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QEP CO INC
Form 10-Q
January 13, 2003

Securities and Exchange Commission
Washington D.C. 20549

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

For the fiscal quarter ended: November 30, 2002
Commission file number: 0-21161

Q.E.P. CO., INC.
(Exact name of registrant as specified in its charter)

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

1081 Holland Drive
Boca Raton, Florida 33487
(Address of principal executive offices)
(Zip code)

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

Indicate by check mark whether 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 the number of shares outstanding of each of the registrant's classes of common stock: as of January 14, 2003, 3,381,190 shares of common stock, par value \$.001 per share.

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PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

Q.E.P. CO., INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	November 30

	(UNAUDI
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 80
Accounts receivable, less allowance for doubtful accounts of \$368,000 and \$422,000 at November 30, 2002 and February 28, 2002, respectively	20,40
Notes receivable	2
Inventories	22,43
Prepaid expenses	1,54
Deferred income taxes	48

Total current assets	45,69
Property and equipment, net	6,21
Deferred income taxes	86
Intangible assets, net	12,26
Notes receivable	2
Other assets	51

Total assets	\$ 65,58
	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

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CURRENT LIABILITIES

Lines of credit	\$ 17,42
Acquisition notes payable	63
Current maturities of long-term debt	1,77
Accounts payable	8,34
Accrued liabilities	4,72

Total current liabilities 32,90

Notes payable	3,77
Acquisition notes payable	1,45
Subordinated long term debt	4,02
Deferred income taxes	50
Warrant put liability	95

Commitments and contingencies

SHAREHOLDERS' EQUITY

Preferred stock, 2,500,000 shares authorized, \$1.00 par value; 336,660 shares issued and outstanding at November 30, 2002 and February 28, 2002, respectively	33
Common stock, 20,000,000 shares authorized, \$.001 par value; 3,381,190 shares issued and outstanding at November 30, 2002 and February 28, 2002, respectively	
Additional paid-in capital	9,06
Retained earnings	14,95
Cost of stock held in treasury	(43)
Accumulated other comprehensive loss	(1,97)

Total liabilities and shareholders' equity \$ 65,58

The accompanying notes are an integral part of these statements

Q.E.P. CO., INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE NINE MONTHS AND THREE MONTHS ENDED NOVEMBER 30, 2002 AND 2001
(UNAUDITED)

	Nine Months Ended November 30, -----		Three Nov ---
	2002	2001	2002
	----	----	----
Net Sales	\$ 96,950,655	\$ 82,799,415	\$ 32,351,50
Cost of goods sold	63,679,614	54,992,347	21,193,04
	-----	-----	-----
Gross profit	33,271,041	27,807,068	11,158,46
	-----	-----	-----

Costs and expenses

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Shipping	8,838,459	7,226,292	2,895,24
General and administrative	8,521,044	7,608,567	2,986,72
Selling and marketing	10,378,003	8,884,184	3,571,48
Other expense (income), net	304,640	(220,774)	63,08
	-----	-----	-----
	28,042,146	23,498,269	9,516,52
	-----	-----	-----
Operating income	5,228,895	4,308,799	1,641,93
Interest income	653	9,615	2
Interest expense	(1,470,142)	(1,812,565)	(513,64
	-----	-----	-----
Income before provision for income taxes and cumulative effect of change in accounting principle	3,759,406	2,505,849	1,128,31
Provision for income taxes	(1,585,377)	(954,124)	(464,36
	-----	-----	-----
Net Income before cumulative effect of change in accounting principle	2,174,029	1,551,725	663,95
Cumulative effect of change in accounting principle	(3,047,788)	--	--
	-----	-----	-----
Net (loss) income	\$ (873,759)	\$ 1,551,725	\$ 663,95
	=====	=====	=====
Basic and diluted (loss) earnings per common share:			
Income before cumulative effect of change in accounting principle	\$ 0.64	\$ 0.46	\$ 0.2
Cumulative effect of change in accounting principle	(0.89)	--	--
	-----	-----	-----
Net (loss) income	\$ (0.25)	\$ 0.46	\$ 0.2
	=====	=====	=====

The accompanying notes are an integral part of these statements.

