not exceed approximately \$3,200,000, which represents the potential costs that may be incurred over time for the Claims within the applicable insurance policy deductibles or retentions. From time to time, depending upon the nature of a particular case, the Company may decide to spend in excess of a deductible or retention to enable more discretion regarding the defense, although this is not common. It is possible that the results of operations or liquidity of the Company, as well as the Company's ability to procure reasonably priced insurance, could be adversely affected by the pending litigation, potentially materially. The Company is currently unable to estimate the ultimate liability, if any, that may result from the pending litigation, or potential litigation from future claims or claims that have not yet come to our attention, and accordingly, the liability in the consolidated financial statements primarily represents an accrual for legal costs for services previously rendered, and outstanding or anticipated settlements for Claims. The liabilities recorded on the Company's books at September 30, 2019 and December 31, 2018 were \$150,000 and are included in Other Liabilities.

6. STOCK BASED PLANS

Phantom Stock Plan

Plan Description. On April 1, 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. 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
- 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, at an amount equal to the closing price of the Company's common stock on the grant date, but are recorded at fair value using the Black-Sholes method as described below. The Units follow a vesting schedule, with a

maximum vesting of three years after the grant date. Upon vesting, the Units represent a contractual right of payment for the value of the Unit. The Units will be paid on their maturity date, one year after all of the Units granted in a particular award have fully vested, unless an acceptable event occurs under the terms of the Plan prior to one year, which would allow for earlier payment. The amount to be paid to the participant on the maturity date is dependent 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 be 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.

On December 9, 2009, the Board of Directors authorized an amendment to the Plan to pay an amount equal to the value of any cash or stock dividend declared by the Company on its common stock to be accrued to the phantom stock units outstanding as of the record date of the common stock dividend. The dividend equivalent will be paid at the same time the underlying phantom stock units are paid to the participant.

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 their 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 termination.

Grants of Phantom Stock Units. As of December 31, 2018, the Company had 17,805 unvested units outstanding, all of which were granted at *Full Value*. On February 15, 2019, the Company granted an additional 6,050 *Full Value* Units with a fair value of \$65.40 per unit on grant date, using historical volatility. In February 2019, the Company paid \$746,000 for the 10,460 fully vested and matured units that were granted during 2015, including their respective earned dividend values. On August 27, 2019, the Company granted an additional 1,508 *Full Value* Units with a fair value of \$76.79 per unit on grant date, using historical volatility. As of September 30, 2019, the Company had 15,493 unvested units outstanding.

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 (including adjustment of the liability to its fair value) from the Units is recognized over the vesting period of each grant or award.

The FASB ASC Topic 718, *Compensation - Stock Compensation*, 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 limited experience related to any stock-based plan forfeitures, the Company applied a 0% forfeiture rate to Plan Units outstanding in determining its Plan Unit compensation expense as of September 30, 2019.

The total Phantom Stock related liability as of September 30, 2019 was \$2,719,000 of which \$1,389,000 is included in Other Liabilities, as it is expected to be paid in February and August of 2020, and the balance of \$1,330,000 is included in Other Long Term Liabilities. At December 31, 2018, the total Phantom Stock liability was \$1,692,000, with \$599,000 in Other Liabilities, and \$1,093,000 included in Other Long Term Liabilities.

Related to the Phantom Stock Plan, in accordance with FASB ASC Topic 718, *Compensation - Stock Compensation*, the Company recorded compensation expense of approximately \$1,745,000 and \$445,000 for the nine months ended September 30, 2019 and 2018, respectively. Compensation expense for a given period largely depends upon fluctuations in the Company's stock price.

The following table summarizes information about the Company's nonvested phantom stock Units at September 30, 2019:

	<u>Units</u>	<u>Weighted Average Grant Date Fair Value</u>
Number of Phantom Stock Unit Awards:		
Nonvested at December 31, 2018	17,805	\$46.08
Granted	7,558	\$67.67
Vested	(9,870)	\$41.31
Forfeited	---	---
Canceled	---	---
Nonvested at September 30, 2019	<u>15,493</u>	<u>\$59.65</u>
Phantom Stock Unit Awards Expected to Vest	<u>15,493</u>	<u>\$59.65</u>

The total unrecognized compensation costs calculated at September 30, 2019 are \$1,118,000 which will be recognized through August of 2022. The Company will recognize the related expense over the weighted average period of 1.36 years.

7. LEASES

In the United States, the Company owns its two main operating facilities located in Exton, PA. In addition to the owned facilities, the Company also has operations in other locations that are leased, as well as other leased assets. In conjunction with the new guidance for leases, as defined by the FASB with ASU 2016-02, *Leases* (Topic 842), the Company has described the existing leases, which are all classified as operating leases, pursuant to the below.

Facility leases within the United States include a warehousing and distribution center in Houston, Texas, which currently provides manufacturing, stocking and sales operations, with the original lease term running through October 2019. In April 2019, the Company entered into a

new operating lease agreement extending the lease term through October 2024. Additionally, the Company leases its corporate office space in Middletown, CT, with the lease term expiring in 2022.

In the United Kingdom, the Company leases a facility in Banbury, England, which serves sales, warehousing and operational functions with the lease term ending in March 2021.

In addition to the above property leases, the Company also has lease agreements in place for various fleet vehicles and equipment with various lease terms.

In the September 30, 2019 condensed consolidated balance sheet, the Company has recorded right-of-use assets of \$680,000, and a lease liability of \$697,000, of which \$305,000 is reported as a current liability. The respective weighted average remaining lease term and discount rate are approximately 2.96 years and 3.70%.

