

FLANDERS CORP  
Form 10-K  
March 14, 2008

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

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**FORM 10-K**

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(Mark One)

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the year ended December 31, 2007

or

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-27958

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**FLANDERS CORPORATION**

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(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

2399 26th Avenue North, St. Petersburg, FL

(Address of principal executive offices)

13-3368271

(IRS Employer ID Number)

33734

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: None

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

Title of each class

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Common Stock, \$.001 per share par value

Indicate by check mark if the registrant is a well-known seasoned issuer (as defined in Rule 405 of the Securities Act).

YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

YES  NO

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

YES  NO

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

YES  NO

As of June 30, 2007, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$142.9 million.

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

YES  NO

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YES  NO

As of February 15, 2008, the number of shares outstanding of the registrant's common stock was 25,806,632 shares.

Documents incorporated into this report on Form 10-K by reference: None.

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## FLANDERS CORPORATION FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2007

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## **PART I**

### **Item 1. Business** **OVERVIEW**

We design, manufacture and market air filters and related products, and are focused on providing complete environmental filtration systems for end uses ranging from controlling contaminants in residences and commercial office buildings through specialized manufacturing environments for semiconductors, pharmaceuticals, chemical, biological, radiological and nuclear processing. Currently, we believe, based on available trade and industry data, that we are one of the largest domestic manufacturers of air filters that are utilized by many industries including those associated with commercial and residential heating, ventilation and air conditioning systems (commonly known as HVAC systems), semiconductor manufacturing, ultra-pure materials, chemical, biological, radiological and materials processing, biotechnology, pharmaceuticals, synthetics, nuclear power and nuclear materials processing. We also design and manufacture much of our own production equipment to automate our processes in order to decrease labor costs associated with our standard products. Our customers include Abbott Laboratories, The Home Depot, Inc., Motorola, Inc., Merck & Co., Inc., Upjohn Co., Wal-Mart Stores, Inc., Westinghouse Electric Corp., Ace, True Value, Intel, etc.

The majority of our revenues come from the sale of after-market replacement filters, since air filters are typically placed in equipment designed to last much longer than the filters.

### **GENERAL DEVELOPMENT OF BUSINESS**

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Flanders Corporation was originally incorporated on July 2, 1986 in the State of Nevada, but is currently incorporated in the State of North Carolina. Our principal executive offices are currently located at 2399 26<sup>th</sup> Avenue North, St. Petersburg, FL 33713. The Company's internet website address is [www.flanderscorp.com](http://www.flanderscorp.com). The information contained on our website is not part of our reports with the Securities and Exchange Commission and is not incorporated by reference into this report. The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, and all amendments thereto, are available free of charge on the Company's website as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission.

### FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

This annual report, including all documents incorporated herein by reference, includes certain forward-looking statements within the meaning of that term in Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, including, among others, those statements preceded by, following or including the words believe, expect, anticipate or similar expressions. These forward-looking statements are based largely on the current expectations of management and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. In addition to the other risks described in the Factors That May Affect Future Results discussion under Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II of this annual report, important factors to consider in evaluating such forward-looking statements include risks associated with demand for our products, market acceptance, economic conditions, competitive products and pricing, difficulties in product development, commercialization and technology. In light of these risks and uncertainties, there can be no assurance that the events contemplated by the forward-looking statements contained in this annual report will, in fact, occur. Accordingly, readers should not place undue reliance on forward-looking statements. The forward-looking statements speak as of the date of this report and we do not undertake any obligation to revise or update the forward-looking statements.

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### STRATEGY

We have embarked on a program to increase earnings, and hence shareholder value, by improving our operating efficiency. We are seeking to grow at rates in excess of our market's general rate of growth, primarily through the introduction of qualitatively superior new products to our major marketplaces through existing customers.

#### INTRODUCE NEW PRODUCTS

In the last three years, we have focused our development efforts on products which address the actual technical requirements of maintaining clean air to promote health. Maintaining ultra-clean air in residential and commercial settings requires continuous and complete replacement of used air contaminated by contact with hair, skin, carpet, solvents, cigarette smoke and other common particle sources with air filtered through a combination of pre-filters, High Efficiency Particulate Air (commonly called HEPA) filtration, and odor removal, as well as controlling all air inlets. This typically requires upgraded and augmented blowers for central or zoned HVAC systems necessary to push air through more effective filters, additional filtration placed at building air inlets, and enough additional HVAC capacity to generate over-pressure so that the majority of air leaks push clean air out, rather than allow dirty air inside.

We have developed 5 new patents associated with our new nested filter concept during 2005. This concept enables us to stack 4 filters into a space normally holding only 1 filter. This provides labor savings associated with handling of inventory, storage space savings as well as significant freight savings. This product rolled out into retail stores during the second quarter of 2006.

During the fourth quarter of 2006 we began manufacturing our own air filtration medias for our Merv 6, Merv 8, Merv 10, and Merv 11. (MERV stands for Minimum Efficiency Reporting Values) retail and commercial pleated products. These new medias meet the new anticipated reporting standards to be effective July of this year by using mechanical means of filtration instead of relying on electrically charged medias. Electrically charged medias tend to discharge in many environments and do not benefit the end user.

We have also been able to provide an upgrade path for government buildings, large commercial office buildings and other public venues wishing to utilize HEPA filtration as part of a program to harden buildings against bioterrorist attacks.

Most currently available air filters for commercial, industrial and residential use are primarily useful for protecting motors, coils and other mechanical components from airborne grease condensation and other contaminants which reduce the life and energy-efficiency of the HVAC equipment and have little or no effect on reducing airborne contamination which may be harmful to humans. In fact, standard pleated filters, even those with high-MERV ratings, offer no appreciable benefit in terms of better air quality for the inhabitants than the cheapest spun-glass filters. These pleated filters are accompanied by increased heating and cooling costs caused by the decreased amount of air flowing through the system, and decreased efficiency, which may be accompanied by more frequent equipment breakdowns as equipment is stressed by attempting to push higher volumes of air through tighter filters. Our new products are designed to offer end-users substantial and measurable benefits to health and productivity through substantially cleaner air, and are properly engineered to reduce detrimental effects on equipment life.

*Co-branding with major name-brands.* During the past four years, we have developed and co-marketed products which utilize, and are branded with, Church and Dwight's Arm&Hammer® products. We believe the brand-name recognition associated with these products will enable us to gain entrance with major retailers who are not currently our customers or to increase the number of our products carried by current customers who only carry portions of our product line. We will continue to look for appropriately branded technologies which might produce similarly beneficial products and branding opportunities. Additionally we are beginning to establish our own brand name NaturalAire®.

*Security Products for Government Buildings and Commercial Office Buildings.* We have adapted our containment control technology to be used in hardening government facilities, large commercial office buildings and public venues against anthrax attacks and other bioterrorist incidents. While these systems do

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not offer complete protection against bioterrorist attacks, any credible multi-layered defense requires HEPA filtration and related technologies adapted to the unique requirements of these facilities. Marketing for these products will include analysis and diagnostic services offered through our IAQ (Indoor Air Quality) Diagnostic Group, adapted sales literature, technical seminars and electronic multimedia presentations.

**IMPROVE OPERATING EFFICIENCY**

*Centralize Overhead Functions.* During 2007, we continued our ongoing programs to centralize functions and eliminate duplication of efforts between subsidiaries in the following areas: purchasing, production planning, shipping coordination, accounting and personnel management, risk management and benefit plan administration.

*Strategic Global Containment Systems, Inc. (GCS)* is a wholly owned subsidiary of Flanders Corporation which manufactures critical environments for the nuclear, pharmaceutical and semi conductor. During 2008 GCS will be merged back under our Flanders Filters, Inc. and Charcoal Services Corporation divisions and these divisions will be working directly with the Department of Energy for creation of these projects.

Additionally, during 2004, Flanders Complete Service Division (Flanders CSD), an air filtration service provider was formed. Flanders CSD offers weekly, monthly and quarterly service contracts for clean room and glove box certification; commercial, industrial, retail and residential surveys, onsite service; and complete filtration management including mold remediation and analysis. Flanders CSD continues to expand its footprint and currently enjoys various regional contracts and should expand its base over the next year to be ready to take on national contracts.

*Strategic Acquisitions.* We will continue to evaluate acquisition opportunities, however, it is not likely we will make any acquisitions in 2008 as we continue to focus on improving core competencies rather than making acquisitions.

*Optimization of Mature Products.* Now that we have completed the rationalization and consolidation of our product lines, we should be able to stabilize designs and complete efficiency studies on our manufacturing processes and supply chains which should enable us to duplicate our most successful processes across all plants.

**INCREASE MARKET SHARE**

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*Use Strategically Located Facilities Throughout the United States to Increase Market Share.* Through acquisition and the establishment of new plants, we have placed facilities within one day's over-the-road shipping to most major population centers in the United States. We believe this ability to regionalize production and distribution has improved our business in several ways: (i) decreased cost of products to customers by reducing the average distance between our plants and both our customers and our major raw materials suppliers, hence decreasing freight expenses; (ii) increased responsiveness by decreasing the average time required to ship products to customers; and (iii) increased our share of national accounts' total business by having manufacturing facilities in closer proximity to customers' regional distribution centers. The ability to service all major population centers with regional manufacturing centers is critical for our business, allowing us to compete on price against less broadly based competitors without sacrificing margins as well as the ability to respond more rapidly than most of our competition. We will continue to review the market for new locations for expansion.

*Continued Emphasis on Quality and Performance.* A continued emphasis on product quality and on-time shipments has allowed us to capture market share in serving several industries in recent years. We are expanding our NQA1 Quality Assurance Program to include a more expanded approach to allow us to provide many other products related to our current product line.

*Utilize High Efficiency Production and Logistics Systems to Dominate Niche Markets.* During the past several years we have invested heavily in upgrading and opening new production facilities, scheduling

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capacity, and logistics management capabilities. We intend to continue using these advantages to capture market share in niche markets with specialized products tailored to their exact requirements. Many end users with specialized air filtration needs are currently making do with standard products. It has been our experience that minor changes made to our standard products to meet specialized requirements may offer significant operational savings to these end users, although the actual filters cost more.

#### **AIR FILTER MARKET BACKGROUND**

The air filtration market is mature, with market growth driven by a gradual trend toward higher efficiency filters for residential, commercial and industrial applications.

Management is of the belief that concerns about anthrax and other harmful microbes will accelerate this trend over the next five years as commercial buildings in large U.S. cities upgrade their ventilation systems to install more efficient filters. Other growth drivers include an increasing propensity towards using higher-performance filters in commercial and residential spaces instead of current low-efficiency models, and the use of HEPA filters in new applications.

Management believes the forces driving the air filtration market are evolving, beginning in the past decade and continuing for the next several years, from preserving machinery and equipment to maintaining and or facilitating indoor air quality. In addition, we expect many technology industries to increase their reliance on air filters to remove microscopic and gaseous contaminants from sensitive manufacturing processes associated with semiconductor manufacturing, pharmaceutical production, ultra-pure materials manufacturing, nuclear power and materials processing, and biotechnology. Companies are devoting resources to air filtration products to enhance process efficiency and employee productivity.

Air filters are used in many different applications, including the following:

*Commercial and Residential HVAC Systems.* Replacement filters are an essential requirement for the efficient operation of commercial and residential HVAC systems.

*Residential air cleaners.* Stand-alone air cleaners which produce ultra-clean air in a defined area are also gaining in popularity among allergy sufferers and asthmatics, although follow-up sales of replacement filtration cartridges have been limited.

*General Industrial.* Air filters are used in standard industrial settings to provide cleaner work environments; for example, auto makers use air filtration systems to remove oil mist contaminants from the air in their plants and industrial paint booth users utilize air filtration to remove paint particles from the air.

*Semiconductors.* HEPA and carbon filters are necessary to meet the increasingly stringent manufacturing environment requirements of semiconductor manufacturers, where microscopic airborne contaminants can ruin microchips during production, having a large impact on manufacturing yield and profitability. Carbon filters are also being increasingly used to filter gaseous contaminants from semiconductor manufacturing areas.

*Pharmaceuticals.* Pharmaceutical companies are increasingly using cleanrooms to prevent cross-contamination between different products and different lots of the same product being manufactured at the same facility. The increasing use of cultured microbes for drug production is also expected to increase demand for high-end containment environments.

*Biotechnology.* Containment systems for the manipulation of viruses and bacteria using genetic engineering techniques are critical to the biotechnology industry.

*Nuclear Power and Materials Processing.* Filtration systems are necessary to radioactive containment procedures for all nuclear facilities, containment systems are necessary to provide shielding.

*Chemical, Biological and Radiological Safe Environments.* Filtration systems are necessary to provide a safe environment for those working in sensitive areas that may be subject to exposure to such substances.

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**RECENT TRENDS**

Recent trends in the air filter industry, as well as changes in laws and governmental regulations during the past five years, all encourage an increased awareness of the benefits of the use of air filtration products. Some of these trends and changes are:

*Security Initiatives to Counter Terrorist Threats.* We believe initiatives to harden buildings against bioterrorist attacks and other security initiatives will result in many governmental and commercial facilities upgrading their HVAC systems to incorporate HEPA filters and other types of upgraded air control systems. We have seen orders increase in this area over the past quarter.

*Semiconductor Downturn and Economic Recovery.* Sales of air filtration products for semiconductor facilities, historically a major market, are expected to be slow again during 2007, with most analysts pushing recovery for this sector out until 2008. The strengthening economy is also having a positive effect on sales of all of our products.

*Indoor Air Quality and Health.* We believe there is an increase in public concern regarding the effects of indoor air quality on employee productivity and health, as well as an increase in interest in standards for detecting and solving IAQ problems. For example, the American Society of Heating Refrigeration and Air-Conditioning Engineers (ASHRAE) has recently established certain minimum standards for ventilation and indoor air quality for commercial and industrial settings. The World Health Organization has recently been studying the effects of air quality on human health, including widely publicized epidemiological studies indicating that airborne contaminants kill more people than automobile accidents. We are seeing a greater interest in upgrading residential filtration systems as well as commercial systems to address both energy savings and better indoor quality.

*Lack of Legitimate Competing Products.* We believe there is an increase in public and regulatory frustration with spurious and misleading claims made by certain manufacturers in the air filtration industry. This trend is evidenced by recent rulings by the Federal Trade Commission disallowing claims of cleaning the air in an entire room made by several manufacturers of area HEPA filtration systems as well as medical benefits claimed by manufacturers of passive electrostatic washable synthetic filters and other articles in consumer reports. ASHARE (American Society of Heating, Air, and Refrigeration Engineers) is tightening the test standards to help the consumer more easily rate air filters. We hope that as the public becomes more interested in real filtration products that we will see continued strength in this market.

*Hazardous Working Environments.* Several studies recognize that air quality in working facilities has an impact upon human health. OSHA regulations, in particular, have made IAQ a consideration in a wide variety of industries, ranging from those industries using spray-paint booths to those using automobile assembly lines. We are encouraged by the awareness and increased interest in improving indoor air quality in working environments.

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*Sick Building Syndrome.* Sick Building Syndrome, which is characterized by lethargy, frequent headaches, eye irritation and fatigue, has recently been shown to be a valid concern and is a major design consideration in new and renovated commercial and industrial buildings. The identification of sick buildings, and solutions for mitigation, involve complex issues which need to be examined on a case-by-case basis by qualified engineers. Solutions typically include improving the HVAC and filtration systems of the affected buildings.

### MARKETING

*Retail Sales:* Retail marketing is focused on increasing the effectiveness and efficiency of communicating to customers, consumers, suppliers, and prospects (customers and suppliers). The communication is directed to all four groups of constituents:

1. Institutional to enhance Flanders image by educating on the depth of knowledge and expertise Flanders has in air filtration.
2. Persuade that our products have want-satisfying capabilities

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3. Advertorial to inform prospects of the existence of our products.