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Q.E.P. CO., INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED NOVEMBER 30, 2002 AND 2001
(UNAUDITED)

Cash flows from operating activities:

Net (loss) income

\$ (

November

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Adjustments to reconcile net (loss) income to net cash provided by operating activities:	
Cumulative effect of change in accounting principle	3,
Change in fair value of warrant put liability	
Depreciation and amortization	1,
Bad debt expense	
Deferred income taxes	
Changes in assets and liabilities, net of acquisitions	
Accounts receivable	(2,
Inventories	(1,
Prepaid expenses	
Other assets	(
Accounts payable and accrued liabilities	1,

Net cash provided by operating activities	1,

Cash flows from investing activities	
Capital expenditures	(
Acquisitions, net of cash acquired	(

Net cash used in investing activities	(1,

Cash flows from financing activities:	
Net borrowings under lines of credit	
Borrowings of long-term debt	4,
Repayments of long-term debt	(4,
Repayments of acquisition notes payable	(
Purchase of treasury stock	
Payments received on notes receivable	
Purchase of common stock warrants	
Dividends	

Net cash provided by (used in) financing activities	

Cumulative currency translation adjustment	(
Net increase (decrease) in cash	
Cash and cash equivalents at beginning of period	

Cash and cash equivalents at end of period	\$
	=====
Supplemental disclosure of cash flow information:	
Interest paid	\$ 1,
Income taxes paid	\$

The accompanying notes are an integral part of these statements.

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Note 1. Basis of Presentation

The accompanying financial statements for the interim periods are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the periods presented. These financial statements should be read in conjunction with the financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the Annual Report on Form 10-K for the year ended February 28, 2002, of Q.E.P. Co., Inc. (the "Company") as filed with the Securities and Exchange Commission. The February 28, 2002 balance sheet was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the nine and three months ended November 30, 2002 are not necessarily indicative of the results for the full fiscal year ending February 28, 2003.

Note 2. Inventories

The major classes of inventories are as follows:

	November 30, 2002	February 28, 2002
Raw materials and work-in-process	\$ 3,958,325	\$ 3,837,402
Finished goods	18,479,444	16,041,076
	\$22,437,769	\$19,878,478

Note 3. Earnings per Share

Basic earnings per share is computed by dividing net income, after deducting preferred stock dividends accumulated during the period, by the weighted average number of shares of common stock outstanding during each period. Diluted earnings per share is computed by dividing net income, after deducting preferred stock dividends accumulated during the period, by the weighted average number of shares of common and dilutive common stock equivalent shares outstanding during each period. Diluted common stock equivalent shares consist of stock options and warrant common stock equivalent shares which are not used when the effect is antidilutive.

For the nine months and three months ended November 30, 2002 and 2001, the weighted average number of basic shares of common stock outstanding amounted to 3,381,190. For the nine months ended November 30, 2002 and November 30, 2001, the weighted average number of diluted shares of common stock outstanding amounted to 3,440,424 and 3,386,819, respectively. For the three months ended November 30, 2002 and November 30, 2001, the weighted average number of diluted shares of common stock outstanding amounted to 3,434,731 and 3,393,212, respectively.

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Note 4. Comprehensive Income

The Company records comprehensive income in accordance with Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income." SFAS 130 requires foreign currency translation adjustments to be included in other comprehensive income.

For the nine months ended November 30, 2002 and 2001, the Company's comprehensive (loss) income totaled (\$1,033,736) and \$980,071, respectively. Excluding the effect of the change in accounting principle, the Company's comprehensive income for the nine months ended November 30, 2002 was \$2,014,052. For the three months ended November 30, 2002 and 2001, the Company's comprehensive income totaled \$670,824 and \$16,211, respectively. The change in accounting principle did not effect comprehensive income for the three months ended November 30, 2002.

Note 5. Non-cash Investing and Financing Activities

In July 2002, the Company made an acquisition of an Australian distributor. In connection with this acquisition, liabilities were assumed as follows:

Cash paid	\$ 495,630
Liabilities assumed	718,222
Issuance of notes to related seller	795,470

Purchase price	\$ 2,009,322
Fair value of assets acquired	1,596,296

Excess of purchase price over fair value of assets acquired	\$ 413,026
	=====

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Q.E.P. CO., INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 6. Debt Refinancing

In November 2002 the Company entered into an amended and restated loan agreement with its existing lender. Under the terms of the agreement the Company obtained a \$4 million dollar term loan, which was used to refinance its existing two term loans with this lender and provide additional working capital. Under the terms of the new loan, which will mature in 2007, the Company will pay \$400,000 per quarter during the first year of the loan and \$200,000 per quarter thereafter. The agreement, which now includes another financial institution as a participant, also increased the Company's borrowing capacity under a revolving loan facility to \$23 million dollars under the same formula for eligible accounts receivable and inventory that currently exists for the Company. The term loan and the revolver each have an interest rate that ranges from Libor plus 1.50% to Libor plus 2.25%, and are collateralized by substantially all of the Company's assets. The agreement also prohibits the Company from incurring certain additional indebtedness, limits certain investments, advances or loans and restricts substantial asset sales and capital expenditures. At November 30, 2002, the rate was Libor (1.69% at November 30, 2002) plus 2.00% and the Company

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had approximately \$2,420,000 available for future borrowings under its facility.