As of September 30, 2019, payment of the lease liability over the next five years, which includes the related interest, is as follows:

<u>Twelve Months Ending September 30,</u>	<u>Lease Liability Payments</u> (in thousands)
2020	\$ 305
2021	210
2022	90
2023	43
2024	45
Thereafter	<u>4</u>
Total Lease Payments	<u>\$ 697</u>

A similar description of the lease obligations for the previous year is disclosed in the Company's December 31, 2018 Form 10-K.

Lease expense for the operating leases was approximately \$73,000 and \$223,000 for the three and nine months ended September 30, 2019, respectively. Lease expense is allocated to each portion of the business generally based upon use, with the majority absorbed by manufacturing (cost of goods sold), and the remainder apportioned to selling, administrative and engineering.

8. SHAREHOLDERS' EQUITY

As of September 30, 2019 and December 31, 2018, the Company had authorized 20,000,000 common stock shares with par value of \$0.01 per share. At these same dates, the total number of outstanding shares was 10,094,322 and 10,091,822, shares held in Treasury was

59,311 and 61,811, and total shares issued was 10,153,633 for both periods.

During 2019 and 2018, upon approval of the Board of Directors (the “Board”) the Company has made regular quarterly dividend payments, as set forth in the following table:

Dividend Declared		Dividend Paid on or Before	
Date	Price Per Share	Date	Amount
September 6, 2019	\$0.28	October 2, 2019*	\$2,826,000
June 13, 2019	\$0.28	July 2, 2019*	\$2,826,000
April 9, 2019	\$0.24	April 29, 2019**	\$2,422,000
December 13, 2018	\$0.24	January 3, 2019**	\$2,422,000
September 11, 2018	\$0.24	October 2, 2018**	\$2,422,000
September 6, 2018	\$0.24	July 3, 2018**	\$2,422,000
April 10, 2018	\$0.22	April 30, 2018**	\$2,220,000
December 13, 2017	\$0.22	January 3, 2018**	\$2,220,000

The number of shares outstanding on the dividend payment date was *10,094,322 and **10,091,822.

In addition to the above dividend amounts, there were dividends approved by the Company’s foreign subsidiary during April 2018, which amounted to an outlay of cash of \$491,000 to the foreign subsidiary’s noncontrolling interest, and again in July 2019, with the cash distribution to the noncontrolling interest of \$137,000 paid during July 2019.

It should be noted that from time to time, the Board may elect to pay special dividends, in addition to or in lieu of the regular quarterly dividends, depending upon the financial condition of the Company.

The Board approved and granted a total of 2,500 restricted stock unit awards (the “Awards”) to be allocated to the existing non-employee directors of the Company. The Awards were approved by the shareholders’ of the Company at the annual meeting on June 11, 2019, and distributed on June 20, 2019. A Form S-8 registration statement, and the restricted stock unit award agreements, were filed with the SEC on December 13, 2018 (2,000 units) and May 24, 2019 (500 units). The related director compensation cost of approximately \$217,000 was recognized during June 2019.

On April 4, 2014, the Company’s Board of Directors authorized an extension of its stock repurchase program without expiration, up to a maximum amount of \$1,000,000. The original program established in December 2007 authorized the purchase of up to \$5,000,000 of its common stock. The purchases may be made from time-to-time in the open market or in privately negotiated transactions, depending on market and business conditions. The Board retained the right to cancel, extend, or expand the share buyback program, at any time and from time-to-time. Since inception, the Company has purchased a total of 61,811 shares for approximately \$932,000, or approximately \$15 per share, which were held as treasury shares. The Company has not made any stock repurchases since 2014; however, as stated above, there were 2,500 shares distributed from treasury to non-employee directors during June 2019.

9. RELATED PARTY TRANSACTIONS

From time to time the Company may have related party transactions (“RPTs”). In short, RPTs represent any transaction between the Company and any Company employee, director or officer, or any related entity, or relative, etc. The Company performs a review of transactions each year to determine if any RPTs exist. Through this investigation, the Company is currently not aware of any RPTs between the Company and any of its current directors or officers outside the scope of their normal business functions or expected contractual duties. The Company does on occasion share a small amount of services with its former parent Mestek, Inc., mostly related to board meeting expenses. Additionally, the Company is aware of transactions between a few service providers which employ individuals indirectly associated to Omega Flex employees, but these have been determined to be independent transactions with no indication that they are influenced by the related relationships. The Company had note agreement assets with related parties amounting to approximately \$5,000 at December 31, 2018, which were contractually secured by the Company. In February 2019, the amounts due from related parties were collected.

10. SUBSEQUENT EVENTS

The Company evaluated all events or transactions that occurred through the date of this filing. During this period, the Company did not have any material subsequent events that impacted its condensed consolidated financial statements.

Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report contains forward-looking statements, which are subject to inherent uncertainties. These uncertainties include, but are not limited to, variations in weather, changes in the regulatory environment, customer preferences, general economic conditions, increased competition, the outcome of outstanding litigation, and future developments affecting environmental matters. All of these are difficult to predict, and many are beyond the ability of the Company to control.

Certain statements in this Quarterly Report on Form 10-Q that are not historical facts, but rather reflect the Company’s current expectations concerning future results and events, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words “believes”, “expects”, “intends”, “plans”, “anticipates”, “hopes”, “likely”, “will”, and similar expressions identify such forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from future results, performance or achievements expressed or implied by such forward-looking statements.

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 Form 10-Q. The Company undertakes 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.