Direct interaction with Retailers will continue. Trade show participation will be minimized to contracted agreements primarily with Hardware Co-ops and these venues will focus on the institutional and advertorial messages. Our direct interaction methods are primarily technical selling with emphasis on providing solutions for consumers through our filtration expertise and experience; and Creative selling of providing our key retailers analytical support to grow their market share.

Our non-personal presentation and promotion of the marketing message is print, primarily industry journals, magazines, and newspapers; direct advertising, mail and billboards; broadcast, primarily radio. The billboard, newspaper and radio campaigns focus on strategic markets with well defined geographic exposure where effectiveness can be measured.

A marketing strategy for prospects will include opening and penetrating new retail market segments.

*Commercial & Industrial Sales:* Marketing for the Commercial and Industrial Division is focused on increasing communication and education to our customer distribution network. This will be accomplished through printed material, email, CD s, technical presentations and website.

Direct interaction will continue with four Regional Managers covering the United States, Mexico and Canada. Regional Managers support the existing customer base as well as new prospects with product expertise, experience, and support in the filtration industry.

Management will continue direct interaction with existing customer base. Education and visual presence will be achieved with actively being involved through professional memberships such as NAFA, ASHRAE, IEST, CETA, ABSA, CBSA, ANS and HARDI. Management will also put more emphasis on securing product specifications on all products through specifying engineering firms.

Tradeshows will continue but only on a selective nature. Market-share will be gained by increasing factory-support with educated staff, improved stocking programs, decreased lead-times, as well as new and improved products from our R&D Department. Non-personal advertising will be increased to promote and increase our presence in the filtration industry primarily in the industry journals and magazines.

*Expansion:* Global Containment Systems, Inc. (GCS) is a wholly owned subsidiary of Flanders Corporation which manufactures critical environments for the nuclear, pharmaceutical and semi conductor. During 2008 GCS will be merged back under our Flanders Filters, Inc. and Charcoal Services Corporation divisions and these divisions will be working directly with the Department of Energy for creation of these projects.

Additionally, during 2004, Flanders Complete Service Division (Flanders CSD), an air filtration service provider was formed. Flanders CSD offers weekly, monthly and quarterly service contracts for clean room and glove box certification; commercial, industrial, retail and residential surveys; and complete filtration management including mold remediation and analysis. The company is currently negotiating several large contracts and if they are executed, the company expects to have national coverage by the end of 2010.



## PRODUCTS

We design, manufacture and market a broad range of air filters and related products, including:

Residential heating and air conditioning filters, typically sold through retailers under the Flanders~Precisionaire brand name.

Residential air cleaners, developed in 2000, which offer different filtration types ranging from single-room HEPA units which clean the air in a room to near-cleanroom levels to in-duct electrostatic precipitators which remove large quantities of airborne contaminants from entire residences without negatively impacting the efficiency of HVAC systems.

Industrial specialty filters which fall under specifications that are categorized by efficiency ratings

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established by ASHRAE and used in a wide variety of industries, including paint facilities, automobile factories, chemical treatment plants, mushroom farms, coal mines, oil refineries and power plants.

Commercial and industrial filters for use in office and general manufacturing environments, typically sold through wholesalers and distributors.

High Efficiency Particulate Air (HEPA) filters (at least 99.97% efficient to 99.999997% efficient) in various grades, for use in semiconductor facilities, nuclear containment vessels, disease containment facilities, and other critical applications.

Absolute Isolation Barriers which are customized stand-alone units, typically manufactured of stainless steel, used in various industries which require absolute control over contaminants, atmospheric composition and containment.

Carbon filters, both in bonded panels, various impregnated medias, and activated charcoal beds, used to remove gaseous contaminants, odors and toxic chemical vapors in various commercial and industrial applications.

Specialized air filter housings for use in multi-stage filtration applications.

Other related products, including ductwork and equipment cleaning chemicals, custom air handlers and specialized filter housings.

Surface finishing filters for any paint booth or surface finishing application in the overall surface finishing market.

## MANUFACTURING

We manufacture air filters, housings, Absolute Isolation Barriers and related equipment at several facilities in the United States and Mexico, which range in size from 18,000 square feet to approximately 600,000 square feet. The major plants are:

Fourteen separate manufacturing and warehousing facilities located in Washington, North Carolina (2 locations); Bath, North Carolina; Bartow, Florida; Momence, Illinois; Smithfield, North Carolina (2 locations); Tijuana, Mexico; Matamoros, Mexico (2 locations); Clarkton, North Carolina; Stafford, Texas; Dallas, Texas and Auburn, Pennsylvania, produce a broad range of HEPA, commercial, residential and industrial filters.

Other facilities in Bath and Washington, North Carolina, and Stafford, Texas, manufacture HEGA filters, high-end containment environments, housings, custom filter assemblies and other custom filtration products and systems which require extensive custom design, production and lot tracking, including products used in the production and containment of potentially dangerous biologically engineered microorganisms.

Ten direct offices spread across the US that provide a distribution point as well as light manufacturing.

In addition, we design and manufacture much of our automated production equipment.

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Our manufacturing operations are subject to periodic inspection by regulatory authorities. Because of the nature of some of our products, these agencies include the Department of Energy, Department of Defense and other agencies responsible for overseeing sensitive technologies. One of the considerations in deciding which types of products each facility will manufacture is the segregation of highly-regulated products to a minimal number of facilities to reduce the overhead associated with regulatory monitoring and compliance.

Each of our manufacturing facilities utilizes testing and design strategies appropriate to the products manufactured. These range from standard statistical process quality controls for residential replacement filters to individual testing and certification with patented proprietary particle scanning technologies for each laminar-grade HEPA filter. We believe that our ability to comprehensively test and certify HEPA filters is a competitive advantage.

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#### **SOURCE AND AVAILABILITY OF RAW MATERIALS**

Our principal raw materials are cardboard, fiberglass fibers, recyclable waste-glass, extruded glass, sheet metal, extruded aluminum, stainless steel, various grades of mild rolled steel, adhesives, resins and wood. All of these raw materials are readily available in sufficient quantities from many suppliers.

#### **COMPETITION**

The air filtration market is fragmented and highly competitive. There are many companies which compete in our market areas. We believe that the principal competitive factors in the air filtration business include product performance, name recognition, price, product knowledge, reputation, customized design, timely delivery and product maintenance. We believe that we compete favorably in all of these categories. Competitors include companies with resources, assets, financial strength and market share which may be greater than ours. Major competitors include American Air Filter International, Camfil Farr Company, Donaldson Company, Inc. and Airguard Corporation.

#### **PATENTS, TRADEMARKS AND LICENSES**

The Company and its subsidiaries currently holds approximately (30) Thirty patents relating to filtration technology including patents relating to HEPA filters and fabrication methods, filter leak testing methods, filter assembly, laminar flow cleanrooms, components of isolation barriers, and the baking soda impregnation method used in the manufacture of the Arm & Hammer® infused Filters.

In addition, the Company maintains twenty-five (25) trademark registrations including the following: FLANDERS®, PRECISIONAIRE®, EZ FLOW®, SMILIE®, AIRVELOPE®, CHANNEL-CEIL®, PUREFORM®, ECONO-CELL®, GAS-PAK®, PUREFRAME®, DIMPLE PLEAT®, BLU-JEL®, VLSI®, KWIK KUT®, SUPER-FLOW®, NATURALAIRE®, AIRPURE®, PURESEAL®, FLANDERS ABSOLUTE ISOLATION®, FLANDERS/CSC®, TECH-SORB®, NATURALAIRE FILTER FRAGRANCE®, AIRIA®, and BECAUSE WE KNOW AIR FORWARDS AND BACKWARDS®. The Company also has applied for federal trademark protection for the SWISSAIRE mark (Serial No. 76/475,934) for its new paintbooth product line. Although management believes that the patents and trademarks associated with our various product lines and subsidiaries are valuable, we do not consider any of them to be essential to our business.

The Company developed 5 new patents associated with its new nested filter concept during 2005. This concept enables us to stack 4 filters into a space normally holding only 1 filter. This also provides labor savings associated with handling of inventory, storage space savings as well as significant freight savings. This product rolled out into retail stores during the first quarter of 2006.

The Company currently holds a license for the intellectual property mark of Arm & Hammer® from Church & Dwight Company for labeling uses on our baking soda infused product line. The Company is party to a Royalty Agreement with Church & Dwight for the use of said mark which management believes to be a reasonable and necessary agreement that is in the best interest of the Company

#### **CUSTOMERS**

We are not dependent upon any single customer. One customer, Wal-Mart Stores, Inc., accounted for 10.4%, 13% and 15% of net sales during 2007, 2006 and 2005, respectively. The Home Depot, Inc., accounted for 16%, 16% and 15% of net sales during 2007, 2006 and 2005,

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respectively. No other single customer accounted for 10% or more of net sales during the past three years. Other significant customers include Abbott Laboratories, Motorola, Inc., Intel Corporation, Merck & Co., Inc., Upjohn Co., Westinghouse Electric Corp., and several U.S. government agencies.

### **BACKLOG**

We had approximately \$25.1 million of firm backlog on December 31, 2007, compared to \$44.2 million on December 31, 2006. Firm backlog includes orders received and not yet begun and the unfinished, unbilled portion of

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special orders. Orders are typically not cancelable without penalty, except for certain stable filter supply contracts to nuclear facilities operated by the United States government. Backlog varies from week to week, based on the timing and mix of orders received. All backlog at December 31, 2007, is expected to be shipped by the end of the second quarter of 2008.

### **EMPLOYEES**

The Company employed 2,800 full-time employees on December 31, 2007; 2,512 in manufacturing, 29 in development and technical staff, 61 in sales and marketing, 12 in services, and the remaining 186 in support staff and administration. None of these are represented by a union. The Company believes that its relationship with its employees is satisfactory.

### **GOVERNMENT REGULATION**

Although we believe our operations are in material compliance with applicable environmental laws and regulations, risks of significant costs and liabilities are inherent in manufacturing operations, and we cannot assure that significant costs and liabilities will not be incurred. Moreover, it is possible that other developments, such as increasingly strict environmental laws and regulations and enforcement policies, and claims for damages to property or persons resulting from our operations, could result in substantial costs and liabilities to us. We believe that changes in environmental laws and regulations will not have a material adverse effect on our financial position, results of operations or cash flows in the near term.

We are also subject to the requirements of OSHA and comparable state statutes. We believe we are in material compliance with OSHA and state requirements, including general industry standards, record keeping requirements and monitoring of occupational exposures. In general, we expect to increase our expenditures to comply with stricter industry and regulatory safety standards such as those described above. Although such expenditures cannot be accurately estimated at this time, we do not believe that they will have future material adverse effect on our financial position, results of operations or cash flows.

### **SEASONALITY**

Historically, our business has been seasonal, with a substantial percentage of sales occurring during the second and third quarters of each year. We believe that this will continue in future years. In addition, demand for our general commercial and industrial products appears to be highly influenced by the weather, with higher sales generally associated with extremes of either hot or cold weather, and lower sales generally associated with temperate weather. Because of these seasonal and weather-related demand fluctuations, quarter-to-quarter performance may not be a good predictor of future results.

### **EXPORT SALES**

We sell products to end users outside of the United States through domestic specialty cleanroom contractors. These sales are counted as domestic sales. We also sell products through foreign distributors, primarily in Europe, and through Flanders International, Ltd., a wholly-owned subsidiary located in Singapore which sells to customers in the Pacific Rim. Sales through foreign distributors and Flanders International amounted to less than 5% of net sales for each of the last three fiscal years. Assets held outside the United States are negligible.

**Item 1A. Risk Factors**

Investors should carefully consider the risks described below and all other information in this Form 10-K. The risks and uncertainties described below are not the only ones facing the Company. Additional risks and uncertainties not presently known to the Company or that it currently deems immaterial may also impair the Company's business and operations.

If any of the following risks actually occur, the Company's business, financial condition or results of operations could be materially adversely affected. In such case, the trading price of the Company's common stock could decline and investors may lose all or part of their investment.

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

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

recruit, train and manage our work force, particularly in the areas of corporate management, accounting, research and development and operations,

manage production and inventory levels to meet product demand,

manage and improve production quality,

expand both the range of customers and the geographic scope of our customer base, and

improve financial and management controls, reporting systems and procedures.

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

*Failure to Adequately Ramp-Up Production Capacity to Meet Demand Could Adversely Impact Our Business Due to Strain on Financial Resources.*

Any delays in an untried supply chain, new production chains, and other delays common to the launch of a new product line could also adversely impact the success of the products, as well as current relationships with major accounts.

*Our Business May Suffer If Our Competitive Strategy is Not Successful*

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

increasing our market share,

expanding our market through the introduction of new products which require periodic replacement, and

improving operating efficiencies.

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

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

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

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

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

If we experience extended periods of downtime due to the malfunction or failure of our automated production equipment, our business, financial condition and operations may suffer. We design and manufacture much of the automated production equipment used in our facilities. We also use other technologically advanced equipment for

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which manufacturers may have limited production capability or service experience. If we are unable to quickly repair our equipment or quickly obtain new equipment or parts from outside manufacturers, we could experience extended periods of downtime in the event of malfunction or equipment failure.

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

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

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

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

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

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

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

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

### *Management Controls a Significant Percentage of Our Stock*

As of December 31, 2007, our directors and executive officers beneficially held approximately 34.52% of our outstanding common stock. As a result, such shareholders effectively control or significantly influence all matters requiring shareholder approval. These matters include the election of directors and approval of significant corporate transactions. Such concentration of ownership may also have the effect of delaying or preventing a change in control that may otherwise be advantageous to the non-affiliated shareholders.

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

We have granted options to purchase a total of 3,267,000 shares of common stock to various parties with exercise prices ranging from \$1.74 to \$11.72 per share. The majority of these options are currently exercisable. Additionally, if the option holders exercise their options, the interests of current shareholders may be diluted.

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

Our Articles of Incorporation and Bylaws contain provisions that are designed to provide our Board of Directors with time to consider whether a hostile takeover offer is in our best interest and the best interests of our shareholders. These provisions may discourage potential acquisition proposals and could delay or prevent a change of control in

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our business. Additionally, we are subject to the Control Shares Acquisition Act of the State of North Carolina. This act provides that any person who acquires control shares of a publicly held North Carolina corporation will not have voting rights with respect to the acquired shares unless a majority of the disinterested shareholders of the corporation vote to grant such rights. This could deprive shareholders of opportunities to realize takeover premiums for their shares or other advantages that large accumulations of stock would typically provide.

### *Our Business Can be Significantly Affected by Environmental Laws*

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

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### *Fire disruptions may adversely affect our business*

Our raw materials and manufacturing process involve a greater than average risk of fire loss or disruption. We have recently experienced two fires. In April 2006, a manufacturing facility in Texas was destroyed by fire. In July 2007, a manufacturing facility in Bartow, Florida was destroyed by fire. To date we have been able to mitigate the effects of fires and floods by transferring manufacturing, warehousing and shipping to other facilities. Our management has advised us that to date we have been insured against the losses caused by such fires. Although we intend to increase security and increase fire protection equipment at our facilities, another major fire could occur and materially affect our operations. Furthermore, there is no assurance that we will be able to maintain business interruption, loss of income and physical damage insurance in sufficient amounts to fully recoup losses caused by fire or other natural disasters. It is an event of default under our credit facility with Bank of America if we are not fully insured for any loss, theft, damage or destruction to our assets, subject to agreeable insurance deductibles, that exceeds \$200.

### *Covenants in our credit facilities could restrict our ability to borrow additional funds, which could impair the improvement and expansion of our operations*

Certain covenants in our credit facility with Bank of America restrict the types and amounts of additional indebtedness that we may incur. In addition, the credit facility contains specific financial covenants. These restrictions could inhibit our ability to improve and expand our operations. Our credit facility with Bank of America matures in October 2009. There is no assurance that we will be able to maintain covenant compliance, negotiate extensions to this credit facility or find a replacement credit facility on comparable terms. We pledged substantially all of our assets as security for the Bank of America credit facility.