Prior to this agreement the Company's revolver provided borrowings for up to \$20 million dollars. Interest on this revolver and one of its term loans ranged from Libor plus 1.75% to Libor plus 2.5%. The Company also had a second term note, which it obtained in April 2001 at an interest rate of Libor plus 2.75%. Both of these term notes were repaid as a result of the November 2002 refinancing.

The lending institutions have also agreed to refinance the Company's mortgage loan in Canada and to finance the Company's expansion of this facility. The mortgage refinancing will be for 80% of the as-built appraisal, is expected to be approximately \$1.4 million, will amortize over a 15-year period, will mature in October 2007 and will bear an interest rate of Libor plus 2.00%.

Finally, under the terms of the agreement, the lending institutions will also provide the Company with approximately \$4.5 million in a second term financing to refinance its existing Subordinated Debt Facility. This financing will be available to the Company no earlier than May 2003 and is to be repaid in monthly installments over a three year period, requires the personal guaranty of the Company's Chairman, has an interest rate of Libor plus 3.25% and is conditioned upon the Company meeting certain financial covenants. The Company has not closed on either the mortgage or the second term loan.

Note 7. Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 provides accounting and reporting guidance for legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction or normal operations of long-lived assets. This standard is effective for fiscal years beginning after June 30, 2002. The Company is currently reviewing the provisions of this standard and expects that adoption of the standard will not have a material effect on its financial statements.

In April 2002, the FASB issued SFAS No. 145 "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections". FASB No. 145 rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt", and an amendment of that Statement, FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements". This Statement also rescinds FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers". This Statement amends FASB Statement No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. This Statement also amends other existing authoritative pronouncements to make various technical

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corrections, clarify meanings, or describe their applicability under changed conditions. This Statement is effective for financial statements issued on or after May 15, 2002. The adoption of this standard did not have an effect on the financial statements of the Company.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and

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certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. The standard is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company anticipates that the adoption of this standard will not have a material effect on its financial statements.

Note 8. Adoption of SFAS No. 142, "Goodwill and Other Intangible Assets"

On July 20, 2001, the FASB issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Intangible Assets." SFAS No. 141 is effective for all business combinations completed after June 30, 2001. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001; however, certain provisions of this statement apply to goodwill and other intangible assets acquired between July 1, 2001 and the effective date of SFAS No. 142. Major provisions of these statements and their effective dates for the Company are as follows: (i) all business combinations initiated after June 30, 2001 must use the purchase method of accounting, and the pooling of interest method of accounting is prohibited except for transactions initiated before July 1, 2001; (ii) intangible assets acquired in a business combination must be recorded separately from goodwill if they arise from contractual or other legal rights or are separable from the acquired entity and can be sold, transferred, licensed, rented or exchanged, either individually or as part of a related contract, asset or liability; (iii) goodwill, as well as intangible assets with indefinite lives, acquired after June 30, 2001, will not be amortized, and effective March 1, 2002, all previously recognized goodwill and intangible assets with indefinite lives were not subject to amortization; (iv) effective March 1, 2002, goodwill and intangible assets with indefinite lives will be tested for impairment annually and whenever there is an impairment indicator; and (v) all acquired goodwill must be assigned to reporting units for purposes of impairment testing and segment reporting. As of March 1, 2002, the Company stopped amortizing goodwill in accordance with SFAS No. 142.

In August 2002, the Company completed the valuation of its goodwill for impairment under the provisions of SFAS No. 142. As a result of this evaluation, the Company determined that the goodwill associated with its Latin American and European subsidiaries was impaired and, as a result, the Company recorded a charge to earnings of approximately \$3,048,000 effective March 1, 2002 and this charge was recognized as a cumulative effect of a change in accounting principle.

As a result of the adoption of SFAS No. 142, the Company did not recognize goodwill amortization for the three nor six months ended November 30, 2002. If SFAS No. 142 was in effect during the comparable three and nine months ended November 30, 2001, the Company would not have recognized approximately \$117,000 and \$353,000, respectively in goodwill amortization; therefore, net income applicable to common shareholders would have increased to approximately \$455,000 and \$1,905,000, respectively and earnings per share applicable to common shareholders would have increased by \$0.03 and \$0.10, respectively.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Q.E.P. Co., Inc. (the "Company") manufactures, markets and distributes a broad line of specialty tools and flooring related products for the home improvement market. The Company markets over 3,000 specialty tools and flooring related products used primarily for surface preparation and installation of ceramic tile, carpet and marble. The Company's products are sold to home improvement retailers, specialty distributors to the hardware, construction,

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flooring and home improvement trades, chain or independent hardware, tile and carpet retailers for use by the do-it-yourself consumer as well as the construction or remodeling professional and original equipment manufacturers. Dollar figures set forth below are rounded to the nearest thousand.