OVERVIEW

The Company is a leading manufacturer of flexible metal hose (also described as corrugated tubing), and is currently engaged in a number of different markets, including construction, medical, healthcare and pharmaceutical industries, manufacturing, transportation, petrochemical, and other industries.

The Company’s business is managed as a single operating segment that consists of the manufacture and sale of flexible metal hose, as well as the sale of the Company’s related proprietary fittings and a vast array of accessories. The Company’s products are concentrated in residential and commercial construction, and general industrial markets, with a comprehensive portfolio of intellectual property and patents issued in various countries around the world. The Company’s primary product, flexible gas piping, is used for gas piping within residential and commercial buildings. Through its flexibility and ease of use, the Company’s TracPipe® and TracPipe® CounterStrike® flexible gas piping, along with its fittings distributed under the trademarks AutoSnap® and AutoFlare®, allows users to substantially cut the time required to install gas piping, as compared to traditional methods. The Company’s DoubleTrac® product is used to carry gasoline and diesel gasoline products (both above and below the ground) in a double containment piping to contain any possible leaks, which is used in automotive and marina refueling applications, and fueling for back-up generation. Developed for healthcare, medical

and pure gas applications, the Company's newest corrugated tubing product MediTrac[®], has received robust interest during its launch. Similar to TracPipe[®] and CounterStrike[®], with a flexible design and availability in long continuous lengths, MediTrac[®] can be installed in any facility that uses medical or pure gas in a safer and more cost and time efficient manner than traditional medical grade rigid copper pipe. The Company's products are manufactured at its Exton, Pennsylvania facilities in the United States, and in Banbury, Oxfordshire in the United Kingdom. Through the use of its broad network of independent outside sales organizations, such as sales representatives, the Company primarily sells its products to distributors, wholesalers and OEM's, mostly throughout North America, and to a lesser extent in other global markets.

CHANGES IN FINANCIAL CONDITION

For the period ended September 30, 2019 vs. December 31, 2018

The Company's cash balance of \$25,158,000 at September 30, 2019, decreased \$7,234,000 or 22.3% from the \$32,392,000 balance at December 31, 2018. During 2019, the Company made a net purchase of investments of \$7,921,000 and paid regular quarterly dividends during the year totaling \$7,807,000. Additionally, consistent with prior years, the Company paid a significant amount of cash during the first quarter for obligations that were accrued as of the end of the preceding year, such as sales promotional incentive programs and various incentive related compensation. Those cash outflows were partially offset by income generated from operations during 2019. The condensed consolidated statement of cash flows is provided on page eight which provides further details regarding changes in cash.

Investments were \$22,865,000 and \$14,944,000 as of September 30, 2019 and December 31, 2018, respectively, increasing \$7,921,000 or 53.0%. During 2019, the Company invested excess funds in various liquid interest earning instruments including U.S. Treasury bills. These investments are stated at fair value, which approximates amortized cost, and are classified as available-for-sale in accordance with Accounting Standards Codification 320, *Investments – Debt and Equity Securities* (or "ASC 320"). Maturities, from the date of purchase, were more than three months and less than one year.

Inventories were \$10,466,000 and \$7,976,000 as of September 30, 2019 and December 31, 2018, respectively, increasing \$2,490,000 or 31.2%. A majority of the increase is related to the build-up of inventory for the Company's newest product, MediTrac[®] flexible medical gas piping, in anticipation of customer orders.

Accrued Compensation was \$3,159,000 at September 30, 2019, compared to \$5,295,000 at December 31, 2018, decreasing \$2,136,000 or 40.3%. A significant portion of the liability that existed at year end related to incentive compensation earned in 2018. As is customary, the liability was then paid during the first quarter of the following year, or 2019, thus diminishing the balance. The liability now represents amounts earned during the current year.

Other Liabilities were \$6,590,000 and \$3,591,000 at September 30, 2019 and December 31, 2018, respectively. The primary contributors to the \$2,999,000 or 83.5% increase, relates to accruals for legal expenses associated with one class action case, and executive compensation for prior equity awards impacted by the surging stock price.

RESULTS OF OPERATIONS

Three-months ended September 30, 2019 vs. September 30, 2018

The Company reported comparative results from continuing operations for the three-month periods ended September 30, 2019 and 2018 as follows:

	<u>Three-months ended September 30,</u> (in thousands)			
	<u>2019</u>	<u>2019</u>	<u>2018</u>	<u>2018</u>
Net Sales	\$28,030	100.0%	\$27,199	100.0%
Gross Profit	\$17,704	63.2%	\$16,547	60.8%
Operating Profit	\$ 4,373	15.6%	\$ 6,676	24.6%

Net Sales. The Company's 2019 third quarter net sales (sales) of \$28,030,000 increased \$831,000 or 3.1% over the third quarter of 2018, which generated sales of \$27,199,000. The Company continues to see sustained demand for our products and maintain a dominant position in our core market.

Gross Profit. The Company's gross profit margins were 63.2% and 60.8% for the three-months ended September 30, 2019 and 2018, respectively, reflecting an improvement in the Company's core operations.

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, and freight. Selling expenses for the three-months ended September 30, 2019 of \$5,383,000 were \$1,118,000 (26.2%) higher than selling expenses experienced during the third quarter of 2018, which were \$4,265,000. A majority of the additional expense relates to atypical consulting costs of \$654,000 during the quarter attributable to the Company's new product, MediTrac[®] flexible medical gas piping. The Company has also expanded its staffing resources, and recognized an increase in commissions during the year, largely driven by the increase in sales. Selling expenses as a percent of sales were 19.2% and 15.7% for the third quarter ended September 30, 2019 and 2018, respectively.