### *A significant amount of our leased physical facilities are owned by Mr. Amerson.*

We are the lessee under a series of six (6) real estate operating leases for approximately 1,006,000 square feet of warehousing, shipping and manufacturing facilities, expiring in 2025, 2026 or 2027 with Wal-Pat II, LLC ( Wal-Pat ), an entity owned by Robert R. Amerson. Mr. Amerson is our CEO and Chairman of our Board of Directors and beneficially owns approximately 29.6% of our outstanding common shares as of December 31, 2007. Mr. Amerson acquired Mr. Clark's interest in Wal-Pat as part of the Settlement and Mutual Release with Mr. Clark.

Our aggregate monthly base lease payment obligation to Wal-Pat is approximately \$221. Our total remaining aggregate obligation under the Wal-Pat operating leases is approximately \$50,639. These amounts exclude any obligations for payment of real estate taxes and repairs and maintenance, which are our responsibility as the lessee.

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In September 2007, we entered into a Master Lease Modification Agreement with Wal-Pat, which requires Wal-Pat to notify us at least thirty (30) days in advance of any future proposed sale of any of the premises or a proposed sale of a majority of the equity interests in Wal-Pat. In such event, we have the right to accept, renegotiate or terminate the leases. We were granted a future right of first refusal in connection with a sale of any of the leased Wal-Pat facilities. In the event of a future sale of Flanders, which includes a merger, sale of substantially all of our assets or acquisition of greater than 50% of our shares, by a party other than Mr. Amerson, then Flanders is granted the right to terminate or renegotiate the terms of the Wal-Pat leases. We also have a fair market value purchase option for the facilities we lease from Wal-Pat.

A default by us under the terms of any of these leases or a default by Wal-Pat, or Mr. Amerson, as guarantor on their obligations to BB&T, the financial institution which holds mortgages and deeds of trust on these properties, could adversely affect our leasehold interests in these properties. Mr. Amerson has pledged 5,128,103 of our common shares as security to BB&T in order to facilitate the financings to Wal-Pat, other personal loans, and the acquisition of Mr. Clark's shares.

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

### **Item 1B. Unresolved Staff Comments**

There are no unresolved comments from the staff comment letter dated December 12, 2007.

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**Item 2. Properties**

The following table lists our principal facilities. Management believes that these properties are adequate for its current operational needs. We may, at some point, relocate, reorganize or consolidate various facilities for reasons of operating efficiencies or may open new plants to take advantage of perceived new economic opportunities. We are of the opinion that all properties are well maintained and appropriately insured.

<u>Principal Facility</u>	<u>Location</u>	<u>Approximate Floor Space (sq. ft.)</u>	<u>Monthly Payment</u>	<u>Lease/Type</u>
Manufacturing and office facility	Washington, North Carolina	285,000	N/A	Owned
Manufacturing, service and office facility	Bath, North Carolina	46,000	N/A	Owned
Land	Bartow, Florida	N/A <sup>1</sup>	N/A	Owned
Manufacturing plant	Lake Wales, Florida	137,693	\$ 31,555	Leased
Warehouse	Bartow, Florida	60,000	\$ 15,671	Leased
Warehouse	Terrell, Texas	75,000	N/A	Owned
Manufacturing plant	Auburn, Pennsylvania	92,000	\$ 5,857	Owned
Office space and headquarters	St. Petersburg, Florida	18,000	N/A	Owned
Manufacturing plant	Momence, Illinois	211,000	\$ 136,174 <sup>2</sup>	Owned
Sales office and warehouse	Singapore	3,800	\$ 2,100	Leased
Manufacturing and warehouse	Smithfield, North Carolina	415,000	\$ 79,816	Leased <sup>3</sup>
Manufacturing plant	Smithfield, North Carolina	474,000	\$ 11,981 <sup>4</sup>	Owned
Manufacturing and office facility	Fort Bend, Texas	60,000	30,850	Leased <sup>3</sup>
Warehouse	Salt Lake City, Utah	192,000	N/A	Leased

<sup>1</sup> Property was destroyed by fire in 2007.

<sup>2</sup> Property is pledged as security for an Economic Development Revenue Bond with a face value of \$6,000,000. The obligation is paid quarterly rather than monthly by paying a portion of principal and interest on the entire amount. The payment shown above is for the entire fourth quarter of 2007.

<sup>3</sup> The property and building is owned by Wal-Pat.

<sup>4</sup> The property is used as security for two Industrial Revenue Bonds with face value of \$4,500,000 and \$4,000,000. Monthly payments are for interest only on the bonds, and vary from month to month based on the interest rate during the period.



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Manufacturing plant and office facility	San Diego, California	96,000	\$49,914	Leased
Manufacturing plant	Tijuana, Mexico	127,000 <sup>5</sup>	\$46,651	Leased
Direct Sales Office	Phoenix, Arizona	22,000	\$ 6,697	Leased
Direct Sales Office	Santa Fe Springs, California	20,000	\$ 8,650	Leased
Direct Sales Office	Hayward, California	10,000	\$ 5,900	Leased
Direct Sales Office	Salt Lake City, Utah	15,000	\$ 3,139	Leased
Direct Sales Office	Sanford, North Carolina	1,000	\$ 950	Leased
Direct Sales Office& Warehouse	Kent, Washington	12,500	\$ 5,640	Leased
Manufacturing plant	Washington, North Carolina	110,000	\$12,500	Leased <sup>3</sup>
Direct Sales Office& Warehouse	Philadelphia, Pennsylvania	26,000	\$16,000	Leased <sup>3</sup>
Manufacturing Plant	Matamoros, Mexico	86,651	\$30,328	Leased
Manufacturing Plant	Matamoros, Mexico	107,323	\$33,270	Leased
Manufacturing Plant	Beaufort County, North Carolina	120,000	\$27,000	Leased
Direct Sales Office& Warehouse	Cerritos, California	21,735	\$11,270	Leased
Direct Sales Office& Warehouse	Dallas, Texas	120,000	\$32,000	Leased
Direct Sales Office& Warehouse	Clarkton, North Carolina	350,000	\$49,321	Leased <sup>3</sup>
Direct Sales Office& Warehouse	Greenville, North Carolina	50,000	\$12,000	Leased <sup>3</sup>
Direct Sales Office& Warehouse	Las Vegas, Nevada	10,106	\$ 8,006	Leased
Direct Sales Office& Warehouse	Chaska, Minnesota	28,000	\$14,000	Leased

**Item 3. Legal Proceedings**

From time to time, the Company is a party as plaintiff or defendant to various legal proceedings related to our normal business operations. In the opinion of management, although the outcome of any legal proceeding cannot be predicted with certainty, the ultimate liability of the Company in connection with its legal proceedings will not have a material adverse effect on the Company's financial position, but could be material to the results of operations in any one future accounting period. The Company makes appropriate reserves for litigation, even if not material. Defense costs are expensed as incurred.

**Item 4. Submission of Matters to a Vote of Security Holders**

The Company held its annual meeting of shareholders on December 17, 2007. During the meeting, holders of 22,824,402 shares, representing eighty-eight percent (88%) of the 25,896,729 shares outstanding on the record date,

<sup>5</sup> The Tijuana plant has 2 temporary buildings measuring 45,000 sq. ft. and 40,000 sq. ft.

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attended either in person or by proxy. Holders in excess of 60% of the totals vote cast voted for the election of members to the Board of Directors for Robert R. Amerson, Harry Smith, Kirk Dominick, Jeff Korn., and David M. Mock. As a result of the meeting, Messrs. Amerson, Smith, Dominick, Korn, and Mock were elected for an additional one-year term as directors.

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Table of Contents**PART II****Item 5. Market for Registrant's Common Equity and Related Stockholder Matters**  
**PRICE RANGE OF COMMON STOCK**

The Company's common stock is listed on the Nasdaq National Market System under the symbol FLDR. The following table sets forth, for the periods indicated, the high and low sale prices of the Company's common stock as reported by the Nasdaq National Market System. Such quotations do not include retail mark-ups, mark-downs, or other fees or commissions.

	<u>High</u>	<u>Low</u>
<b>2007</b>		
Fourth Quarter ended December 31, 2007	\$ 6.86	\$ 4.53
Third Quarter ended September 30, 2007	\$ 8.20	\$ 4.39
Second Quarter ended June 30, 2007	\$ 7.67	\$ 6.31
First Quarter ended March 31, 2007	\$ 9.52	\$ 7.07
<b>2006</b>		
Fourth Quarter ended December 31, 2006	\$ 10.27	\$ 8.42
Third Quarter ended September 30, 2006	\$ 10.36	\$ 8.56
Second Quarter ended June 30, 2006	\$ 11.99	\$ 9.49
First Quarter ended March 31, 2006	\$ 12.10	\$ 10.29
<b>2005</b>		
Fourth Quarter ended December 31, 2005	\$ 12.46	\$ 9.81
Third Quarter ended September 30, 2005	\$ 14.09	\$ 8.85
Second Quarter ended June 30, 2005	\$ 11.67	\$ 7.77
First Quarter ended March 31, 2005	\$ 11.43	\$ 8.55

**EQUITY COMPENSATION PLAN INFORMATION**

The following table provides information about our Equity Compensation Plans as of December 31, 2007.

Plan Category	Number of securities to be issued upon	Weighted average price of	Number of securities remaining available
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	exercise of outstanding options	outstanding options	for future issuance
Equity Incentive plan approved by security holders	620,000	\$ 5.23	1,380,000
Equity Incentive plan not approved by security holders			
Long Term Incentive plan approved by security holders	370,000	\$ 7.45	
Long Term Incentive plan not approved by security holders			
Directors and Officers plan approved by security holders	277,000	\$ 7.43	
Directors and Officers plan not approved by security holders			
Other equity compensation plan approved by security holders	2,000,000	\$ 5.00	
Other equity compensation plan not approved by security holders			

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**APPROXIMATE NUMBER OF EQUITY SECURITYHOLDERS**

On February 15, 2008, Flanders common stock closed at \$6.46. As of February 15, 2008, there were approximately 135 holders of record of the Company's common stock.

**DIVIDENDS**

We have not declared or paid cash dividends on our common stock. Currently, we retain any future earnings, except those used to repurchase stock, to finance the growth and development of the business, however, we are currently considering paying cash dividends in the future. The Board of Directors may decide to declare a dividend, based upon its evaluation of our earnings, financial position, capital requirements and any other factors the Board of Directors may consider to be relevant. Under the terms of our revolving credit line we cannot pay dividends without the prior written consent of the bank. The Company also has a stock repurchase program that is currently subject to restriction under the Company's line of credit facility. See Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and Notes to Consolidated Financial Statements Note G.

**Item 6. Selected Financial Data**

The following financial data is derived from, and should be read in conjunction with, the Consolidated Financial Statements and notes thereto. Information concerning significant trends in the financial condition and results of operations is contained in Management's Discussion and Analysis of Financial Condition and Results of Operations.

**SELECTED HISTORICAL OPERATIONS DATA** (In thousands, except per share data)

	Year Ended December 31,				
	2007	2006	2005	2004	2003
Net sales	\$ 244,941	\$ 238,378	\$ 229,276	\$ 199,933	\$ 182,780
Gross profit	31,789	48,725	52,917	48,288	43,271
Operating expenses	58,511	40,868	35,297	33,569	32,112
Operating income from continuing operations	(26,722)	7,857	17,620	14,719	11,159
Earnings from continuing operations before income taxes	(28,691)	8,208	17,245	14,351	11,251
Provision for income taxes	(8,791)	2,683	4,739	4,581	3,505
Earnings from continuing operations	(19,900)	5,525	12,506	9,770	7,746
Cumulative effect of accounting change					
Extraordinary Gain (Loss)	213	(3,475)			
Net earnings (loss)	\$ (19,687)	\$ 2,050	\$ 12,506	\$ 9,770	\$ 7,746

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Earnings per share from continuing operations										
Basic	\$	(0.75)	\$	0.21	\$	0.48	\$	0.37	\$	0.30
Diluted	\$	(0.75)	\$	0.20	\$	0.45	\$	0.36	\$	0.29
Net earnings (loss) per share										
Basic	\$	(0.75)	\$	0.08	\$	0.48	\$	0.37	\$	0.30
Diluted	\$	(0.75)	\$	0.07	\$	0.45	\$	0.36	\$	0.29
Weighted average common shares outstanding										
Basic		26,362		26,340		26,309		26,201		26,033
Diluted		26,362		27,725		27,807		27,289		26,428

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**SELECTED HISTORICAL BALANCE SHEET DATA** (In thousands)

	December 31,				
	2007	2006	2005	2004	2003
Working capital	\$ 50,251	\$ 67,967	\$ 60,595	\$ 54,212	\$ 45,547
Total assets	183,555	207,104	172,216	159,670	145,415
Long-term obligations <sup>1</sup>	32,348	42,880	27,293	23,059	26,290
Total shareholders' equity	87,402	107,379	105,534	93,161	80,709

<sup>1</sup> Long-term obligations include long-term notes payable, long-term debt, including current maturities, convertible debt, and committed capital.

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion should be read in conjunction with Item 6 Selected Financial Data and our Consolidated Financial Statements, all included herein. The information set forth in this Management's Discussion and Analysis of Financial Condition and Results of Operations includes forward-looking statements that involve risks and uncertainties. Many factors, including but not limited to those discussed below under Factors That May Affect Future Results could cause actual results to differ materially from those contained in these forward-looking statements.

**OVERVIEW**

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

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We base our estimates on the aging of our accounts receivable balances and our historical write-off experience, net of recoveries. Significant changes were made to the Company's estimate of allowance for doubtful

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accounts during the third quarter of 2007 as a result of the Company changing its methodology and assumptions of estimating this allowance. If the financial condition of our customers were to deteriorate, additional allowances may be required.

We value our inventories at the lower of cost or market. We write down inventory balances for estimated obsolescence or unmarketable inventory equal to the difference between the cost of the inventory and the estimated market value based upon assumptions about future demand and market conditions. Inventories were written down to net realizable value during the third quarter of 2007. This was due mainly to discontinued product lines as well as discovery of some damaged inventory. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

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

Goodwill is reviewed for possible impairment at least annually or more frequently upon the occurrence of an event or when circumstances indicate that the Company's carrying amount is greater than the fair value. In accordance with SFAS 142, the Company examined goodwill for impairment and determined that the Company's carrying amount did not exceed the fair value, thus, there was no impairment.

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

**RESULTS OF OPERATIONS** (thousands omitted, except per share amounts)

**2007 Compared to 2006**

The following table summarizes the Company's results of operations as a percentage of net sales for 2007 and 2006.

	2007	2006
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Net sales	\$ 244,941	100.0%	\$ 238,378	100.0%
Gross profit	31,789	13.0	48,725	20.4
Operating expenses	58,511	23.9	40,868	17.1
Operating income (loss)	(26,722)	(10.9)	7,857	3.3
Non operating income (expense)	(1,969)	(0.1)	351	.2
Earnings before income taxes	(28,691)	(11.7)	8,208	3.4
Provision (Benefit) for income taxes	(8,791)	(3.6)	2,683	1.1
Extraordinary items	213	.1	(3,475)	(1.5)
Net earnings (loss)	(19,687)	(8.0)	2,050	.1

*Net Sales:* Net sales for 2007 increased by \$6,563 or 2.8%, to \$244,941, from \$238,378 for 2006. Sales growth increased during the year of 2007 in the retail sector primarily due to the release of our new Microparticle Plus product at Home Depot. Our commercial and industrial sales have also attributed to the increase. The overall market demand increased during the last year. The Company also introduced two new products, EnergyAire and our new nested product in the first half of 2007.