A summary of significant accounting policies followed by the Company is set forth in Note B to the Company's consolidated financial statements in the Company's Annual Report on Form 10K for the year ended February 28, 2002, which is incorporated herein by reference.

Forward-Looking Statements

This report contains certain forward-looking statements that are made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. Statements as to what the Company "believes," "intends," "expects," or "anticipates" and other similar anticipatory expressions, are generally forward-looking and are made only as of the date of this report and are not related to historical results. Such statements include statements relating to the adequacy of the Company's liquidity sources to meet the Company's working capital needs and anticipated expenditures. Additionally, the report is subject to risks and uncertainties which could cause actual results to differ materially from those discussed in the forward-looking statements and from historical results of operations. Among the risks and uncertainties which could cause such a difference are the assumptions upon which the Company bases its assessments of its future working capital and capital expenditure requirements and those relating to the Company's ability to satisfy its working capital needs and to finance its anticipated capital expenditures which could prove to be different than expected, the Company's dependence upon a limited number of customers for a substantial portion of its sales, the Company's reliance upon suppliers and sales agents for the purchase of finished products which are then resold by it, the level of demand for the Company's products among existing and potential new customers, the Company's dependence upon certain key personnel and its ability to successfully integrate new management personnel into the Company, the Company's ability to accurately predict the number and type of employees required to conduct its European and South American operations and the compensation required to be paid to such personnel, its ability to manage its growth, the risk of economic and market factors affecting the Company or its customers, the Company's belief that there will be no future adverse effect on the fair value of the Company's assets in accordance with the provisions of SFAS No. 142 and other risks and uncertainties described elsewhere herein.

Results of Operations

Nine months ended November 30, 2002 compared to nine months ended November 30, 2001

Net sales for the nine months ended November 30, 2002 were approximately \$96,951,000 compared to approximately \$82,799,000 for the nine months ended November 30, 2001, an increase of \$14,152,000 or 17.1%. Sales increased primarily as a result of an increase in volume to the Company's home center customer base resulting from new product introduction into existing stores and an increase in the number of home center stores operated by these customers, in addition to increased sales attributable to the acquisition of the Australian distributor (approximating \$2.6 million). Selling prices remained relatively stable during the period.

Gross profit for the fiscal 2003 period was approximately \$33,271,000 compared to \$27,807,000 for the fiscal 2002 period, an increase of \$5,464,000 or 19.6%. As a percentage of net sales, gross profit increased to 34.3% in the fiscal 2003 period from 33.6% in the fiscal 2002 period. The Company has increased its gross margin through a

reduction of certain raw material costs and a change, by its customers, towards higher margin products. Additionally, the Company experienced an increase in gross margin at the Company's European subsidiary.

Shipping expenses for the fiscal 2003 period were approximately \$8,838,000 compared to \$7,226,000 for the fiscal 2002 period, an increase of \$1,612,000 or 22.3%. As a percentage of net sales, these expenses increased to 9.1% in the fiscal 2003 period from 8.7% in the fiscal 2002 period primarily as a result of a decrease in the Company's average order size and an increase in freight rates charged by common carriers. The actual increase is a result of the higher sales volume to home center customers and the absorption, by the Company, of a higher percentage of freight costs to its domestic distributor customers. Further, the newly acquired Australian distributor accounted for approximately \$200,000 of the actual increase.

General and administrative expenses for the fiscal 2003 period were approximately \$8,521,000 compared with approximately \$7,609,000 for the fiscal 2002 period, an increase of \$912,000 or 12.0%. As a percentage of net sales, these expenses decreased to 8.8% in the fiscal 2003 period from 9.2% in the fiscal 2002 period, principally due to the absorption of certain fixed costs over a higher sales volume and the elimination of goodwill amortization in accordance with SFAS No. 142 amounting to approximately \$353,000. The actual increase was primarily the result of an increase in personnel resulting from the Company's Australian acquisition and its domestic e-commerce operations.

Selling and marketing costs for the fiscal 2003 period were approximately \$10,378,000 compared to \$8,884,000 for the fiscal 2002 period, an increase of \$1,494,000 or 16.8%. As a percentage of net sales, these expenses remained flat at 10.7% in the fiscal 2003 and fiscal 2002 periods. The actual increase is the result of an increase in commissions and marketing allowances paid resulting from the increase in sales to home center customers and an increase in the Company's marketing and product management costs to facilitate future growth. Additionally, approximately \$210,000 of the increase is a result of the newly acquired Australian distributor.