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 \$6,786,000 and \$4,385,000 for the three-months ended September 30, 2019 and 2018, respectively, thus increasing by \$2,401,000 or 54.8%. Legal and product liability defense costs increased \$1,886,000, associated primarily with one pending class action case, which the Company continues to vigorously defend itself against. There was also an increase in incentive compensation primarily related to prior equity awards impacted by the surge in the Company's stock price during the third quarter of 2019. As a percentage of sales, general and administrative expenses increased to 24.2% for the three-months ended September 30, 2019 from 16.1% for the three-months ended September 30, 2018.

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 \$1,162,000 and \$1,221,000 for the three-months ended September 30, 2019 and 2018, respectively, decreasing by \$59,000 or 4.8%. Engineering expenses decreased as a percentage of sales, being 4.2% for the three-months ended September 30, 2019, and 4.5% for the same period in 2018.

Operating Profits. Reflecting all of the factors mentioned above, operating profits were \$4,373,000 and \$6,676,000 for the quarters ended September 30, 2019 and 2018, respectively, decreasing by \$2,303,000 or 34.5%.

Interest Income (Expense)-Net. Interest income is recorded on cash investments, and interest expense is recorded at times when the Company has debt amounts outstanding on its line of credit. The Company recorded \$229,000 and \$130,000 of interest income during the third quarters of 2019 and 2018, respectively.

Other Income (Expense)-Net. Other Income (Expense)-net primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our UK subsidiary. There was expense of \$55,000 and \$40,000 recorded during the third quarter 2019 and 2018, respectively.

Income Tax Expense. Income Tax Expense was \$1,153,000 for the third quarter of 2019, compared to \$1,556,000 for the same period in 2018. The \$403,000 or 25.9% decrease in tax expense was largely the result of the decrease in income before taxes. A lower rate was in effect during the third quarter of both 2019 and 2018 attributable to the Tax Cuts and Jobs Act enacted at the end of 2017. The Act reduced the U.S. federal tax rate from 35% to 21%, effective for the Company's 2018 tax year. The Company's tax provision also reflects other changes as a result of the Act, including the impact of the Global Intangible Low Taxed Income provisions, and changes effecting the deductibility of certain executive compensation.

Nine-months ended September 30, 2019 vs. September 30, 2018

The Company reported comparative results from continuing operations for the nine-month periods ended September 30, 2019 and 2018 as follows:

Nine-months ended September 30, (in thousands)

	<u>2019</u> <u>(\$000)</u>	<u>2019</u> <u>%</u>	<u>2018</u> <u>(\$000)</u>	<u>2018</u> <u>%</u>
Net Sales	\$81,627	100.0%	\$79,443	100.0%
Gross Profit	\$51,386	63.0%	\$47,794	60.2%
Operating Profit	\$15,108	18.5%	\$18,534	23.3%

Net Sales. The Company's sales for the first nine months 2019 of \$81,627,000 increased \$2,184,000 or 2.8% over the first nine months of 2018, which generated sales of \$79,443,000.

Gross Profit. The Company's gross profit margins were 63.0% and 60.2% for the nine-months ended September 30, 2019 and 2018, respectively. The Company has experienced strong expansion in gross profit due to robust pricing actions, and a focus on costs and operating leverage.

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, and freight. A majority of the additional expense relates to atypical consulting costs attributable to the Company's new product, MediTrac[®] flexible medical gas piping. The Company has also expanded its staffing resources, and recognized an increase in commissions during the year, largely driven by the increase in sales. Selling expense was \$14,193,000 and \$12,960,000 for the nine-months ended September 30, 2019 and 2018, respectively, representing an increase of \$1,233,000 or 9.5%. Selling expenses as a percent of net sales compared to last year, were 17.4% for the nine-months ended September 30, 2019, and 16.3% for the nine-months ended September 30, 2018, increasing slightly.

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 \$18,430,000 and \$12,939,000 for the nine-months ended September 30, 2019 and 2018, respectively, thus increasing by \$5,491,000 or 42.4%. Legal and product liability defense costs increased \$4,376,000, associated primarily with one pending class action case, which the Company continues to vigorously defend itself against. The Company also experienced an increase in incentive compensation primarily related to prior equity awards impacted by the Company's surging stock price during 2019, and an increase in director compensation due to the distribution of shares awarded to the non-employee directors upon approval by the shareholders in September 2019. As a percentage of sales, general and administrative expenses increased to 22.6% for the nine-months ended September 30, 2019 from 16.3% for the nine-months ended September 30, 2018.

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 \$3,655,000 and \$3,361,000 for the nine-months ended September 30, 2019 and 2018, respectively, increasing by \$294,000 or 8.8%, with staffing and consulting costs representing the majority of the change. Engineering expenses increased as a percentage of sales, being 4.5% for the nine-months ended September 30, 2019, and 4.2% for the same period in 2018.

Operating Profits. Reflecting all of the factors mentioned above, operating profits were \$15,108,000 and \$18,534,000 for the quarters ended September 30, 2019 and 2018, respectively, decreasing by \$3,426,000 or 18.5%.

Interest Income (Expense)-Net. Interest income is recorded on cash investments, and interest expense is recorded at times when the Company has debt amounts outstanding on its line of credit. The Company recorded \$685,000 and \$275,000 of interest income during the first nine months of 2019 and 2018, respectively, reflecting a greater return during 2019.