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*Gross Profit:* Gross profit for 2007 decreased \$16,936 or 34.8%, to \$31,789 which made up 13.0% of net sales, from \$48,725 for 2006, which made up 20.4% of net sales. The US economy experienced cost increases due to inflation including increases in in-bound shipping costs due to increased fuel costs and raw material costs, especially in the cost of metal. In addition, gross profit during the last six months has decreased due to the start up of new production lines for the EnergyAire and nested filters. Also, the success of the nested flat panel filter continues to have a negative impact on product mix and consequently gross margins. The Company also increased its reserve for obsolete inventory during the third quarter of 2007 by \$3.1 million.

*Operating Expenses:* Operating expenses for 2007 increased \$17,643, or 43.2%, to \$58,511, from \$40,868 in 2006. Operating expenses as a percentage of sales increased in 2007 to 23.9% from 17.1% in 2006. The increase in operating expenses was primarily due to an increase in management's estimate of allowance for doubtful accounts during the third quarter of 2007 by \$8.1 million and the Company disposing of assets considered impaired of approximately \$2.5 million, as well as an increase in fuel costs. Additionally, an increase in operating expenses is expected with a higher volume of sales.

*Non operating Income (Expenses):* Non operating expense increased approximately \$2,320 to (\$1,969) of expense for 2007, compared to \$351 of income in 2006. The increase in expense was due to an increase of interest expense of approximately \$700. Additionally, the balance in 2006 included an amount of \$500 from favorable litigation. Additionally in 2007, the Company relocated from certain offices it was subleasing which reduced 2007 other income by \$500 compared to 2006.

*Provision for Income Taxes:* Our effective state and federal tax rate, adjusted for the effect of certain credits and adjustments, was approximately 38% and 38% for 2007 and 2006, respectively. The IRS is currently examining the Company's federal income tax returns of 2004, 2005, and 2006. To date the IRS has not proposed any material adjustments for the 2004 through 2006. For the 2002 and 2003 examination, the IRS has proposed certain changes, resulting in additional liabilities due. The Company has submitted a petition for a redetermination of the changes with the U.S. Tax Court.

*Extraordinary Items:* In 2006, a warehouse in Texas was destroyed by a fire and a warehouse in Pennsylvania was damaged by a flood. The Company reported an extraordinary gain on the fire of \$4,558 (net of income taxes of \$3,039). In 2007, a warehouse in Bartow was destroyed by a fire. The Company reported an extraordinary loss on the fire of \$4,345 (net of income taxes of \$2,897).

### **2006 Compared to 2005**

The following table summarizes the Company's results of operations as a percentage of net sales for 2006 and 2005.

**2006**

**2005**

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Net sales	\$ 238,378	100.0%	\$ 229,276	100.0%
Gross profit	48,725	20.4	52,917	23.1
Operating expenses	40,868	17.1	35,297	15.4
Operating income	7,857	3.3	17,620	7.7
Nonoperating income (expense)	351	.2	(375)	(.2)
Earnings before income taxes	8,208	3.4	17,245	7.5
Provision for income taxes	2,683	1.1	4,739	2.1
Extraordinary items	(3,475)	(1.5)	0	0.0
Net earnings	2,050	.1	\$ 12,506	5.5

*Net Sales:* Net sales for 2006 increased by \$9,102 or 4.0%, to \$238,378, from \$229,276 for 2005. The increase in net sales was due to our success in increasing our market share in our industrial division which was partially offset by a downturn in our retail sector as well as delays in shipping containment. The Company introduced two new products, Energy Air and our new nested product which increased sales but was offset by the plant fire in Texas and plant flood in Pennsylvania which reduced manufacturing capacity.

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*Gross Profit:* Gross profit for 2006 decreased \$4,192 or 7.9%, to \$48,725 which made up 20.4% of net sales, from \$52,917 for 2005, which made up 23.1% of net sales. The US economy experienced cost increases due to inflation including increases in in-bound shipping costs due to increased fuel costs, raw material costs, especially in the cost of metal. These costs were partially offset by vertical integration of certain manufacturing processes. The gross profit during the quarter has decreased due to the start up of three new plants in Clarkton, North Carolina, Dallas, Texas and Matamoros, Mexico as well as new production lines for the EnergyAire and nested filters. The plant fire in Texas and the plant flood in Auburn, Pennsylvania increased the overall cost of production. Additionally, the product mix has shifted towards lower margin items, however it is anticipated that this trend will reverse during the near term.

*Operating Expenses:* Operating expenses for 2006 increased \$5,571, or 15.8%, to \$40,868, from \$35,297 in 2005. Operating expenses as a percentage of sales increased in 2006 to 17.1% from 15.4% in 2005. The increase in operating expenses was primarily caused by an increase in the number of sales locations resulting in increased salaries and commissions of \$2,150, rents of \$987 and freight out of \$359. Additionally, bad debt expense increased by \$969.

*Nonoperating Income (Expenses):* Nonoperating expense increased approximately \$726 to \$351 of income for 2006, compared to (\$375) of expense in 2005. The increase was due to favorable litigation.

*Provision for Income Taxes:* Our effective state and federal tax rate, adjusted for the effect of certain credits and adjustments, was approximately 38% and 38% for 2006 and 2005, respectively. The IRS is currently examining the Company's federal income tax returns of 2002, 2003, and 2004. The IRS has proposed certain changes resulting in additional liabilities due. The Company disagrees with the proposed changes and is vigorously contesting these proposed changes and believes any final changes will be immaterial.

*Extraordinary Items:* In 2006, a warehouse in Texas was damaged by a fire and a warehouse in Pennsylvania was damaged by a flood. The Company reported an extraordinary loss on the fire of \$3,475 (net of income taxes of \$2,315).

### **EFFECTS OF INFLATION**

The Company's business and operations have not been materially affected by inflation during the periods for which financial information is presented.

### **LIQUIDITY AND CAPITAL RESOURCES** (dollar amounts in thousands)

Working capital was \$50,251 at December 31, 2007, compared to \$67,967 at December 31, 2006. This included cash and cash equivalents of \$498 and \$568 at December 31, 2007 and 2006, respectively. The primary reason for the decrease in working capital was the reduction of accounts receivable as well as a reduction of inventory due to an increased reserve estimate as well as a strategic reduction of inventory levels.

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Trade receivables decreased \$4,646, or 8.6% at December 31, 2007 from \$53,740 at December 31, 2006. The decrease in accounts receivable is attributable to receivables being written off along with the timing differences in shipments and payments received.

Inventories decreased \$11,703 or 19.9% to \$47,236 at December 31, 2007 from \$58,939 at December 31, 2006. The decreased inventory was due to an increase of the reserve estimate for bad inventory combined with a strategic reduction of inventory levels.

Continuing operations generated \$4,607 of cash in 2007, compared to consuming \$4,088 of cash in 2006. The increase in cash flows was primarily related to the decrease in inventory combined with insurance proceeds received in 2007. Investing activities for continuing operations generated \$4,869 of cash during 2007, compared to consuming \$11,519 during 2006. The increase in cash provided by investing activities was primarily attributable to the reduction in the Company's acquisition of equipment that was done in 2006 related to the fire and flood that occurred as well proceeds from the sale of fixed assets in 2007. Financing activities consumed \$9,546 of cash in 2007, compared to

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generating \$15,480 of cash in 2006, consisting primarily of payments on the revolving credit agreement and other long term borrowings.

On October 17, 2002, we signed agreements for a credit facility with Fleet Capital Corporation, now known as Bank of America through acquisition, which replaced and repaid our previous \$30 million revolving credit facility. The new \$36 million facility has up to \$11 million of letters of credit and a \$25 million revolving credit line, which expires on October 17, 2009. The term loan bears interest, at our option, at either (i) LIBOR plus between 2.5% and 3%, dependent on the Company's fixed charge coverage during the prior twelve months; or (ii) the greater of the Federal Funds Effective Rate plus 0.5% or Bank of America's base rate, plus between 0.5% and 1%, dependent on the Company's fixed charge coverage during the prior twelve months. The \$36 million revolving credit facility bears interest at 0.25% less than the term loan. Up to \$11 million of the revolving credit facility may be used to issue letters of credit. The facility is collateralized by substantially all of the Company's assets. The line of credit agreement restricts capital expenditures, dividends and share repurchases. As of December 31, 2007, all financial covenants were waived. Unless this credit facility is renewed, it will expire on October 17, 2009. There are no prepayment penalties on any of the credit facilities with Bank of America.

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

As of December 31, 2007 we had the following fixed obligations and commitments

Year ended December 31,	Operating leases	Capital leases	Long-term debt	Other long-term obligations
2008	5,494	618	2,118	
2009	5,566	656	16,376	
2010	4,790	194	380	
2011	3,909	46	404	
2012	3,613	46	427	
Thereafter	41,504	0	11,083	1,444

We believe that our cash on hand, cash generated by operations, and cash available from our existing credit facilities is sufficient to meet the capital demands of our current operations during the 2008 fiscal year. Any major increases in sales, particularly in new products, may require substantial capital investment for the manufacture of filtration products. Failure to obtain sufficient capital could materially adversely impact our growth potential.

In 1998, the Board of Directors authorized the repurchase of up to two million shares of our common stock, which repurchase was completed in September 2000. On September 22, 2000, the Board of Directors authorized the repurchase of up to an additional two million shares of common stock through open market or negotiated transactions. Further repurchases under this program are restricted under our current line of credit



agreement, and require prior consent of Bank of America. As of February 22, 2008 approximately 408,000 shares had been repurchased in the open market under this authorization.

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**Outlook**

Global Containment Systems, Inc. (GCS) is a wholly owned subsidiary of Flanders Corporation which manufactures critical environments for the nuclear, pharmaceutical and semi conductor. During 2008 GCS will be merged back under our Flanders Filters, Inc. and Charcoal Services Corporation divisions and these divisions will be working directly with the Department of Energy for creation of these projects.

Additionally, during 2004, Flanders Complete Service Division (Flanders CSD), an air filtration service provider was formed. Flanders CSD offers weekly, monthly and quarterly service contracts for clean room and glove box certification; commercial, industrial, retail and residential surveys; and complete filtration management including mold remediation and analysis. The company is currently negotiating several large contracts and if they are executed, the company expects to have national coverage by the end of 2010.

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

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

We have adapted our biocontainment products for use as part of a system for hardening government buildings, commercial office complexes and public venues against airborne bioweapons such as anthrax and smallpox. There is currently an increase of interest in these products over the past quarter. Any interest towards hardening these types of facilities against airborne bioweapons could have a significant impact on our business.

Sales of air filtration products for semiconductor facilities, historically a major market, are expected to be slow again during 2008, with most analysts pushing recovery for this sector out until 2009. However, the strengthening economy is also having a positive effect on sales of all our products.

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

Our most common products, in terms of both unit and dollar volume, are residential throw-away spun-glass filters, which usually sell for prices under \$1.00. Any increase in consumer concern regarding air pollution, airborne pollens, allergens, and other residential airborne contaminants could result in replacement of some of these products with higher value products. Our higher value products include our NaturalAire® higher-efficiency filters for residential use, and our Arm&Hammer® co-branded product, with associated sales prices typically over \$5.00 each. Any such trend would have a beneficial effect on our business.

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

Currently, the largest domestic market for air filtration products is for mid-range ASHRAE-rated products and

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

We have continually looked for cost reductions in our products. During the past five years, we have continued to complete the development and redesigning of numerous systems and products which were only partially completed when we acquired the companies which originally claimed to have fully developed them. These products include the automated machinery necessary for high-speed production of our pleated filters, acquired with Precisionaire, and the mass-production processes for bonded carbon high-mass zero-density products. During 2006, we built our first fully automated production lines which are expected to significantly reduce our labor related costs.

We plan on rebuilding the Bartow facility which was destroyed by a fire in July 2007. The new facility will be a 265,000 square foot, state of the art filter manufacturing facility. Construction will begin in March 2008 with an estimated completion time of seven to ten months.

This Outlook section, and other portions of this document, include certain forward-looking statements within the meaning of that term in Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, including, among others, those statements preceded by, following or including the words believe, expect, intend, anticipate or similar expressions. These forward-looking statements are based largely on the current expectations of management and are subject to a number of assumptions, risks and uncertainties. Our actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating such forward-looking statements include those discussed in Item 1A. Risk Factors as well as:

the shortage of reliable market data regarding the air filtration market,

changes in external competitive market factors or in our internal budgeting process which might impact trends in our results of operations,

anticipated working capital or other cash requirements,

changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the market,

product obsolescence due to the development of new technologies, and

various competitive factors that may prevent us from competing successfully in the marketplace.

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

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk** (dollar amounts in thousands)

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

The fair value of the Company's total long-term debt, including capital leases and current maturities of long-term debt, at December 31, 2007 was \$32,348 Market risk was estimated as the potential decrease (increase) in future earnings and cash flows resulting from a hypothetical 10% increase (decrease) in the Company's estimated weighted average borrowing rate at December 31, 2007. Although most of the interest on the Company's debt is indexed to a market rate, there would be no material effect on the future earnings or cash flows related to the Company's total debt for such a hypothetical change.

We have only a limited involvement with derivative financial instruments. We have two interest-rate swap agreements to hedge against the potential impact on earnings from increases in market interest rates of two variable rate bonds. Under the interest rate swap agreements, we receive or make payments on a monthly basis, based on the

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differential between 5.14% and a tax exempt interest rate as determined by a remarketing agent. This interest rate swap is accounted for as a cash flow hedge in accordance with SFAS 133 and SFAS 138. Gains or losses related to inefficiencies of the cash flow hedge were included in net income during the period related to hedge ineffectiveness. The tax affected fair market value of the interest rate swap of \$782 is included in Accumulated other comprehensive loss on the balance sheet. The interest rate swap contracts expire in 2013 and 2015.

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

**Item 8. Financial Statements and Supplementary Data**

Beginning at page F-1.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable

**Item 9A. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

Our management carried out an evaluation, under the supervision and with the participation of our President and Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of our year ended December 31, 2007 pursuant to Exchange Act Rule 13a-15(b). Based upon that evaluation, our President and Chief Executive Officer and our Chief Financial Officer concluded that, as of the end of our year ended December 31, 2007, our disclosure controls and procedures were effective.

The term disclosure controls and procedures, as defined under the Exchange Act, means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting*

There have been no changes in our internal control over financial reporting that occurred during the year ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our management, under the supervision and with the participation of our President and Chief Executive Officer and our Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Exchange Act Rule 13a-15(f). Our management has assessed the effectiveness of our internal control over financial reporting as of December 31, 2007.

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Management's evaluation was based on criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Internal control over financial reporting is a process designed 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. Our internal control over financial reporting includes those policies and procedures that:

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- (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and board of directors; and
- (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting determined to be effective can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on the COSO criteria and our management's evaluation, our management believes our internal control over financial reporting as of December 31, 2007 was effective.

Our independent registered public accounting firm, Pender Newkirk & Co., LLC, has audited the financial statements included in this Annual Report on Form 10-K and has issued an attestation report on our internal control over financial reporting. This report appears in this Annual Report on Form 10-K.

### *Important Considerations*

The effectiveness of our disclosure controls and procedures and our internal control over financial reporting is subject to various inherent limitations, including cost limitations, judgments used in decision making, assumptions about the likelihood of future events, the soundness of our systems, the possibility of human error, and the risk of fraud. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and the risk that the degree of compliance with policies or procedures may deteriorate over time. Because of these limitations, there can be no assurance that any system of disclosure controls and procedures or internal control over financial reporting will be successful in preventing all errors or fraud or in making all material information known in a timely manner to the appropriate levels of management.

**Item 9B. Other**  
Not applicable

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## PART III

**Item 10. Directors, Executive Officers and Corporate Governance of the Registrant**  
**IDENTIFICATION OF DIRECTORS AND EXECUTIVE OFFICERS**

Set forth below is information regarding (i) the current directors of the Company, who will serve until the next annual meeting of shareholders or until their successors are elected or appointed and qualified, and (ii) the current executive officers of the Company, who are elected to serve at the discretion of the Board of Directors.