Other expenses for the nine months ended November 30, 2002 include, among other things, a charge of \$376,000 resulting from a change in the future value of the Put Warrants. For the comparable fiscal 2002 period, there was no effect on earnings as a result of the Put Warrants.

Interest income for the fiscal 2003 period was approximately \$1,000 compared to \$10,000 in the fiscal 2002 period. Interest expense for the fiscal 2003 period was approximately \$1,470,000 compared to approximately \$1,813,000 in the fiscal 2002 period. Interest expense decreased primarily as a result of a decrease in the borrowing rate applied to the Company's outstanding indebtedness and the elimination of the interest rate swap agreements that negatively impacted the fiscal 2002 period.

Provision for income taxes was approximately \$1,585,000 in the fiscal 2003 period compared to approximately \$954,000 in the fiscal 2002 period, an increase of \$631,000 or 66.1%. The effective tax rate was approximately 42.2% for the fiscal 2003 period and 38.1% for the fiscal 2002 period. The estimated tax rate is based upon the most recent effective tax rates available and is higher in fiscal 2003 primarily due to the Company not recognizing an income tax benefit for the European subsidiary's loss and the aforementioned adjustment to the warrant put liability.

In August 2002, the Company completed the valuation of its goodwill in

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accordance with the provisions of SFAS No. 142. The result of this valuation was an impairment loss to goodwill at the Company's European and Latin American subsidiaries. This impairment loss, amounting to approximately \$3,048,000, was recorded as a cumulative effect of a change in accounting principle and was effected as of March 1, 2002.

As a result of the above, net income, exclusive of the cumulative effect of a change in accounting principle, for the fiscal 2003 period increased to \$2,174,000 from \$1,552,000 in the fiscal 2002 period, an increase of \$622,000 or 40.1% and net income as a percentage of net sales increased to 2.2% in the fiscal 2003 period compared to 1.9% in the fiscal 2002 period. Inclusive of the approximate \$3,048,000 change in accounting principle, the Company's net loss for the fiscal 2003 period was approximately \$874,000.

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Three months ended November 30, 2002 compared to three months ended November 30, 2001.

Net sales for the three months ended November 30, 2002 were approximately \$32,352,000 compared to approximately \$26,646,000 for the three months ended November 30, 2001, an increase of \$5,706,000 or 21.4%. The increase is primarily the result of an increase in sales to the Company's home center customer base resulting from new store openings and new product introduction into existing stores. Also, the newly acquired Australian distributor accounted for approximately \$1.3 million of the increase in net sales. Selling prices remained relatively stable during the period.

Gross profit for the fiscal 2003 quarter was approximately \$11,158,000 compared to approximately \$8,898,000 in the fiscal 2002 quarter, an increase of \$2,260,000 or 25.4%. As a percentage of net sales, gross profit increased from 33.4% in the fiscal 2002 quarter to 34.5% in the fiscal 2003 quarter, primarily due to a reduction in certain raw material costs and a change in the Company's domestic product mix towards higher margin products and an increase in margin at the Company's European subsidiary.

Shipping expenses for the fiscal 2003 quarter were approximately \$2,895,000 compared to approximately \$2,384,000 for the fiscal 2002 quarter, an increase of \$511,000 or 21.4%. As a percentage of net sales, these expenses remained flat at 8.9% in the fiscal 2003 and 2002 periods. The actual increase was the result of the higher sales volume and approximately \$121,000 from the newly acquired Australian distributor.

General and administrative expenses for the fiscal 2003 quarter were approximately \$2,987,000 compared to approximately \$2,490,000 for the fiscal 2002 quarter, an increase of \$497,000 or 20.0%. As a percentage of net sales, general and administrative expenses decreased to 9.2% in the fiscal 2003 quarter from 9.3% in the fiscal 2002 quarter, primarily as a result of fixed costs being spread over an increased sales volume. The actual increase is primarily the result of an increase in costs at the Company's foreign subsidiaries, an increase in personnel costs and e-commerce costs at the Company's domestic operations and approximately \$100,000 from the Australian distributor recently acquired by the Company offset by the elimination of goodwill amortization in accordance with SFAS No. 142 in the approximate amount of \$117,000.

Selling and marketing costs for the fiscal 2003 quarter were approximately \$3,571,000 compared to approximately \$2,906,000 for the fiscal 2002 quarter, an increase of \$665,000 or 22.9%. As a percentage of net sales, these expenses increased to 11.0% in the fiscal 2003 quarter from 10.9% in the fiscal 2002 quarter, reflecting higher commissions paid to the Company's sales

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force. The actual increase is primarily the result of an increase in commissions and marketing allowances paid as a result of the increase in sales volume to the Company's home center customer base and an approximate \$110,000 increase attributable to the newly acquired Australian distributor.