Other Income (Expense)-Net. Other Income (Expense)-net primarily consists of foreign currency exchange gains (losses) on transactions with Omega Flex Limited, our UK subsidiary. There was expense of \$50,000 recorded during the first nine months of 2019, and expense of \$80,000 for the same period in 2018.

Income Tax Expense. Income Tax Expense was \$3,896,000 for the first nine months of 2019, compared to \$4,504,000 for the same period in 2018. The \$608,000 or 13.5% decrease in the tax expense was largely the result of the decrease in income before taxes. A lower rate was in effect during the first nine months of both 2019 and 2018 attributable to the Tax Cuts and Jobs Act enacted at the end of 2017. The Act reduced the U.S. federal tax rate from 35% to 21%, effective for the Company's 2018 tax year. The Company's tax provision also reflects other changes as a result of the Act, including the impact of the Global Intangible Low Taxed Income provisions, and changes effecting the deductibility of certain executive compensation.

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 Condensed Consolidated Financial Statements include a summary of the significant accounting policies and methods used in the preparation of our condensed consolidated financial statements. The following is a discussion of the Company's significant accounting policies.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of 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 and related sales incentives, accounts receivable valuations, investment valuations, inventory valuations, goodwill valuation, product liability reserve, stock-based compensation valuations 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

Effective January 1, 2018, the Company adopted the requirements of Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner to depict the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services.

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified

retrospective approach). The Company selected the modified retrospective approach however there was no material impact which required a cumulative effect adjustment.

The principle of Topic 606 was achieved through applying the following five-step approach:

- *Identification of the contract, or contracts, with a customer* — a contract with a customer exists when the Company enters into an enforceable contract with a customer, typically a purchase order initiated by the customer, that defines each party's rights regarding the goods to be transferred and identifies the payment terms related to these goods.
- *Identification of the performance obligations in the contract* — performance obligations promised in a contract are identified based on the goods that will be transferred to the customer that are distinct, whereby the customer can benefit from the goods on their own or together with other resources that are readily available from third parties or from us. Persuasive evidence of an arrangement for the sale of product must exist. The Company ships product in accordance with the purchase order and standard terms as reflected within the Company's order acknowledgments and sales invoices.
- *Determination of the transaction price* —the transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring goods to the customer. This would be the agreed upon quantity and price per product type in accordance with the customer purchase order, which is aligned with the Company's internally approved pricing guidelines.
- *Allocation of the transaction price to the performance obligations in the contract* — if the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. This applies to the Company as there is only one performance obligation to ship the goods.
- *Recognition of revenue when, or as, the Company satisfies a performance obligation* — the Company satisfies performance obligations at a point in time when control of the goods transfers to the customer. Determining the point in time when control transfers requires judgment. Indicators considered in determining whether the customer has obtained control of a good include:
 - The Company has a present right to payment
 - The customer has legal title to the goods
 - The Company has transferred physical possession of the goods
 - The customer has the significant risks and rewards of ownership of the goods
 - The customer has accepted the goods

It is important to note that the indicators are not a set of conditions that must be met before the Company can conclude that control of the goods has transferred to the customer. The indicators are a list of factors that are often present if a customer has control of the goods.

The Company has typical, unmodified FOB shipping point terms. As the seller, the Company can determine that the shipped goods meet the agreed-upon specifications in the contract or customer purchase order (e.g. items, quantities, and prices) with the buyer, so customer acceptance would be deemed a formality, as noted in Accounting Standards Codification (“ASC”) 606-10-55-86. As a result, the Company has a legal right to payment upon shipment of the goods.

Based upon the above, the Company has concluded that control substantively transfers to the customer upon shipment.

Other considerations of Topic 606 include the following:

- *Contract Costs* - costs to obtain a contract (e.g. customer purchase order) include sales commissions. Under Topic 606, these costs may be expensed as incurred for contracts with a duration of one year or less. The majority of the customer purchase orders are fulfilled (e.g. goods are shipped) within two days of receipt.
- *Warranties* - the Company does not offer customers to purchase a warranty separately. Therefore there is not a separate performance obligation. The Company does account for warranties as a cost accrual and the warranties do not include any additional distinct services other than the assurance that the goods comply with agreed-upon specifications. There is no impact of warranties under Topic 606 upon the financial reporting of the Company.
- *Returned Goods* - from time to time, the Company provides authorization to customers to return goods. If deemed to be material, the Company would record a “right of return” asset for the cost of the returned goods which would reduce cost of sales.
- *Volume Rebates (Promotional Incentives)* - volume rebates are variable (dependent upon the volume of goods purchased by our eligible customers) and, under Topic 606, must be estimated and recognized as a reduction of revenue as performance obligations are satisfied (e.g. upon shipment of goods). Also under Topic 606, to ensure that revenue recognized would not be probable of a significant reversal, the four following factors are considered:
 - The amount of consideration is highly susceptible to factors outside the company’s influence.
 - The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
 - The Company’s experience with similar types of contracts is limited.
 - The contract has a large number and broad range of possible consideration amounts.

If it was concluded that the above factors were in place for the Company, it would support the probability of a significant reversal of revenue. However, as none of the four factors apply to the Company, promotional incentives are recorded as a reduction of revenue based upon estimates of the products expected to be sold.

Regarding disaggregated revenue disclosures, as previously noted, the Company's business is controlled as a single operating segment that consists of the manufacture and sale of flexible metal hose. Most of the Company's transactions are very similar in nature, contract, terms, timing, and transfer of control of goods. As indicated within Note 2, under the caption "Significant Concentration", the majority of the Company's sales were geographically contained within North America, with the remainder scattered internationally. All performance assessments and resource allocations are generally based upon the review of the results of the Company as a whole.