<u>Name</u>	<u>Age</u>	<u>Title</u>
Robert R. Amerson	57	Chief Executive Officer and Director
Harry L. Smith, Jr.	37	Chief Operating Officer and Director
Cully Bohush	36	Chief Accounting Officer
David M. Mock	62	Independent Director
Kirk Dominick	40	Independent Director
Jeffrey Korn	50	Independent Director

**Robert R. Amerson.** Mr. Amerson, age 57, has been President and Chief Executive Officer of the Company since 1987 but retired from these positions in December 2004 and served as Chairman of the Board of Directors until August 13, 2007, when he assumed the additional positions of Chief Executive Officer and President. Mr. Amerson has been a director since 1988. Mr. Amerson has a Bachelor of Science degree in Business Administration from Atlantic Christian College.

**Harry L. Smith, Jr.** Mr. Smith, age 37, has a long history in the air filtration industry. He has worked at Flanders since 1997, holding roles of increasing responsibility including working with the Flanders direct offices; ARW Wholesale Division; FSS-Filter Sales and Service; FFI-Flanders Filters, Inc.; CSC-Charcoal Services, Inc., and AirSeal Filter Housings. Mr. Smith received his Bachelor of Science degree in Business Administration from East Carolina University in 1992. Mr. Smith was appointed our Chief Operating Officer in August 2007.

**Cully Bohush.** Mr. Bohush began with the Company as the Corporate Controller. From 1997 to 2002 Mr. Bohush worked in public accounting for various CPA firms including Deloitte & Touche, LLP. He is a Certified Public Accountant in the state of Florida and has a Bachelor's Degree in Accounting from the University of Buffalo as well as a Masters of Accountancy Degree from the University of South Florida.

**David M. Mock.** Mr. Mock, age 62, has served as an independent director of the Company since August 2003. He serves on both the Compensation Committee and Audit Committee. Mr. Mock is a General Partner with GMG Capital Partners, a New York-based investment firm, which he co-founded in 1997. Prior to joining GMS/GMG Partners, Mr. Mock was a private investor pursuing an investment strategy similar to that of GMG. Mr. Mock has extensive operations and private investment experience with respect to technology companies. He is currently Chairman of the Board of Captus Networks as well as serving as Director or Officer to several other companies including Alloptic, Inc., Forum Systems, and Connecting Point, Inc. Mr. Mock holds an Accounting degree from the University of Utah.

**Kirk Dominick.** Mr. Dominick, age 40, serves as President of DNS Associates, a full-service consulting firm that specializes in strategy development, organizational restructuring, management consulting, and board and resource development. Prior to joining DNS, Mr. Dominick enjoyed a seventeen-year career with Boys & Girls Clubs of America, most recently in the Office of Government Relations in Washington, D.C. In addition, Mr. Dominick is a

Partner in InnerBanks Capital, a private equity firm focused on real estate development in emerging growth markets. Mr. Dominick holds a Bachelor of Science in Criminal Justice from East Carolina University.

**Jeffrey Korn.** Mr. Korn, age 50, has been a corporate attorney since 1982. He was originally in private practice in Jacksonville, Florida from 1982-1999 in a commercial litigation and business practice. He was general counsel and a member of the board of directors of Prosoft Training (formerly a NASDAQ company now sold) from 1987-2005. Since 2003, Mr. Korn has served as general counsel in iMergent, Inc. (IIG, AMEX). Since 2001, Mr. Korn has maintained a private legal and corporate consulting practice.

## **Our Corporate Governance Practices**

At Flanders Corporation we have always believed in strong and effective corporate governance procedures and practices. In that spirit, we have summarized several of our corporate governance practices below.

### **Adopting Governance Guidelines**

The Board of Directors has adopted a set of corporate governance guidelines to establish a framework within which it will conduct its business and to guide management in its running of your Company. The governance guidelines can be found on our website at [www.flanderscorp.com](http://www.flanderscorp.com) and are summarized below.

### **Monitoring Board Effectiveness**

It is important that our Board of Directors and its Committees are performing effectively and in the best interest of the Company and its stockholders. The Board of Directors and each Committee are responsible for annually assessing their effectiveness in fulfilling their obligations. In addition, our Nominating and Governance Committee is charged with annually reviewing the Board of Directors and its membership.

### **Conducting Formal Independent Director Sessions**

At the conclusion of each regularly scheduled Board meeting, the independent Directors meet without Flanders Corporation management or any non-independent Directors.

### **Hiring Outside Advisors**

The Board and each of its Committees may retain outside advisors and consultants of their choosing at the Company's expense, without management's consent.

### **Avoiding Conflicts of Interest**

Flanders Corporation expects its Directors, executives and employees to conduct themselves with the highest degree of integrity, ethics and honesty. Flanders Corporation's credibility and reputation depend upon the good judgment, ethical standards and personal integrity of each Director, executive and employee. In order to provide assurances to Flanders Corporation and its stockholders, Flanders Corporation has implemented standards of business conduct which provide clear conflict of interest guidelines to its employees, as well as an explanation of reporting and investigatory procedures.

### **Providing Transparency**

Flanders Corporation believes it is important that stockholders understand our governance practices. In order to help ensure transparency of our practices, we have posted information regarding our corporate governance procedures on our website at [www.flanderscorp.com](http://www.flanderscorp.com).

### **Communications with the Board of Directors**

Although Flanders Corporation does not have a formal policy regarding communications with the Board of Directors, stockholders may communicate with the Board of Directors by writing to the Company at Flanders Corporation, Attention: Investor Relations, 2399 26<sup>th</sup> Avenue North, Saint Petersburg, FL 33713. Stockholders who would like their submission directed to a member of the Board may so specify, and the communication will be forwarded, as appropriate.

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### **Standards of Business Conduct**

The Board of Directors has adopted a Code of Business Conduct and Ethics for all of the Company's employees and Directors, including the Company's principal executive and senior financial officers. You

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can obtain a copy of our Code of Business Conduct and Ethics via our website at [www.flanderscorp.com](http://www.flanderscorp.com), or by making a written request to the Company at Flanders Corporation, Attention: Investor Relations, 2399 26<sup>th</sup> Avenue North, Saint Petersburg, FL 33713. We will disclose any amendments to the Code of Business Conduct and Ethics, or waiver of a provision therefrom, on our website at the same address.

### **Ensuring Auditor Independence**

Flanders Corporation has taken a number of steps to ensure the continued independence of our outside auditors. Our independent auditors report directly to the Audit Committee, which also has the ability to pre-approve or reject any non-audit services proposed to be conducted by our outside auditors.

### **Item 11. Executive Compensation COMPENSATION DISCUSSION AND ANALYSIS**

#### Overview

The goal of our named executive officer compensation program is the same as our goal for operating the company to create long-term value for our shareowners. Toward this goal, we have designed and implemented our compensation programs for our named executives to reward them for sustained financial and operating performance and leadership excellence, to align their interests with those of our shareowners and to encourage them to remain with the company for long and productive careers. Most of our compensation elements simultaneously fulfill one or more of our performance, alignment and retention objectives. These elements consist of salary, bonus, equity incentive compensation, health and other benefits. In deciding on the type and amount of compensation for each executive, we focus on both current pay and the opportunity for future compensation. We combine the compensation elements for each executive in a manner we believe optimizes the executive's contribution to the company.

#### Compensation Objectives

*Performance.* Our three executives who are identified in the Summary Compensation Table (whom we refer to as our named executives) have held different positions and been promoted to increasing levels of responsibility. The amount of compensation for each named executive reflects his management experience, performance and service. A key element of compensation is equity incentive compensation in the form of stock options, the value of which is contingent upon the performance of the Flanders Corporation share price.

We believe that the compensation of our executives should reflect their success in attaining our key objectives. Our key objectives are currently: (i) growth in operating earnings and earning per share, (ii) growth or maintenance of market share, and (iii) improved operating margins. The key individual factors for each executive include but are not limited to: (i) the value of their skills and capabilities, (ii) performance of their management responsibilities, (iii) whether that individual is capable to assuming greater responsibilities, (iv) leadership qualities, (v) tenure and career experience, (vi) current compensation arrangements, (vii) long-term potential to enhance shareholder value, and (viii) contribution as a member to our executive management team.

We allocate compensation between cash compensation and equity based compensation. We provide cash compensation in the form of base salaries to meet competitive salary norms and reward performance on an annual basis, if warranted. Base salary and bonus are designed to reward annual achievements and be commensurate with the executive's scope of responsibilities, demonstrated leadership abilities, and management experience and

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effectiveness. Our other elements of compensation focus on motivating and challenging the executive to achieve superior, longer-term, sustained results. We provide non-cash compensation in the form of equity incentive arrangements to retain and attract key individuals and to reward performance against specific objectives and long-term strategic goals.

*Alignment.* We seek to align the interests of the named executives with those of our investors by evaluating executive performance on the basis of key financial measurements which we believe closely correlate to long-term shareowner value, including revenue, organic revenue, operating profit, earnings per share, operating margins, return on total equity or total capital, cash flow from operating activities and total shareholder

return. A key element of compensation that align the interests of our executives with shareowners is equity incentive compensation, which links a significant portion of compensation to shareowner value because the total value of those awards corresponds to stock price appreciation.

#### Implementing Our Objectives

During 1996, the Company adopted the Long Term Incentive Plan (LTI Plan) to assist the Company in securing and retaining key employees and consultants. The LTI Plan authorizes grants of incentive stock options, nonqualified stock options, stock appreciation rights ( SARs ), restricted stock performance shares and dividend equivalents to officers and key employees and outside consultants. In December 2007 our shareholders approved the 2007 Equity Incentive Plan, which reserves up to 2,000,000 shares for issuance. Our 1996 Long-Term Incentive Plan had a life of ten (10) years. Furthermore, there are no more shares available for issuance under the 1996 Long-Term Incentive Plan. Therefore, we adopted the 2007 Equity Incentive Plan as discussed above. We believe that reserving 2,000,000 shares under the 2007 Equity Incentive Plan is a reasonable number of shares for the foreseeable future.

#### *Equity Incentive Plan*

During 2007, the Company adopted the Equity Incentive Plan (the Plan) to assist the Company in securing and retaining key employees and consultants. The Plan authorizes grants of incentive stock options, non-qualified stock options, restricted stock and stock appreciation rights ( awards ) to officers, directors, outside consultants and key employees of the Company. There are 2,000,000 shares of Common Stock reserved for award under the Plan. During 2007 the Company awarded options to purchase 620,000 shares of Common Stock under the Plan.

The 2007 Equity Incentive Plan is administered by the Compensation Committee. The Compensation Committee determines the total number and type of awards granted in any year, the number and selection of employees or consultants to receive awards, the number and type of awards granted to each grantee and the other terms and provisions of the awards, subject to the limitations set forth in the Equity Incentive Plan.

*Stock Option Grants.* The Compensation Committee has the authority to select individuals who are to receive options under the Plan and to specify the terms and conditions of each option so granted (incentive or nonqualified), the exercise price (which must be at least equal to the fair market value of the common stock on the date of grant with respect to incentive stock options), the vesting provisions and the option term. Unless otherwise provided by the Compensation Committee, any option granted under the Plan expires the earlier of five years from the date of grant or, three months after the optionee's termination of service with the Company if the termination of employment is attributable to (i) disability, (ii) retirement, or (iii) any other reason, or 15 months after the optionee's death. We do not have a program for the timing of Stock Option grants.

*Stock Appreciation Rights.* The 2007 Equity Incentive Plan also allows for the issuance of stock appreciation rights, performance shares, restricted stock awards, dividend equivalents, and other forms of equity incentive arrangements. Historically, we have utilized stock options as the primary method of rewarding and compensating employees under our equity incentive arrangements. However, if the need arises, we have the flexibility to utilize other equity incentive instruments besides stock options under the 2007 Equity Incentive Plan. As of December 31, 2007, no SARs are outstanding under the Plan.

*Restricted Stock Awards.* The Compensation Committee is authorized under the Plan to issue shares of restricted common stock to eligible participants on such terms and conditions and subject to such restrictions, if any, outstanding under the Plan. As of December 31, 2007, no restricted shares have been awarded.

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*Section 16(a) Beneficial Ownership Reporting Compliance.* Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, and persons who own more than ten percent of a registered class of the Company's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Officers and directors are required by SEC regulation to furnish the Company with copies of all Section 16(a) forms filed. Based solely upon review of copies of such forms, or written representations that there were no unreported holdings or transactions, the Company believes that for the fiscal year ending December 31, 2007 all Section 16(a) filing requirements applicable to its officers and directors were complied with on a timely basis.

#### **REPORT OF THE COMPENSATION COMMITTEE ON EXECUTIVE COMPENSATION**



General

The Compensation Committee of the Board of Directors is currently composed of two independent directors, Messrs. Mock and Korn who have no interlocking relationships (as defined by the SEC), the Board Chairman and CEO, Mr. Amerson, who recuses himself from votes and discussions on his own compensation.

We are engaged in highly competitive businesses and compete nationally for personnel at the executive and technical staff level. Outstanding candidates are aggressively recruited, often at premium salaries. Highly qualified employees are essential to our success. We are committed to providing competitive compensation that helps attract, retain, and motivate the highly skilled people we require. We strongly believe that a considerable portion of the compensation for the Chief Executive Officer and other top executives must be tied to the achievement of business objectives, completing acquisitions, and to business unit and overall financial performance, both current and long-term.

Executive Compensation

Our executive compensation program is administered by the Compensation Committee. The role of the Compensation Committee is to review and approve salaries and other compensation of the executive officers of the Company, to administer the Equity Incentive Plan, and to review and approve stock option grants to all employees including the executive officers of the Company.

Base Salary and Executive Officer Bonus Target

Current base salaries for the executive officers were determined by arms length negotiations with the Board of Directors. Messr. Amerson has an employment contract with the Company which sets a base salary and allows for bonus targets and levels to be set at the sole discretion of this committee. During 2007, none of the executive officers reached their bonus targets, hence no bonuses were awarded to executive officers in 2007, nor will bonuses be awarded in 2008 for performance in 2007.

Chief Executive Officer Compensation

The current base salary for the Chief Executive Officer of \$350,000 is set according to his employment contract, which also includes provision for annual bonuses at the sole discretion of this committee. No bonuses were awarded to the Chief Executive Officer in 2007 and none were accrued based upon 2007 performance.

**REPORT OF THE AUDIT COMMITTEE**

General

The Audit Committee of the Board of Directors is composed of three independent directors who have no interlocking relationships as defined by the Commission, Messrs. Mock, Korn, and Dominick.

The Audit Committee reviews the results and scope of the audit and other services provided by the Company's independent auditors, reviews and evaluates the Company's internal audit and control functions, and monitors transactions between the Company and its employees, officers and directors.

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Audit Committee Charter

During 2000, the Audit Committee recommended the approval of a formal Charter, which expanded the Audit Committee's primary duties and responsibilities to include:

Serve as an independent and objective party to monitor the Company's financial reporting processes and internal control systems.

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Review and appraise the audit efforts of the Company's independent accountants and internal finance department.

Provide an open avenue of communication between the independent accountants, financial and senior management, the internal finance department, and the Board of Directors.

Review quarterly and annual financial statements submitted to the Securities and Exchange Commission, or the public, including any certification, opinion or review rendered by the Company's independent accountants.

### Review of Annual Results

The Audit Committee reviewed and discussed the Company's financial statements for the year ended December 31, 2007 with the Company's management. The Audit Committee also discussed the statements with the Company's independent auditors. In particular, the Audit Committee discussed with the independent auditors the matters required by SAS 61.

It is not the responsibility of the Audit Committee to render an opinion regarding the Company's financial statements, but to monitor the Company's internal controls and reporting processes, as well as the Company's relationship with its internal auditors.

The Audit Committee received the written disclosures and the letter from the independent accountants required by Independence Standards Board Standard No. 1 and has discussed with and confirmed the independence of the independent accountant.

Based on its review and the discussions noted above, the Audit Committee recommended to the Board of Directors that the Company's Consolidated Financial Statements for the years ended December 31, 2007, 2006 and 2005 be included in the Company's Annual Report on Form 10-K for 2007.