Other expenses for the fiscal 2003 period include, among other things, a charge of \$120,000 resulting from the change in the future value of the Put Warrants. For the comparable fiscal 2002 period, there was no effect on earnings resulting from the Put Warrants.

Interest income for the fiscal 2003 quarter was insignificant compared to \$9,000 for the fiscal 2002 quarter. Interest expense for the fiscal 2003 quarter was approximately \$514,000 compared to approximately \$579,000 in the fiscal 2002 quarter. Interest expense decreased as a result of a reduction in the amount of the Company's outstanding long-term indebtedness and a reduction in the borrowing rate applied to that indebtedness. Further, the prior period was negatively impacted by the interest rate swap agreements in existence in the prior year.

Provision for income taxes was approximately \$464,000 in the fiscal 2003 period compared to \$208,000 in the fiscal 2002 quarter, an increase of approximately \$256,000 or 123.1%. The effective tax rate was approximately 41.1% for the fiscal 2003 quarter and 38.0% for the 2002 quarter. The estimated tax rate is based upon the most recent tax rates available and is higher in fiscal 2003 primarily due to the Company not recognizing an income tax benefit for the European subsidiary's loss and the aforementioned adjustment to the warrant put liability.

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As a result of the above, net income for the fiscal 2003 quarter was approximately \$664,000 compared to approximately \$338,000 for the fiscal 2002 quarter, an increase of \$326,000 or 96.4%. As a percentage of net sales, the net income was 2.1% in the fiscal 2003 quarter compared to a net income of 1.3% in the fiscal 2002 quarter.

Liquidity and Capital Resources

Working capital as of November 30, 2002 increased from approximately \$9,710,000 at February 28, 2002 to \$12,788,000, an increase of \$3,078,000, primarily as a result of an increase in the Company's income from operations, the refinancing of the Company's debt in November 2002 as further described herein and an approximate increase of \$1,177,000 resulting from the acquisition of the Australian distributor. Any cash in excess of anticipated requirements is invested in commercial paper or overnight repurchase agreements with a financial institution. The Company states the value of such investments at market price and classifies them as cash equivalents on its balance sheet.

Net cash provided by operating activities during the fiscal 2003 period was approximately \$1,413,000 compared to approximately \$1,981,000 for the comparable fiscal 2002 period. The decrease is primarily due to an increase in the Company's income from operations, as adjusted for non-cash charges, and an increase in accounts receivable and inventory offset by an increase in accounts payable. Net cash used in investing activities was approximately \$1,364,000 compared to approximately \$286,000 for the comparable fiscal 2002 period. The change is primarily due to an increase in capital expenditures of approximately \$580,000 and approximately \$500,000 of cash used to purchase the Australian distributor.

For the fiscal 2003 period, cash provided by financing activities was

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approximately \$477,000 compared to cash used in financing activities of approximately \$1,179,000 for the comparable fiscal 2002 period. Cash provided by financing activities for the current year was primarily the result of an increase in long term debt and the Company's line of credit facility offset by payments of long term debt. Cash used in financing activities for the prior year was principally the result of payments of certain subordinated, term and acquisition debt amounting to approximately \$8,200,000 offset by new long-term borrowings of \$6,000,000 and an increase in the Company's line of credit facility to fund working capital needs

In November 2002 the Company entered into an amended and restated loan agreement with its existing lender. Under the terms of the agreement the Company obtained a \$4 million dollar term loan, which was used to refinance its existing two term loans with this lender and provide additional working capital. Under the terms of the new loan, which will mature in 2007, the Company will pay \$400,000 per quarter during the first year of the loan and \$200,000 per quarter thereafter. The agreement, which now includes another financial institution as a participant, also increased the Company's borrowing capacity under a revolving loan facility to \$23 million dollars under the same formula for eligible accounts receivable and inventory that currently exists for the Company. The term loan and the revolver have an interest rate that ranges from Libor plus 1.50% to Libor plus 2.25%, and are collateralized by substantially all of the Company's assets. The agreement also prohibits the Company from incurring certain additional indebtedness, limits certain investments, advances or loans and restricts substantial asset sales and capital expenditures. At November 30, 2002, the rate was Libor (1.69% at November 30, 2002) plus 2.00% and the Company had approximately \$2,420,000 available for future borrowings under its facility.

Prior to this agreement the Company's revolver provided borrowings for up to \$20 million dollars. Interest on this revolver and one of its term loans ranged from Libor plus 1.75% to Libor plus 2.5%. The Company also had a second term note, which it obtained in April 2001 at an interest rate of Libor plus 2.75%. Both of these term notes were repaid as a result of the November 2002 refinancing.