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. Carrying value approximates fair value. Cash and cash equivalents are deposited at various area banks, which at times may exceed federally insured limits. The Company monitors the viability of the banking institutions carrying its assets on a regular basis, and has the ability to transfer cash to various institutions during times of risk. The Company has not experienced any losses related to these cash balances, and believes its credit risk to be minimal.

Accounts Receivable and Provision for Doubtful Accounts

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 their inability to make payments, additional allowances may be required.

The allowance for doubtful accounts reflects the Company's 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. The reserve for future credits, discounts, and doubtful accounts was \$1,060,000 and \$985,000 as of September 30, 2019 and December 31, 2018, respectively. In regards to identifying uncollectible accounts, the Company reviews an aging report on a consistent basis to determine past due accounts, and utilizes a well-established credit rating agency. The Company charges off those accounts that are deemed uncollectible once all collection efforts have been exhausted.

Investments

The Company invests excess funds in liquid interest earning instruments including U.S. Treasury bills and bank time deposits. These investments are stated at fair value, which approximates amortized cost, and are classified as available-for-sale in accordance with ASC 320, *Investments – Debt and Equity Securities*. Investments were \$22,865,000 and \$14,944,000 as of September 30, 2019 and December 31, 2018, respectively. Maturities, from the date of

purchase, were more than three months and less than one year.

Inventories

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

Property and Equipment

Property and equipment are initially recorded 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 other income or expense for the period. The cost of maintenance and repairs is expensed as incurred; significant improvements are capitalized.

Goodwill

In accordance with Financial Accounting Standards Board (“FASB”) ASC Topic 350, *Intangibles – Goodwill and Other*, the Company performed an annual impairment test in accordance with this guidance as of December 31, 2018. This analysis did not indicate any impairment of goodwill. There were no circumstances that indicate that goodwill might be impaired as of September 30, 2019.

Stock-Based Compensation Plans

In 2006, the Company adopted a Phantom Stock Plan (the “Plan”), which allows the Company to grant phantom stock units (“Units”) to certain key employees, officers or directors. The Units each represent a contractual right to payment of compensation in the future based upon the market value of the Company’s common stock. The Units follow a vesting schedule of three years from the grant date, and are then paid upon maturity. In accordance with FASB ASC Topic 718, *Compensation - Stock Compensation*, the Company uses the Black-Scholes option pricing model as its method for determining the fair value of the Units. Further details of the Plan are provided in Note 6.

Product Liability Reserves

Product liability reserves mostly represent the estimated unpaid amounts under the Company’s insurance policies with respect to existing claims. The Company uses the most current available data to estimate claims. As explained more fully under Note 5, Commitments and Contingencies, for various product liability claims covered under the Company’s general liability insurance policies, the Company must pay certain defense and settlement costs within its deductible or self-insured retention limits, ranging primarily from \$25,000 to \$1,000,000 per claim, depending on the terms of the policy in the applicable policy year, up to an aggregate amount. The Company is vigorously defending against all known claims.

Leases

Effective January 1, 2019, the Company adopted the requirements of FASB ASU 2016-02, *Leases* (Topic 842) which defines a lease as any contract that conveys the right to use a specific asset for a period of time in exchange for consideration. Leases are classified as a finance lease, formerly called a capital lease, if any of the following criteria are met:

1. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
2. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
3. The lease term is for the major part of the remaining economic life of the underlying asset.
4. The present value of the sum of lease payments and any residual value guaranteed by the lessee equals or exceeds substantially all of the fair value of the underlying asset.
5. The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

For any leases that do not meet the criteria identified above for finance leases, the Company treats such leases as operating leases. As of September 30, 2019, each of the Company's leases are classified as operating leases.

Under the new guidance, both finance and operating leases are reflected on the balance sheet as lease or "right-of-use" assets and lease liabilities. It should be noted that under previous guidance operating leases (non-capital leases) were not required to be recorded as an asset on the balance sheet.

There are some exceptions, which the Company has elected in its accounting policies. For leases with terms of twelve months or less, or below the Company's general capitalization policy threshold, the Company elects an accounting policy to not recognize lease assets and lease liabilities for all asset classes. The Company recognizes lease expense for such leases generally on a straight-line basis over the lease term.

The Company determines if a contract is a lease at the inception of the arrangement. The Company reviews all options to extend, terminate, or purchase its right-of-use assets at the inception of the lease and accounts for these options when they are reasonably certain to be exercised. Certain leases contain non-lease components, such as common area maintenance, which are generally accounted for separately. In general, the Company will assess if non-lease components are fixed and determinable, or variable, when determining if the component should be included in the lease liability. For purposes of calculating the present value of the lease obligations, the Company utilizes the implicit interest rate within the lease agreement when known and/or determinable, and otherwise utilizes its incremental borrowing rate at the time of the lease agreement.

As permitted under ASU 2018-11, the Company elected the optional transition method to adopt the new leases standard. Under this new transition method, the Company initially applied the new leases standard at the adoption date of January 1, 2019 and would have recognized a

cumulative-effect adjustment, if appropriate, to the opening balance of retained earnings in the period of adoption. No cumulative-effect adjustment was recognized. The Company's reporting for the comparative periods prior to 2019 in the financial statements are presented in accordance with existing GAAP in effect for 2018 and earlier (ASC Topic 840, *Leases*).