Respectfully submitted,

David M. Mock                      Jeffrey Korn  
Kirk Dominick

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### SUMMARY COMPENSATION TABLE

The following table sets forth the aggregate cash compensation paid by the Company for services rendered during the last three years to the Company's Named Executive Officers.

Name and Principal Position	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)
Steven K. Clark	2007 <sup>1</sup>	255,770						6,073
Former Chief Executive Officer (Former Principal Executive Officer)	2006	350,000						8,389
	2005	328,846						9,574
Robert Amerson Chief Executive Officer	2007 <sup>1</sup>	350,000						
	2006	350,000						
	2005	328,846						

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Harry Smith Chief Operating Officer	2007	140,095	333,269 <sup>2</sup>
John W. Hodson Former Chief Financial Officer (Former Principal Financial Officer)	2007	75,500	2,241
	2006	127,153	3,857
	2005	107,346	4,431
Cully Bohush Chief Accounting Officer (Principal Accounting Officer)	2007	117,145	1,004
James B. Buddy Mercer Former Vice President Operations	2007	115,877	
	2006	119,899	
	2005	118,247	

1 Mr. Amerson and Mr. Clark each had an annual salary of \$350,000, plus a possible bonus each year, under their respective Employment Agreements, as amended. Mr. Clark was removed from CEO in during 2007.

2 This is grant date fair value of 100,000 vested stock options computed in accordance with FAS 123R.

**GRANTS OF PLAN BASED AWARDS TABLE**

The following tables set forth the number of securities underlying stock options granted to the named executive officers under the Company's stock option plans during the year ended December 31, 2007.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards: Number of Shares of	All Other Option Awards: Number of Shares of	Exercise or Base Price of Option
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)			
Harry Smith	10/16/07				500,000					\$ 4.99
					37					

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**OPTION EXERCISES AND STOCK VESTED TABLE**

The following table sets forth the aggregate number and value of stock options at year end by the Company's Named Executive Officers.

Name	Option Awards		Stock Awards	

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	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise(\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
Robert Amerson		\$		\$
Harry Smith		\$		\$
Cully Bohush	3,826	\$ 24,945		\$

**OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END TABLE**

The following table discloses information regarding outstanding awards under stock option plans as of December 31, 2007. The table omits any Stock Award columns because the Company does not have any Stock Award Plans.

Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan awards: Number of Securities Underlying Unexercised Unearned Options	Option Exercise Price (\$)	Option Expiration Date
Robert R. Amerson	1,000,000			\$ 2.50	12/22/09
	1,000,000			\$ 7.50	11/07/11
Harry Smith	20,000			\$ 5.00	10/03/08
	20,000			\$ 8.60	08/24/09
	50,000			\$ 8.85	07/01/10
	100,000	400,000	400,000	\$ 4.99	10/16/17
Cully Bohush	20,000			\$ 5.21	03/15/09
	50,000			\$ 11.10	12/06/10

The Pension Benefits Table and the Nonqualified Deferred Compensation Table are omitted as they are inapplicable as the Company has no pension plans and deferred compensation arrangements.

**COMPENSATION OF DIRECTORS**

Directors who are Company employees receive no additional or special remuneration for serving as directors.

On May 16, 2007 the board of directors of the Company approved an increase in the compensation of its independent directors. The increase was approved to bring the independent directors' compensation more in line with that of comparable companies and was based upon information provided to the Company by an independent compensation consultant hired by the Company. Retroactive to April 1, 2007, independent directors are paid \$9,625 per quarter. Quarterly compensation is being paid to independent directors no later than the fifteenth day following the beginning of each calendar quarter.

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In addition to the cash compensation described above, upon initial appointment to the Board and pursuant to the 1996 Flanders Corporation Directors Option Plan, a director receives an automatic option to purchase 50,000 shares of the Company's common stock. All independent directors with a minimum of six (6) months on the Board are automatically granted an additional 5,000 options to purchase Company common stock each year thereafter for so long as the director remains on the Board.

We modified our directors' compensation plan for our new directors. New independent directors (Mr. Dominick and Mr. Korn) each received options to acquire 50,000 shares of our common stock with an exercise price equal to the fair market value of our shares as of the date they are elected and agree to serve on our board. We will pay our independent directors a \$5,000 quarterly fee (a reduction from our current quarterly fee

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of \$9,625). Independent directors will be entitled to 5,000 options after a minimum of six (6) months of service on an annual basis. In addition, we will pay our independent directors \$500 for each board of directors meeting personally attended plus reimbursement of associated out-of-pocket costs.

### DIRECTOR COMPENSATION TABLE

The following table sets forth all material Director compensation information during the year ended December 31, 2007.

Name	Fees Earned or Paid in Cash (\$) <sup>1</sup>	Stock Awards (\$)	Option Awards (\$) <sup>2</sup>	All Other Compensation	Total <sup>3</sup>
William D. Mitchum, Jr.	30,875		\$ 23,573		\$ 30,875
David Mock	30,875		\$ 23,573		\$ 30,875
Robert Kelly Barnhill, Sr.	30,875		\$ 23,573		\$ 30,875
Peter Fredericks	30,875		\$ 23,573		\$ 30,875
Jeff Korn			\$ 182,886		\$ 182,886
Kirk Dominick			\$ 182,886		\$ 182,886

<sup>1</sup> This column reports the amount of cash compensation earned in 2007 for Board and committee service.

<sup>2</sup> This column represents the dollar amount recognized for financial statement reporting purposes with respect to the 2007 fiscal year for the fair value of stock options granted to the directors in 2007. The fair value was estimated using the Black-Scholes option-pricing model in accordance with SFAS 123R. The weighted average fair value per option was \$5.70.

<sup>3</sup> The Non-Equity Incentive Plan Compensation and the Change in Pension Value and Nonqualified Deferred Compensation columns are not applicable and are omitted from this table.

### EMPLOYMENT AGREEMENTS

Messr. Amerson has an employment agreement effective as of December 15, 1995 ( Employment Agreement ). The Employment Agreement, as amended, provide for an annual base salary of \$350,000 for Mr. Amerson and terminates in 2010. The Employment Agreements also provide that the executive shall be entitled to the following termination payments: (i) 100% of his current base salary if the employment is terminated as a result of his death or disability; (ii) up to 200% of his current base salary if the employment is terminated by the Company for any reason other than death, disability or for cause, or (iii) up to 250% of the executive's gross income during the year preceding his termination if the Employment Agreement is terminated by the executive for good reason or by the Company for any reason other than death, disability or cause and the termination occurs within two years after a change of control of the Company has occurred.

### OTHER INFORMATION REGARDING THE BOARD OF DIRECTORS

#### Board Meetings and Committees

The Nominating Committee was established in 2004. It oversees the qualification and nomination process for potential director candidates, reviews the continued qualification of existing directors and is responsible for corporate governance oversight.

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During 2007, the Board of Directors met six times and also executed various consent resolutions and written actions in lieu of meetings. Additionally, all directors were present, either in person or by proxy, at the Fiscal 2006 Annual Meeting of the Shareholders held in December of 2007.

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The Board of Directors currently has an Audit Committee and a Compensation Committee. The Audit Committee reviews the results and scope of the audit and other services provided by the Company's independent auditors, reviews and evaluates the Company's internal audit and control functions, monitors transactions between the Company and its employees, officers and directors, and completes other functions as required by the Public Company Accounting Reform and Investor Protection Act (the Sarbanes-Oxley Act) passed in 2002. David Mock is considered the audit committee financial expert. The Compensation Committee administers the Company's equity incentive plans and designates compensation levels for executive officers and directors of the Company. The Audit Committee met four times during 2007. The Compensation Committee met one time during 2007.

Currently, the Audit Committee consists of Messrs. Mock, Korn and Dominick, with Mr. Mock serving as Chair. The Compensation Committee consists of Messrs. Mock and Korn. Mr. Mock serves as Chair and Mr. Amerson serve as non-voting advisory members.

There is no family relationship between the directors, executive officers or persons nominated or appointed by the board to become directors or executive officers. Directors are independent in accordance with the rules of NASDAQ. Each director attended at least 75% of (a) the total number of meetings of the board of directors, and (b) the total number of meetings of all committees of the board of directors on which he served for Fiscal Year 2006. Our policy is to encourage board members to attend the annual meeting of stockholders. All of our directors attended the previous annual meeting.

### Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth all individuals known by the Company to beneficially own 5% or more of the Company's common stock, and all officers and directors of the registrant, with the amount and percentage of stock beneficially owned, as of December 31, 2007. Except as indicated in the following footnotes, each listed beneficial owner has sole voting and investment power over the shares of common stock held in their names.

Name and Address of Beneficial Owner	Shares of Common Stock Beneficially Owned	Percentage of Outstanding Shares of Common Stock <sup>(1)</sup>
Robert R. Amerson <sup>(2)</sup> 531 Flanders Filters Road Washington, NC 27889	7,612,103	29.63%
Harry Smith <sup>(3)</sup> 531 Flanders Filters Road Washington, NC 27889	945,183	3.68%
Cully Bohush <sup>(4)</sup>	73,826	*
Jeff Korn <sup>(5)</sup>	90,000	*
Kirk Dominick <sup>(6)</sup>	50,000	*
David Mock <sup>(7)</sup>	97,700	*
Heartland Advisors 789 North Water Street Milwaukee, WI 53202	2,866,874	11.16%

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Name and Address of Beneficial Owner	Shares of Common Stock Beneficially Owned	Percentage of Outstanding Shares of Common Stock <sup>(1)</sup>
Royce & Associates, LLC 1414 Avenue of the Americas New York, NY 10019	1,375,320	5.35%
	1,302,906	5.07%

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Bank of America Corporation  
100 North Tryon Street, Floor 25  
Bank of America Corporate Center  
Charlotte, NC 28255

Officers and Directors as a group (6 persons) <sup>(2), (3), (4), (5), (6), (7)</sup>	8,868,812	34.52%
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\* Represents less than 1% of the total issued and outstanding shares of common stock.

- (1) Applicable percentage of ownership is based on 25,691,632 shares of common stock outstanding as of December 31, 2007, together with all applicable options for unissued securities for such shareholders exercisable within 60 days. Shares of common stock subject to options exercisable within 60 days are deemed outstanding for computing the percentage ownership of the person holding such options, but are not deemed outstanding for computing the percentage of any other person.
- (2) Includes 1,000,000 shares which are subject to an option to purchase such shares from the Company at \$2.50 per share. These options expire in 2009. Also includes 1,000,000 shares which are subject to an option to purchase such shares from the Company at \$7.50 per share. These options expire in 2011.
- (3) Includes 20,000 shares which are subject to an option to purchase such shares from the Company at \$5.00 per share. These options expire in 2008. Also includes 20,000 shares which are subject to an option to purchase such shares from the Company at \$8.60 per share. These options expire in 2009. Also includes 50,000 shares which are subject to an option to purchase such shares from the Company at \$8.85 per share. These options expire in 2010. Also includes 100,000 shares which are subject to an option to purchase such shares from the Company at \$4.99 per share. These options expire in 2017.
- (4) Includes 20,000 shares which are subject to an option to purchase such shares from the Company at \$5.21 per share. These options expire in 2009. Also includes 50,000 shares which are subject to an option to purchase such shares from the Company at \$11.10 per share. These options expire in 2010.
- (5) Includes 25,000 shares which are subject to an option to purchase such shares from the Company at \$9.03 per share. These options expire in 2010. Also includes 50,000 shares which are subject to an option to purchase such shares from the Company at \$5.55 per share. These options expire in 2017.
- (6) Includes 50,000 shares which are subject to an option to purchase such shares from the Company at \$5.55 per share. These options expire in 2017.
- (7) Includes 50,000 shares which are subject to an option to purchase such shares from the Company at \$4.37 per share. These options expire in 2008. Also includes 5,000 shares which are subject to an option to purchase such shares from the Company at \$11.01 per share. These options expire in 2010. Also includes 5,000 shares which are subject to an option to purchase such shares from the Company at \$11.72 per share. These options expire in 2011. Also includes 5,000 shares which are subject to an option to purchase such shares from the Company at \$9.52 per share. These options expire in 2017.

**Item 13. Certain Relationships and Related Transactions** (dollar amounts in thousands)  
Review and Approval of Related Person Transactions.

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The Audit Committee reviews all relationships and transactions in which the company and our directors and executive officers or their immediate family members are participants to determine whether such persons have a direct or indirect material interest. The company's legal consultant is primarily responsible for the development and implementation of processes and controls to obtain information from the directors and executive officers with respect to related person transactions and for then determining, based on the facts and circumstances, whether the company or a related person has a direct or indirect material interest in the transaction. As required under SEC rules, transactions that are determined to be directly or indirectly material to the company or a related person are disclosed in the company's proxy statement. In addition,

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the Audit Committee reviews and approves or ratifies any related person transaction that is required to be disclosed. As set forth in the Audit Committee's key practices, in the course of its review and approval or ratification of a disclosable related party transaction, the committee considers:

the nature of the related person's interest in the transaction;

the material terms of the transaction, including, without limitation, the amount and type of transaction;

the importance of the transaction to the related person;

the importance of the transaction to the company;

whether the transaction would impair the judgment of a director or executive officer to act in the best interest of the company; and

any other matters the committee deems appropriate.

Any member of the Audit Committee who is a related person with respect to a transaction under review may not participate in the deliberations or vote respecting approval or ratification of the transaction, provided, however, that such director may be counted in determining the presence of a quorum at a meeting of the committee that considers the transaction.

### Satisfaction of related party notes

Mr. Clark, our former chief executive officer and former director, satisfied an outstanding balance of approximately \$5,454,810 as of September 30, 2007 on an outstanding promissory note in consideration of his surrendering 1,183,872 shares of our common stock. These shares were valued at \$4.60, which approximates the 30-day average market value of our shares. See Settlement Agreement and Mutual Release with Mr. Clark.

On October 16, 2007, Mr. Amerson, our current CEO and Chairman of the Board of Directors, paid us in full for all outstanding amounts due under a promissory note of approximately \$2,700,000. We returned to Mr. Amerson 269,761 shares of our common stock, which were held as security for repayment of this note.

### Personal Guaranties/Indemnities

Mr. Amerson is a personal guarantor on our credit facility with Bank of America. As part of the Settlement Agreement and Mutual Release with Mr. Clark, we are required to indemnify Mr. Clark and his affiliates, as a guarantor of this credit facility. In connection with the Settlement Agreement and Mutual Release with Mr. Clark, Mr. Amerson agreed to assign his interest in Mercury Die Cutting (50% owner of Superior Diecutting, Inc.) to Mr. Clark.

In April 2007, our board of directors approved indemnity agreements for its officers and directors. The indemnification agreements provide indemnification for (i) proceedings by or in the right of the company (ii) indemnification for expenses of a party who is wholly or partly successful and (iii) indemnification for expenses as a witness. The indemnification rights generally applies only if the officer or director acted in good faith and in a manner in which he or she reasonably believed to be in or not opposed to the best interests of the Company, and, in the case of a criminal proceeding had no reasonable cause to believe that his or her conduct was unlawful.

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### Related party transactions

As of December 31, 2007 the Company has entered into six operating leases expiring either in 2025 or 2026 with Wal-Pat II. Wal-Pat II is owned by Robert R. Amerson, our Chief Executive Officer. The monthly payments to Wal-Pat II total \$221. The Company made payments of \$3,372, \$2,816 and \$1,067 in 2007, 2006 and 2005, respectively. The Company believes these leases are at prevailing market rates.



**Item 14. Principal Accountant Fees and Services** (dollar amounts in thousands)

Audit Related Fees

Our principal accountants billed us an aggregate of \$279 and \$261 in fees and expenses for professional services rendered in connection with the audits of our financial statements for the calendar years ended December 31, 2007 and 2006, respectively, and reviews of the financial statements included in our quarterly reports on Form 10-Q during such calendar years.