The lending institutions have also agreed to refinance the Company's mortgage loan in Canada and to finance the Company's expansion of this facility. The mortgage refinancing will be for 80% of the as-built appraisal, is expected to be approximately \$1.4 million, will amortize over a 15-year period, will mature in October 2007 and will bear an interest rate of Libor plus 2.00%.

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Finally, under the terms of the agreement, the lending institutions will also provide the Company approximately \$4.5 million in a second term financing to refinance its existing Subordinated Debt Facility. This financing will be available to the Company no earlier than May 2003 and is to be repaid in monthly installments over a three year period, requires the personal guaranty of the Company's Chairman, has an interest rate of Libor plus 3.25% and is conditioned upon the Company meeting certain financial covenants. The Company has not closed on either the mortgage or the second term loan.

The Company's Chilean subsidiary has a revolving credit facility with a financial institution which permits borrowings of up to \$50,000 with interest at 18% per year. The facility is secured by a standby letter of credit given by the Company. This facility expires on May 31, 2003 and, at November 30, 2002, the Chilean subsidiary had the full amount of the facility available for future borrowings.

The Company's Australian subsidiary has an overdraft facility which

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allows it to borrow against a certain percentage of inventory and receivables. At November 30, 2002 the maximum permitted borrowing was approximately \$363,000 and was fully utilized.

In connection with an acquisition in July 2002, the Company's Australian subsidiary entered into a new term loan facility with an Australian financial institution to provide financing of up to AUD\$ 2,500,000 (approximately US \$1,300,000). This facility includes a term facility and a short-term foreign and domestic facility that will be used to provide the capital necessary for acquisitions and general working capital purposes. The term facility expires in June 2005 and requires quarterly payments of AUD \$25,000 (approximately US \$13,000) and a final balloon payment. Further, in July 2002 approximately AUD \$1,298,000 (approximately US \$715,000) of this facility was used to provide financing for the acquisition of an Australian distributor and, in addition, the Company issued a note to the related seller in the approximate amount of AUD \$1,445,000 (approximately US \$795,500). This note requires monthly payments in the amount of approximately \$14,700 through December 2006 with interest at 6.5%.

On April 5, 2001 the Company entered into a new \$4,500,000 subordinated credit facility with HillStreet Fund LP. This facility bears an interest rate of 15% per annum and matures on April 5, 2007. Equal quarterly payments of \$562,500 are required beginning on July 1, 2005. The agreement also provides for an additional 3% interest if the Company does not meet certain financial covenants. In addition, the Company issued 325,000 10-year warrants which have an exercise price of \$3.63 per share. These warrants can be put to the Company on and after April 5, 2006 based on criteria set forth in the warrant agreement. In addition, the Company may call these warrants on and after April 5, 2007 based on the same criteria. The Company has recorded a liability for the Put Warrants based on an independent appraisal. Any change to the fair value of the Put Warrants is being recognized in the earnings of the Company in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The original discount of the subordinated credit facility is being amortized over the life of the debt.

In connection with certain acquisitions during fiscal years 1999 through 2000, the Company issued three notes to the respective sellers. The first note, having an original principal balance of \$900,000 was originally payable in equal installments over a three year period with interest at the Company's prevailing borrowing rate. In October 2002, the Company paid \$50,000 and amended the agreement to provide for payments of \$125,000 each on October 10, 2003 and 2004. Interest on the extended payments is payable quarterly at 7%. The amount outstanding on this note as of November 30, 2002 was \$250,000. The second note, in the principal amount of \$825,000, is payable in installments: \$312,500 plus interest of \$12,500 was paid in December, 2000, \$312,500 plus interest of \$12,500 was partially paid in December, 2001 and the balance was paid over a ten month period beginning January, 2002; the final installment of \$200,000 plus interest of \$25,000 is due in December, 2003. The amount outstanding on this note as of November 30, 2002 was \$200,000. The third note, in the original principal amount of \$1,600,000, is payable quarterly at \$80,000 plus interest at 8% from October 1, 2000 through October 1, 2005 and the amount outstanding as of November 30, 2002 was \$880,000.

In October 2000, the Company entered into an agreement to purchase its Bramalea, Ontario facility for approximately \$988,000. In connection with this purchase, the Company paid approximately \$318,000 in cash and

obtained a loan for the balance from a Canadian lending institution of approximately \$670,000 payable over ten years at an interest rate to be set

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annually (6.1% as of November 30, 2002). At November 30, 2002, the outstanding balance of this loan was approximately \$522,000 and required payments are approximately \$5,700 per month.