The impact of the adoption of this new standard resulted in an increase to the Company's operating lease assets and liabilities on January 1, 2019 of approximately \$800,000. The implementation did not have a material impact on the Company's consolidated statements of income and statements of cash flows.

Fair Value of Financial and Nonfinancial Instruments

The Company measures financial instruments in accordance with FASB ASC Topic 820, *Fair Value Measurements and Disclosures*. The accounting standard defines fair value, establishes a framework for measuring fair value under GAAP, and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard creates a fair value hierarchy which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels as follows: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities; Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and Level 3 inputs are unobservable inputs that reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability. The Company relies upon Level 1 inputs in determining the fair value of investments and the fair value of the Company's reporting unit in its annual impairment test as described in the FASB ASC Topic 350, *Intangibles - Goodwill and Other*.

Earnings per Common Share

Basic earnings per share have been computed using the weighted-average number of common shares outstanding. For the periods presented, there are no dilutive securities. Consequently, basic and diluted earnings per share are the same.

Currency Translation

Assets and liabilities denominated in foreign currencies, most of which relate to the Company's United Kingdom subsidiary whose functional currency is British pound sterling, are translated into U.S. dollars at exchange rates prevailing on the balance sheet dates. The statements of income are translated into U.S. dollars at average exchange rates for the period. 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. Exchange gains and losses resulting from foreign currency transactions are included in the statements of income (other expense) in the period in which they occur.

Income Taxes

The Company accounts for tax liabilities in accordance with the FASB ASC Topic 740, *Income Taxes*. Under this method the Company records tax expense, related deferred taxes and tax benefits, and uncertainties in tax positions.

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.

The FASB ASC Topic 740, *Income Taxes*, clarifies the criteria that an individual tax position must satisfy for some or all of the benefits of that position to be recognized in a company's financial statements. This guidance prescribes a recognition threshold of more-likely than-not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements.

The Company follows the provisions of ASC 740-10 relative to accounting for uncertainties in tax positions. These provisions provide guidance on the recognition, de-recognition and measurement of potential tax benefits associated with tax positions.

The Company reflected the effects of the Tax Cuts and Jobs Act (the "Act") in its financial statements during the 2017 enactment period. This included the effects of the change in the US Corporate tax rate from 35% to 21% on deferred tax assets and liabilities, and a provision related to previously deferred taxes on earnings of the Company's foreign subsidiary. The Company's tax expense for the periods ended September 30, 2019 and 2018 included the continuing effect of the reduction in the U.S. federal tax rate from 35% to 21%, effective for those respective tax years. The Company's tax provision also reflects other changes as a result of the Act, including the impact of the Global Intangible Low Taxed Income ("GILTI") provisions, and changes effecting the deductibility of certain executive compensation.

Other Comprehensive Income

For the three and nine months ended September 30, 2019 and 2018, respectively, the components of other comprehensive income consisted solely of foreign currency translation adjustments.

Significant Concentration

The Company has one significant customer which represented more than 10% of the Company's Accounts Receivable at September 30, 2019 and December 31, 2018. That same customer represented more than 10% of the Company's total Net Sales for the nine months

ended September 30, 2019 and 2018. Geographically, the Company has a significant amount of sales in the United States versus internationally. These concentrations are consistent with those discussed in detail in the Company's December 31, 2018 Form 10-K.

Subsequent Events

The Company evaluates all events or transactions through the date of the related filing that may have a material impact on its condensed consolidated financial statements. Refer to Note 10 of the condensed consolidated financial statements.

Recent Accounting Pronouncements

In January 2017, the FASB amended ASC Topic 350, *Intangibles – Goodwill and Other* (issued under ASU 2017-04, "Simplifying the Test for Goodwill Impairment"). This amendment simplifies the test for goodwill impairment by only requiring an entity to perform an annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount that the carrying amount exceeds the reporting unit's fair value. Any loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendment requires adoption on January 1, 2020. The Company does not expect that the adoption of ASU 2017-04 will have a material impact on its consolidated financial statements.

LIQUIDITY AND CAPITAL RESOURCES

Historically, the Company's primary cash needs have been related to working capital items, which the Company has largely funded through cash generated from operations.

As of September 30, 2019, the Company had a cash balance of \$25,158,000. Additionally, the Company has a \$15,000,000 line of credit available, as discussed in detail in Note 4, which had no borrowings outstanding upon it at September 30, 2019. At December 31, 2018, the Company had a cash balance of \$32,392,000, with no borrowings against the line of credit.

We believe our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next twelve months. Our future capital requirements will depend upon many factors including our rate of revenue growth, the timing and extent of any expansion efforts, and the potential for investments in, or the acquisition of any complementary products, businesses or supplementary facilities for additional capacity. The details of our operating, investing and financing activities are provided below.

Operating Activities

Cash used in operating activities is net income adjusted for certain non-cash items and changes in certain assets and liabilities, such as those included in working capital.

For the first nine months of 2019, the Company's operating activities provided cash of \$9,673,000, compared to the first nine months of 2018 which provided cash of \$11,716,000, a

difference of \$2,043,000. For details of the operating cash flows refer to the condensed consolidated statements of cash flows in Part I – Financial Information on page eight.

Investing Activities

Cash used in investing activities during the first nine months of 2019 and 2018 was \$8,943,000 and \$35,943,000, respectively. Cash was used to purchase short-term investments of \$45,921,000 and \$34,897,000, which was partially offset by cash received from net proceeds from the sale of short-term investments of \$38,000,000 and \$0 during the first nine months of 2019 and 2018, respectively. There were also capital expenditures during 2019 and 2018 amounting to \$1,022,000 and \$1,046,000, respectively. The capital spending during both 2019 and 2018 related to various projects, with prominent spending designated for the new MediTrac products.