Our principal accountants did not bill us any additional fees that are not disclosed under audit fees in each of the last two calendar years for assurance and related services that are reasonably related to the performance of our audit or review of our financial statements.

Tax Fees

Our principal accountants billed us an aggregate of \$180 and \$26 in fees and expenses for tax compliance, tax advice and tax planning during calendar years ended December 31, 2007 and 2006, respectively.

All Other Fees

Our principal accountants billed us an aggregate of \$33 and \$24 in fees and expenses during calendar years ended December 31, 2007 and 2006, respectively, for products and services other than those products and services described above. These services consist of the following:

Audit of profit sharing plan and discussions regarding Sarbanes Oxley 404.

Audit Committee Pre-Approval Process, Policies and Procedures

The appointment of Pender Newkirk & Co., LLP was approved by our Audit Committee and full Board of Directors. Our principal auditors have performed their audit procedures in accordance with pre-approved policies and procedures established by our Audit Committee. Our principal auditors have informed our Audit Committee of the scope and nature of each service provided. With respect to the provisions of services other than audit, review, or attest services, our principal accountants brought such services to the attention of our Audit Committee, or one or more members of our Audit Committee for the members of our Board of Directors to whom authority to grant such approval had been delegated by the Audit Committee, prior to commencing such services. Such services primarily consisted of tax related services.

**Code of Ethics for Senior Financial Officers**

The code of ethics established by the Company for its Senior Financial Officers is required to be signed by each such officer, is maintained on file by the Company, and incorporates the following:

Senior Financial Officers hold an important and elevated role in corporate governance. While members of the management team, they are uniquely capable and empowered to ensure that all stakeholders' interests are appropriately balanced, protected and preserved. This Code provides principles to which Flanders Corporation Officers are expected to adhere and advocate. They embody rules regarding individual and peer responsibilities, as well as responsibilities to employers, the public and other stakeholders. Our Senior Financial Officers agree by their signature below that they will:

1. Act with honesty and integrity, avoiding actual or apparent conflicts of interest in personal and professional relationships.

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2. Will make reasonable efforts to comply with rules and regulations of federal, state, provincial and local governments, and other appropriate private and public regulatory agencies as known to them and will make reasonable efforts to maintain or obtain a professional level of knowledge of applicable rules and regulations.

3. Act in good faith, responsibly, with due care, competence and diligence, without misrepresenting material facts or allowing one's independent judgment to be subordinated.
4. Respect the confidentiality of information acquired in the course of one's work except when authorized or otherwise legally obligated to disclose. Confidential information acquired in the course of one's work will not be used for personal advantage.

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**PART IV**

**Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K**

The following constitutes a list of Financial Statements, Financial Statement Schedules and Exhibits used in this report.

- (a)(1) Financial Statements: Financial Statements are included beginning at page F-1 as follows:
 

Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets at December 31, 2007 and 2006	F-5
Consolidated Statements of Operations for the years ended December 31, 2007, 2006 and 2005	F-6
Consolidated Statements of Stockholders' Equity for the years ended December 31, 2007, 2006 and 2005	F-7
Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006 and 2005	F-8
Notes to Consolidated Financial Statements	F-10
- (a)(2) Financial Statement Schedules
 

Report of Independent Registered Public Accounting Firm on schedule	F-34
Schedule II. Valuation and Qualifying Accounts	F-35

All schedules not listed have been omitted because they are not applicable or the information has been otherwise supplied in the Registrant's financial statements and schedules.
- (a)(3) Exhibits:
  - 3.1 Articles of Incorporation for Flanders Corporation, filed with the Form 8-A dated March 8, 1996, incorporated herein by reference.
  - 3.2 Bylaws of Flanders Corporation, filed with the Form 8-A dated March 8, 1996, incorporated herein by reference.
  - 10.1 Loan and Security Agreement, dated October 9, 2002, by and among Fleet Capital Corporation, Flanders Corporation, Flanders/Precisionaire Corp., Flanders Filters, Inc., Flanders/CSC Corporation, Precisionaire, Inc., Precisionaire of Utah, Inc., Eco-Air Products, Inc., Air Seal Filter Housings, Inc. and Flanders Realty Corp., filed with the Form 8-K/A dated October 21, 2002.

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- 10.2 First Amendment to Loan and Security Agreement, dated October 18, 2002, by and among Flanders Corporation, Flanders/Precisionaire Corp., Flanders Filters, Inc., Flanders/CSC Corporation, Precisionaire, Inc., Precisionaire of Utah, Inc., Eco-Air Products, Inc., Air Seal Filter Housings, Inc., Flanders Realty Corp. and Fleet Capital Corporation, filed with the Form 8-K/A dated October 21, 2002.
- 10.3 Second Amendment to Loan and Security Agreement, dated November 19, 2002, by and among Flanders Corporation, Flanders/Precisionaire Corp., Flanders Filters, Inc., Flanders/CSC Corporation, Precisionaire, Inc., Precisionaire of Utah, Inc., Eco-Air Products, Inc., Air Seal Filter Housings, Inc., Flanders Realty Corp. and Fleet Capital Corporation, filed with the Form 8-K/A dated October 21, 2002.

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- 10.3.1 Third Amendment to Loan and Security Agreement, dated September 6, 2003 by and among Flanders Corporation, Flanders/Precisionaire Corp., Flanders Filters, Inc., Flanders/CSC Corporation, Precisionaire, Inc., Precisionaire of Utah, Inc., Eco-Air Products, Inc., Air Seal Filter Housings, Inc., Flanders Realty Corp. and Fleet Capital Corporation.
- 10.3.2 Fourth Amendment to Loan and Security Agreement, dated December 8, 2003, by and among Flanders Corporation, Flanders/Precisionaire Corp., Flanders Filters, Inc., Flanders/CSC Corporation, Precisionaire, Inc., Precisionaire of Utah, Inc., Eco-Air Products, Inc., Air Seal Filter Housings, Inc., Flanders Realty Corp. and Fleet Capital Corporation.
- 10.4 Support Agreement and Guaranty dated October 18, 2002, between Fleet Capital Corporation and Steven K. Clark, filed with the Form 8-K/A dated October 21, 2002.
- 10.5 Support Agreement and Guaranty dated October 18, 2002, between Fleet Capital Corporation and Robert Amerson, filed with the Form 8-K/A dated October 21, 2002.
- 10.6 Continuing Guaranty Agreement dated October 18, 2002, between Fleet Capital Corporation and Superior Diecutting, Inc., filed with the Form 8-K/A dated October 21, 2002.
- 10.7 Amended and Restated Continuing Guaranty dated November 26, 2002, between Fleet Capital Corporation and Superior Diecutting, Inc., filed with the Form 8-K/A dated October 21, 2002.
- 10.8 Loan Agreement between Will-Kankakee Regional Development Authority and Flanders Corporation dated December 15, 1997, filed with the December 31, 1997 Form 10-K, and incorporated herein by reference.
- 10.9 Loan Agreement between Flanders Corporation and the Johnston County Industrial Facilities and Pollution Control Financing Authority, dated April 1, 1998, filed with the Form 10-Q dated March 31, 1998, and incorporated herein by reference.
- 10.10 Loan Agreement between Flanders Corporation and the Johnston County Industrial Facilities and Pollution Control Financing Authority, dated March 1, 2000, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.11 Flanders Corporation 1996 Director Option Plan, filed with the Form 10-K dated December 31, 1995, and incorporated herein by reference.
- 10.12 Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with the December 31, 1995 Form 10-K, incorporated herein by reference.
- 10.13 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with Form S-1 dated October 21, 1996 (Reg. No. 333-14655) and incorporated herein by reference.
- 10.14 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with the Form 10-K dated December 31, 1997 and incorporated herein by reference.
- 10.15 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Steven K. Clark, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.

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- 10.16 Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc. and Robert R. Amerson, filed with the December 31, 1995 Form 10-K, incorporated herein by reference.
- 10.17 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Robert R. Amerson, filed with Form S-1 dated October 21, 1996 (Reg. No. 333-14655) and incorporated herein by reference.
- 10.18 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Robert R. Amerson, filed with the Form 10-K dated December 31, 1997 and incorporated herein by reference.
- 10.19 Amendment to Employment Agreement between Elite Acquisitions, Inc., Flanders Filters, Inc., and Robert R. Amerson, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.

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- 10.20 Stock Option Agreement between Flanders Corporation and Robert R. Amerson dated February 22, 1996, filed with Form S-8 on July 21, 1997, incorporated herein by reference.
- 10.21 Amendment to Stock Option Agreement between Flanders Corporation and Robert R. Amerson dated December 22, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.22 Stock Option Agreement between Flanders Corporation and Robert R. Amerson dated November 7, 2001, filed with Form 10-K for December 31, 2001, incorporated herein by reference.
- 10.23 Stock Option Agreement between Flanders Corporation and Steven K. Clark dated February 22, 1996, filed with Form S-8 on July 21, 1997, incorporated herein by reference.
- 10.24 Amendment to Stock Option Agreement between Flanders Corporation and Steven K. Clark dated December 22, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.25 Stock Option Agreement between Flanders Corporation and Steven K. Clark dated November 7, 2001, filed with Form 10-K dated December 31, 2001, incorporated by reference.
- 10.26 Note Agreement between Steven K. Clark and Flanders Corporation, dated April 24, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.27 Note Agreement between Robert R. Amerson and Flanders Corporation, dated April 24, 1999, filed with the Form 10-K dated December 31, 1999, and incorporated herein by reference.
- 10.28 Stock Option Agreement between Flanders Corporation and Steven K. Clark dated August 24, 2004, filed with Form 10-K dated December 31, 2004, incorporated by reference.
- 10.29 Stock Option Agreement between Flanders Corporation and Steven K. Clark dated December 7, 2005, filed with Form 10-K dated December 31, 2005, incorporated by reference.
- 10.30 Settlement Agreement and Mutual Release between Steven K. Clark and Flanders Corporation dated October 3, 2007, filed with Form 8-K dated October 5, 2007, incorporated by reference.
- 10.31 Master Lease Amendment between Wal-Pat, LLC and Flanders Corporation dated September 6, 2007, filed with Form 8-K dated September 7, 2007, incorporated by reference.
- 10.32 Separation Agreement and General Release between John Hodson and Flanders Corporation dated August 2, 2007, filed as an exhibit to Form 10-Q dated August 7, 2007, incorporated by reference.
- 10.33 2007 Equity Incentive Plan filed as an exhibit to the 2006 Proxy Statement dated November 13, 2007, incorporated by reference.

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- 21 Subsidiaries of the Registrant.
- 23.1 Consent of Pender Newkirk LLP for incorporation by reference of their report into Form S-8 filed on July 21, 1997, filed herewith.
- 23.2 Consent of Grant Thornton LLP for incorporation by reference of their report into Form S-8 filed on July 21, 1997, filed herewith.
- 24 Power of Attorney (included on Signature page of this report).
- 31 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13A-14 of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
- (b) Form 8-K dated February 21, 2007
  - Form 8-K dated May 2, 2007
  - Form 8-K dated May 18, 2007

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Form 8-K dated July 11, 2007

Form 8-K dated August 1, 2007

Form 8-K dated August 15, 2007

Form 8-K dated September 7, 2007

Form 8-K dated October 15, 2007

Form 8-K dated November 1, 2007

- (c) Financial Statement Schedules: See (a) (2) above.

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## SIGNATURES

Pursuant to the requirements of Section 13 of 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated this 13th day of March, 2008.

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FLANDERS CORPORATION

By /s/ Robert Amerson

\_\_\_\_\_  
Robert Amerson  
Chief Executive Officer / (Principal Executive Officer)

By /s/ Cully Bohush

\_\_\_\_\_  
Cully Bohush  
Chief Accounting Officer / (Principal Accounting Officer)

KNOW ALL PERSONS BY THESE PRESENTS that each person whose signature appears below constitutes and appoints Robert Amerson, his attorney-in-fact, to sign any amendments to this report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Commission, hereby ratifying and confirming all the said attorney-in-fact may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
<u>/s/Robert R. Amerson</u> Robert R. Amerson	Chief Executive Officer / (Principal Executive Officer)	<u>March 13, 2008</u>
<u>/s/Cully Bohush</u> Cully Bohush	Chief Accounting Officer / (Principal Accounting Officer)	<u>March 13, 2008</u>
<u>/s/Harry L. Smith, Jr.</u> Harry L. Smith, Jr.	Director	<u>March 13, 2008</u>
<u>/s/Jeffrey Korn</u> Jeffrey Korn	Director	<u>March 13, 2008</u>
<u>/s/Kirk Dominick</u> Kirk Dominick	Director	<u>March 13, 2008</u>
<u>/s/David M. Mock</u> David M. Mock	Director	<u>March 13, 2008</u>

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FLANDERS CORPORATION  
CONSOLIDATED FINANCIAL STATEMENTS  
Years Ended December 31, 2007, 2006 and 2005

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The accompanying notes are an integral part of these financial statements

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### **Report of Independent Registered Public Accounting Firm**

Board of Directors  
Flanders Corporation and Subsidiaries  
St. Petersburg, Florida

We have audited the accompanying consolidated balance sheets of Flanders Corporation and subsidiaries (the Company) as of December 31, 2007 and December 31, 2006 and the related consolidated statements of operations, stockholders' equity, and cash flows for the years ended December 31, 2007, 2006, and 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amount and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2007 and 2006 and the consolidated results of its operations and cash flows for the years ended December 31, 2007, 2006, and 2005 in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 12, 2008 expressed an unqualified opinion thereon.

Pender Newkirk & Company, LLP  
Certified Public Accountants  
Tampa, Florida  
March 12, 2008

The accompanying notes are an integral part of these financial statements

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### **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial

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statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2007. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment, management believes that, as of December 31, 2007, the Company's internal control over financial reporting is effective based on those criteria.

Our internal control over financial reporting as of December 31, 2007 has been audited by Pender Newkirk and Company, LLP, independent registered public accounting firm, as stated in their report which is included herein.

The accompanying notes are an integral part of these financial statements

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#### **Report of Independent Registered Public Accounting Firm**

Board of Directors  
Flanders Corporation and Subsidiaries  
St. Petersburg, Florida

We have audited the internal control over financial reporting of Flanders Corporation and Subsidiaries (the "Company") as of December 31, 2007 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in



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reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of the Company as of December 31, 2007 and 2006, and the related statements of operations, stockholders' equity and cash flows for the years ended December 31, 2007, 2006 and 2005 and our report dated March 12, 2008 expressed an unqualified opinion thereon.