The Company believes its existing cash balances, internally generated funds from operations and its available bank lines of credit will provide the liquidity necessary to satisfy the Company's working capital needs, including the growth in inventory and accounts receivable balances, and will be adequate to finance anticipated capital expenditures and debt obligations for the next twelve months. There can be no assurance, however, that the assumptions upon which the Company bases its future working capital and capital expenditure requirements and the assumptions upon which it bases that funds will be available to satisfy such requirements will prove to be correct. If these assumptions are not correct, the Company may be required to raise additional capital through loans or the issuance of debt securities that would require the consent of the Company's current lender, or the issuance of equity securities. To the extent the Company raises additional capital by issuing equity securities or obtaining borrowings convertible into equity, ownership dilution to existing stockholders will result, and future investors may be granted rights superior to those of existing stockholders. Moreover, additional capital may be unavailable to the Company on acceptable terms or may not be available at all.

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ITEM 3. QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

The Company averaged approximately \$21,400,000 and \$21,300,000 of variable rate debt during the nine and three months ended November 30, 2002, respectively. If interest rates would have increased by 10%, the effect on the Company would have been an increase to interest expense of approximately \$54,000 and \$27,000, respectively.

On April 5, 2001, in connection with the consummation of a loan transaction, the Company issued warrants to HillStreet Fund LP to purchase up to 325,000 shares of the Company's common stock at an exercise price of \$3.63 per share (the "Put Warrants"). The Put Warrants are exercisable until April 5, 2011 and contain put and call provisions. The put price of the Put Warrants is variable based upon the Company's value at the time the put rights are exercised, and a change in the put price of \$0.10 would result in an adjustment to earnings of \$32,500.

ITEM 4. CONTROLS AND PROCEDURES

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon the evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective in timely alerting them to material information relating to the Company and its consolidated subsidiaries required to be included in the Company's periodic filings. There were no significant changes in the Company's internal controls or in other factors that could significantly affect those controls subsequent to the date of the evaluation.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There have been no other material developments in any litigation proceedings to which the Company is a party since the Company's report on Form 10-K was filed with the Securities and Exchange Commission on May 22, 2002.

Item 6. Exhibits and Reports on Form 8-K

(a) List of Exhibits

Exhibit Number

Description

3.1	Certificate of Incorporation of the Company /(1)/
3.2	By-Laws of the Company /(2)/
4.1	Specimen Common Stock Certificate /(1)/
4.1.1	Form of Warrant issued by the Company to the representative of the underwriters Company's initial public offering /(1)/
10.1	Employment Agreement dated May 1, 2002 by and between Lewis Gould and the Company
10.2	Second Amended and Restated Loan Agreement dated November 14, 2002, by and among Company, its subsidiaries, Fleet Capital Corporation, HSBC Bank USA and Fleet Capital Corporation, as Agent.
10.3	Form of Term Note, Domestic Advances Note, Foreign Advances Note and B.V. Note e in connection with Second Amended and Restated Loan Agreement dated November 14,
99.1	Certification by Lewis Gould, Chief Executive Officer and Chairman of the Board of Directors, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification by Marc P. Applebaum, Senior Vice President and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

/(1)/ Incorporated by reference to Exhibit of the same number filed with the Company's Registration Statement on Form S-1 (Reg. No. 333-07477).

/(2)/ Incorporated by reference to Exhibit of the same number filed with the Company's Annual Report on Form 10-K filed on May 28, 1997.

(b) Reports on Form 8-K

There were no Current Reports on Form 8-K filed by the Company during its fiscal quarter ended November 30, 2002.

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

Q.E.P. CO., INC.

Dated: January 14, 2003

By: /s/ Lewis Gould

Lewis Gould, Chairman, Chief
Executive Officer and Director
(Principal Executive Officer)

Dated: January 14, 2003

By: /s/ Marc P. Applebaum

Senior Vice President and
Chief Financial Officer
(Principal Financial and
Accounting Officer)

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CERTIFICATIONS

I, Lewis Gould, Chairman of the Board of Directors and Chief Executive Officer of Q.E.P. Co., Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Q.E.P. Co., Inc.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. Designed such disclosure controls and procedures 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 quarterly report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on

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our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

- a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

DATE: January 14, 2003

/s/ Lewis Gould

Chairman, Chief Executive Officer
and Director

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I, Marc P. Applebaum, Senior Vice President and Chief Financial Officer of Q.E.P. Co., Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Q.E.P. Co., Inc.;
2. Based on my knowledge, this quarterly 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 quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly 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 quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a. Designed such disclosure controls and procedures 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 quarterly report is being prepared;
 - b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of

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this quarterly report (the "Evaluation Date"); and

- c. Presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

DATE: January 14, 2003

/s/ Marc P. Applebaum

Senior Vice President and Chief Financial Officer

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Sarbanes-Oxley Act of 2002.