Financing Activities

All financing activities relate to dividend payments, which are detailed in Note 8, Shareholders' Equity. Dividend payments through the first nine months of 2019 and 2018, amounted to \$7,807,000 and \$7,353,000 respectively.

CONTINGENT LIABILITIES AND GUARANTEES

See Note 5 to the Company's condensed consolidated financial statements.

OFF-BALANCE SHEET ARRANGEMENTS

None

Item 3. Quantitative and Qualitative Information about 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 4 – Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

At the end of the fiscal third quarter of 2019, 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 required to be disclosed in the periodic reports filed by the Company with the Securities and Exchange Commission. The Company's 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 this report, 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 Company'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 nine-month period covered by this Report on Form 10-Q that has materially affected or is reasonably likely to materially affect the Company's internal control over financial reporting subsequent to the date the chief executive officer and chief financial officer completed their evaluation.

PART II - OTHER INFORMATION

Item 1 – Legal Proceedings

In the ordinary and normal conduct of the Company's business, it is subject to periodic lawsuits, investigations and claims (collectively, the "Claims"). Most of the Claims, including a putative class-action claim, relate to potential lightning damage to our flexible gas piping products, which impact legal and product liability related expenses. The Company does not believe the Claims have legal merit, and therefore has commenced a vigorous defense in response to the Claims. It is possible that the Company may incur increased litigation costs in the future due to a variety of factors, including a higher number of Claims, higher legal costs, and higher insurance deductibles or retentions.

In 2010, the Company took its first Claim to trial in Pennsylvania, and the jury returned a verdict that the Company was not negligent in designing and selling the TracPipe[®] product, but also returned a verdict for plaintiff on strict liability. The Company appealed that portion of the verdict, and in December 2014, the Supreme Court of Pennsylvania ruled in favor of the Company, and returned the case to the trial court for further hearings. The cash bond of \$1,600,000, which was previously included in Other Long Term Assets and posted as security for a subsequent appeal, was returned to the Company in May 2018. This case was finally settled and closed on August 7, 2018.

In March 2017, a putative class action case was re-filed against the Company and other parties in Missouri state court after the predecessor case was dismissed without prejudice by the federal court. The Company successfully removed the case to federal court and is currently vigorously defending the case.

The Company has in place commercial general liability insurance policies that cover most Claims, which are subject to deductibles or retentions, ranging primarily from \$25,000 to \$1,000,000 per claim (depending on the terms of the policy and the applicable policy year), up to

an aggregate amount. Litigation is subject to many uncertainties and management is unable to predict the outcome of the pending suits and claims. The potential liability for a given claim could range from zero to a maximum of \$1,000,000, depending upon the circumstances, and insurance deductible or retention in place for the respective claim year. The aggregate maximum exposure for all current open Claims, excluding the putative class action case, as of September 30, 2019 is estimated to not exceed approximately \$3,200,000, which represents the potential costs that may be incurred over time for the Claims within the applicable insurance policy deductibles or retentions. From time to time, depending upon the nature of a particular case, the Company may decide to spend in excess of a deductible or retention to enable more discretion regarding the defense, although this is not common. It is possible that the results of operations or liquidity of the Company, as well as the Company's ability to procure reasonably priced insurance, could be adversely affected by the pending litigation, potentially materially. The Company is currently unable to estimate the ultimate liability, if any, that may result from the pending litigation, or potential litigation from future claims or claims that have not yet come to our attention, and accordingly, the liability in the consolidated financial statements primarily represents an accrual for legal costs for services previously rendered, and outstanding or anticipated settlements for Claims. The liabilities recorded on the Company's books at September 30, 2019 and December 31, 2018 were \$150,000 and are included in Other Liabilities.

Item 1A – Risk Factors

Risk factors are discussed in detail in the Company's December 31, 2018 Form 10-K. There are no additional risks attributable to the quarter.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3 – Defaults Upon Senior Securities

None.

Item 4 – Mine Safety Disclosures

Not Applicable.

Item 5 – Other Information

None.

Item 6 - Exhibits

Exhibit

No.

Description

- | | |
|------|--|
| 31.1 | Certification of Chief Executive Officer of Omega Flex, Inc. pursuant to Rule 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of Chief Financial Officer of Omega Flex, Inc. pursuant to 15d-14(a) promulgated under the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer of Omega Flex, Inc., pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

SIGNATURES

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

OMEGA FLEX, INC.
(Registrant)

Date: November 4, 2019

By: /s/ Paul J. Kane _____
Paul J. Kane
Vice President – Finance
and Chief Financial Officer

Certification by the Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Kevin R. Hoben, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for fiscal quarter ended September 30, 2019, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) 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
 - (d) 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; and
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 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: November 4, 2019

/s/ Kevin R. Hoben

Kevin R. Hoben
Chief Executive Officer

Certification by the Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Paul J. Kane, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for fiscal quarter ended September 30, 2019, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) 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
 - (d) 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; and
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 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: November 4, 2019

/s/ Paul J. Kane

Paul J. Kane
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 Quarterly Report on Form 10-Q of the Company for the fiscal quarter ended September 30, 2019, 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.

June

Dated: November 4, 2019

/s/ Kevin R. Hoben

Kevin R. Hoben
Chief Executive Officer

/s/ Paul J. Kane

Paul J. Kane
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.