Pender Newkirk & Company, LLP  
 Certified Public Accountants  
 Tampa, Florida  
 March 12, 2008

The accompanying notes are an integral part of these financial statements

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### FLANDERS CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

**December 31,**

(In thousands, except per share data)

	<b>2007</b>	<b>2006</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 498	\$ 568
Receivables:		
Trade, less allowance for doubtful accounts: \$3,663 in 2007 and \$4,313 in 2006	49,094	53,740
Other	1,260	1,200
Inventories	47,236	58,939
Deferred taxes	4,197	3,332
Income taxes	8,549	1,640
Other current assets	2,672	1,832
	<hr/>	<hr/>
Total current assets	113,506	121,251
Related party receivables	0	428
Property and equipment, net	61,468	77,297
Intangible assets, net	3,872	5,975
Other assets	4,709	2,153
	<hr/>	<hr/>
	\$ 183,555	\$ 207,104

**LIABILITIES AND STOCKHOLDERS EQUITY**

Current liabilities		
Current maturities of long-term debt and capital lease obligations	\$ 2,736	\$ 5,075
Accounts payable	30,046	29,442
Accrued expenses	24,593	18,767
Other current liabilities	5,880	0
Total current liabilities	63,255	53,284
Long-term capital lease obligations, less current maturities	943	1,372
Long-term debt, less current maturities	28,669	36,433
Long-term liabilities, other	2,112	1,325
Deferred taxes	1,174	7,311
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$.001 par value, 10,000 shares authorized; none issued		
Common stock, \$.001 par value; 50,000 shares authorized; issued and outstanding: 25,691 and 26,343 as of December 31, 2007 and 2006, respectively	26	26
Additional paid-in capital	87,305	90,872
Notes receivable - secured by common shares	0	(7,441)
Accumulated other comprehensive loss	(782)	(698)
Retained earnings	853	24,620
	87,402	107,379
	\$ 183,555	\$ 207,104

The accompanying notes are an integral part of these financial statements

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**FLANDERS CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF OPERATIONS**

**Year Ended December 31,**  
(In thousands, except per share data)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Net sales	\$ 244,941	\$ 238,378	\$ 229,276
Cost of goods sold	213,152	189,653	176,359
Gross profit	31,789	48,725	52,917
Operating expenses	58,511	40,868	35,297
Operating income (loss)	(26,722)	7,857	17,620

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Non operating income (expense)			
Other income, net	774	2,400	1,297
Interest expense	(2,743)	(2,049)	(1,672)
	(1,969)	351	(375)
Earnings (Losses) from operations before income taxes	(28,691)	8,208	17,245
Provision (Benefit) for income taxes	(8,791)	2,683	4,739
Income (Loss) before extraordinary items	(19,900)	5,525	12,506
Extraordinary Items:			
Extraordinary Loss Flood loss (net of taxes \$1,012)	0	(1,518)	0
Extraordinary Gain (Loss) Fire loss (net of taxes \$142 and \$1,305 for 2007 and 2006, respectively)	213	(1,957)	0
Net earnings (loss)	(19,687)	\$ 2,050	\$ 12,506
Income (Loss) before extraordinary items Basic earnings per share	\$ (.75)	\$ .21	\$ .48
Extraordinary items	\$ .0	\$ (.13)	\$ .0
Net earnings (loss) per share	\$ (.75)	\$ .08	\$ .48
Income (Loss) before extraordinary items Diluted earnings per share	\$ (.75)	\$ .20	\$ .45
Extraordinary items	\$ .0	\$ (.13)	\$ .0
Net earnings (loss) per share	\$ (.75)	\$ .07	\$ .45
Weighted average common shares outstanding			
Basic	26,362	26,340	26,309
Diluted	26,362	27,725	27,807

The accompanying notes are an integral part of these financial statements

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**  
**Years Ended December 31, 2007, 2006 and 2005**  
(In thousands)

Common Stock	Additional Paid-In Capital	Notes Receivable	Accumulated Other Comprehensive	Retained Earnings	Total
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				Loss		
<b>Balance, January 1, 2005</b>	26	90,758	(6,650)	(1,037)	10,064	93,161
Accrued interest on notes receivable secured by common shares			(337)			(337)
Purchase and retirement of 4 shares of common stock		(46)				(46)
Issuance of 18 shares of common stock upon exercise of options		46				46
<b>Comprehensive earnings</b>						
Net earnings					12,506	12,506
Gain on cash flow hedges				204		204
<b>Total comprehensive earnings, net of tax</b>						12,710
<b>Balance, December 31, 2005</b>	\$ 26	\$ 90,758	\$ (6,987)	\$ (833)	\$ 22,570	\$ 105,534
Stock option award compensation		114				114
Accrued interest on notes receivable secured by common shares			(454)			(454)
Purchase and retirement of 13 shares of common stock		(148)				(148)
Issuance of 38 shares of common stock upon exercise of options		148				148
<b>Comprehensive earnings</b>						
Net earnings					2,050	2,050
Gain on cash flow hedges				135		135
<b>Total comprehensive earnings, net of tax</b>						2,185
<b>Balance, December 31, 2006</b>	\$ 26	\$ 90,872	\$ (7,441)	\$ (698)	\$ 24,620	\$ 107,379
Stock option award compensation		859				859
Accrued interest on notes receivable secured by common shares			(360)			(360)
Proceeds from notes receivable secured by common stock			2,355			2,355
Purchase and retirement of 826 shares of common stock	(1)	(4,327)				(4,328)
Issuance of 1,159 shares of common stock upon exercise of options	1	2,958				2,959
Common shares issued for satisfaction of trade accounts payable		1,454				1,454
Common shares received in lieu of Equity note receivable		(5,445)	5,446			1
Loss of controlling interest in affiliate					(4,080)	(4,080)
Tax Benefit from Stock Options		934				934
<b>Comprehensive earnings</b>						
Net earnings					(19,687)	(19,687)
Gain on cash flow hedges				(84)		(84)
<b>Total Comprehensive earnings, net of tax</b>						(19,771)
<b>Balance, December 31, 2007</b>	\$ 26	\$ 87,305	\$ (0)	\$ (782)	\$ 853	\$ 87,402

The accompanying notes are an integral part of these financial statements

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**FLANDERS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Year Ended December 31,**  
(In thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net Earnings	\$ (19,687)	\$ 2,050	\$ 12,506
Adjustments to reconcile earnings from continuing operations to net cash (used in) provided by operating activities:			
Depreciation and amortization	7,415	8,087	8,527
Provision for doubtful accounts and notes	10,638	3,063	2,094
Provision for obsolete inventory	3,133	146	85
Loss on Goodwill	543		
Loss on sale of property and equipment	3,152	1	123
Compensation expense	859	114	0
Extraordinary (Gain) Loss	(213)	5,792	0
Proceeds from insurance claim on inventory	11,228	2,312	0
Loss on sale of subsidiaries	222		
Deferred taxes	(7,082)	825	(5,581)
Minority interest	(19)	66	216
Accrued interest on notes receivable secured by common shares	(360)	(454)	(337)
Change in working capital components:			
Receivables	(10,344)	(7,021)	(8,845)
Inventories	2,527	(21,843)	1,302
Other current assets and income tax receivable	(15,463)	(13,234)	(550)
Accounts payable	5,441	15,479	(5,685)
Accrued expenses	6,069	529	3,419
Increase in Other Current Liabilities	5,880		
Long Term Liabilities Other	668		
Income taxes, net	0	0	0
<b>Net cash (used in) provided by operating activities</b>	<u>4,607</u>	<u>(4,088)</u>	<u>7,274</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Acquisitions, net of cash acquired		(154)	(2,939)
Disposal, net of cash disposed	(97)		
Purchase of property and equipment	(7,838)	(20,490)	(8,136)
Purchase of technology			(451)
Proceeds from sale of property and equipment	6,004	306	195
Proceeds from insurance claim on building and equipment	5,500	8,688	
Cash received (paid) on notes receivables	428	(33)	(21)
Decrease in other assets	872	164	272
<b>Net cash provided (used) in investing activities</b>	<u>4,869</u>	<u>(11,519)</u>	<u>(11,080)</u>

- Continued -

The accompanying notes are an integral part of these financial statements

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**CONSOLIDATED STATEMENTS OF CASH FLOWS**    Continued  
**Years Ended December 31,**  
(In thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net proceeds from (payments on) revolving credit agreement	(4,847)	19,408	5,458
Principal payments on long-term borrowings	(5,685)	(3,928)	(2,843)
Purchase and retirement of common stock	(1,369)		
Proceeds from notes receivable secured by common shares	2,355		
	<u>(9,546)</u>	<u>15,480</u>	<u>2,615</u>
Net cash provided by (used in) financing activities	(9,546)	15,480	2,615
Net (decrease) increase in cash and cash equivalents	(70)	(127)	(1,191)
<b>CASH AND CASH EQUIVALENTS</b>			
Beginning of year	568	695	1,886
End of year	<u>\$ 498</u>	<u>\$ 568</u>	<u>\$ 695</u>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>			
Interest paid, net of \$239, \$474 and \$116 interest capitalized to property and equipment for 2007, 2006 and 2005, respectively:	\$ 2,824	\$ 1,897	\$ 1,656
Income taxes paid	\$ 179	\$ 2,426	\$ 6,910
Tax impact of Stock Options	\$ 934	\$ 0	\$ 0
<b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b>			
Cashless exercise of common stock (Net)	\$ (738)	\$	\$
Accounts receivable in exchange for notes receivable	\$	\$ 20	\$
Stock issued in lieu of trade accounts payable	\$ 1,454	\$	\$
Sale of equipment for note receivable	\$ 996	\$	\$
Common shares received in lieu of Equity note	\$ 5,446	\$	\$
<b>ACQUISITION/DISPOSAL OF COMPANIES</b>			
Working Capital surplus (deficit) acquired/disposed, net of cash and cash equivalents received	\$ 3,880	\$ 215	\$ (1,187)

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Fair value of other assets acquired/(disposed), principally property and equipment	\$ 1,466	\$ 74	\$ 614
Goodwill acquired/(disposed)	\$ 1,428	\$ 295	\$ 4,601
Minority interest	\$	\$	\$ 220
Long-term debt assumed	\$	\$	\$ (1,302)

The accompanying notes are an integral part of these financial statements

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## FLANDERS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in thousands, except per share amounts)

### **Note A. Nature of Business and Summary of Significant Accounting Policies**

The nature of the business and a summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

#### 1. Nature of business

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

The Company sells some products for end users outside of the United States through domestic specialty clean room contractors. These sales are accounted for as domestic sales. The Company also sells products through foreign distributors, primarily in Europe, and through a wholly-owned subsidiary, which sells to customers in the Pacific Rim. Sales through foreign distributors and its wholly owned foreign subsidiary total less than 5% of net sales. Assets held outside the United States are negligible.

The Company has one reportable segment which is air filtration systems.

#### 2. Principles of consolidation

The consolidated financial statements include the accounts and operations of the Company and its subsidiaries, all of which are wholly owned except for Air Filter Sales and Service, Inc. and Superior Diecutting, Inc. which are consolidated in accordance with FIN 46. All intercompany transactions and balances are eliminated in consolidation.

The Company is the primary beneficiary of Air Filter Sales and Service, Inc., which qualifies as a variable interest entity. Accordingly, the assets and liabilities and revenues and expenses of this company have been included in the accompanying consolidated financial statements. As of December 31, 2007 and 2006, Air Filter Sales and Service, Inc. had assets of \$836 and \$771, liabilities of \$788 and \$691, revenues of \$2,871 and \$2,815, and expenses of \$2,903 and \$2,706, respectively. Creditors and beneficial holders of Air Filter Sales and Service, Inc have no recourse to the assets or general credit of the Company.

Prior to September 30, 2007, Superior Diecutting, Inc. was 50% owned by two officers and directors and 50% was owned by other shareholders unrelated to the Company or any of its officers and directors. As of September 30, 2007 Superior Diecutting, Inc. ceased to

be consolidated, due to the Settlement Agreement and Mutual Release filed on October 5, 2007, which resulted in the Company no longer qualifying as the primary beneficiary. The accompanying financial statements present the consolidated result including Superior Diecutting, Inc. up until September 30, 2007 with all intercompany transactions eliminated. After that date the financial statements do not include the financial results of Superior Diecutting, Inc. The revenues and expense of Superior Diecutting, Inc. through September 30, 2007 were \$16,600 and \$16,139, respectively. The revenues and expense for the year ended December 31, 2006 were \$24,206 and \$22,647, respectively.

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

3. Significant customers

Net sales for the years ended December 31, 2007, 2006 and 2005 included sales to the following major customers, together with the receivables due from those customers:

	Amount of Net Sales			Trade Receivable Balance As of December 31,	
	2007	2006	2005	2007	2006
Customer A	\$ 25,679	\$ 30,922	\$ 33,905	\$ 1,874	\$ 5,018
Customer B	\$ 38,431	\$ 38,549	\$ 34,432	\$ 12,739	\$ 11,906

4. Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

**Note A. Nature of Business and Summary of Significant Accounting Policies** Continued



5. Cash and cash equivalents

The Company maintains its cash in bank deposit accounts, which at times, exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents. For purposes of reporting cash flows, the Company considers all cash accounts which are not subject to withdrawal restrictions or designated for equipment acquisitions and certificates of deposit which have an original maturity of three months or less when purchased to be cash equivalents.

6. Accounts Receivable

The Company provides an allowance for losses on trade receivables based on a review of the current status of existing receivables and management's evaluation of periodic aging of accounts. The Company charges off accounts receivable against the allowance for losses when an account is deemed to be uncollectible. It is the Company's policy to accrue interest on past due receivables. The provision expensed for doubtful accounts and notes was \$10,638, \$3,063, and 2,094 for the years ended December 31, 2007, 2006 and 2005, respectively.

7. Fair value of financial instruments

The carrying amount of cash equivalents, trade receivables and trade payables approximates fair value at December 31, 2007 and 2006 because of the short maturity of these instruments. Based on the borrowing rates currently available to the Company for bank loans with similar maturities and similar collateral requirements, the fair value of notes payable and long-term debt approximates the carrying amounts at December 31, 2007 and 2006.

8. Inventories

Inventories are valued at lower of cost (first-in, first-out method) or market.

9. Comprehensive income

FAS 130, Reporting Comprehensive Income, requires disclosure of comprehensive income in addition to the existing income statement. Other comprehensive income (loss) is defined as the change in equity during a period, from transactions and other events, excluding changes resulting from investments by owners (e.g., supplemental stock offerings) and distributions to owners (e.g., dividends). An analysis of the changes in the components of accumulated comprehensive income is presented in the statement of changes in stockholders equity.

10. Derivative financial instruments

Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standard No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) as amended by SFAS 138, Accounting for Certain Derivative Instruments and Hedging Activities an Amendment to FASB Statement No. 133. SFAS 133 and SFAS 138 established new accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are recognized in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
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(Dollars in thousands, except per share amounts)

**Note A. Nature of Business and Summary of Significant Accounting Policies** Continued

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The Company has only limited involvement with derivative financial instruments. The Company has two interest rate swap agreements to hedge against the potential impact on earnings from increases in market interest rates of two variable rate bonds. Under the interest rate swap agreements, the Company receives or makes payments on a monthly basis, based on the differential between 5.14% and a tax exempt interest rate as determined by a remarketing agent. This interest rate swap is accounted for as a cash flow hedge in accordance with SFAS 133 and SFAS 138. The tax effected fair market value of the interest rate swap of \$782 and \$698 is included in accumulated other comprehensive loss at December 31, 2007 and 2006, respectively. The interest rate swap contracts expire in 2013 and 2015.

### 11. Goodwill

As of January 1, 2002, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Thus, effective January 1, 2002, the Company has ceased amortization of goodwill, including goodwill recorded in past business combinations. The Company does not have any intangible assets with indefinite lives other than goodwill.

SFAS 142 requires that goodwill be tested for impairment annually, or more frequently if circumstances indicate potential impairment, by comparing the fair value of the asset to its carrying amount. Such testing requires, as an initial step, that each of the Company's reporting units, as defined in SFAS 142, be identified and that the Company's assets and liabilities, including the existing goodwill and intangible assets, be assigned to those reporting units. The Company has determined it has only one reporting unit and that there is no impairment as of December 31, 2007.

### 12. Trademarks and trade names

Trademarks and trade names are being amortized on a straight line basis over 17 years. At each balance sheet date, the Company evaluates the value of trademarks and trade names for impairment. Based upon its most recent analysis, the Company believes that no impairment of trademarks and trade names exists at December 31, 2007.

### 13. Property and equipment

Property and equipment are stated at cost. Depreciation is computed by the straight-line method over estimated useful lives. Amortization of property and equipment held under capital leases is included in depreciation expense. The carrying amount of all long-lived assets is evaluated periodically to determine if adjustment to the depreciation and amortization period or the unamortized balance is warranted. Based upon its most recent analysis, the Company believes that no impairment of property and equipment exists at December 31, 2007.

### 14. Debt issuance costs

The costs related to the issuance of debt are capitalized and amortized on a straight-line basis over the term of the related debt, which approximates the effective interest method.

### 15. Revenue recognition

The Company's products are sold with terms and conditions, which vary depending on particular business environments in which the Company operates. The standard policy of the Company is to recognize revenue in accordance with accounting principles generally accepted in the United States of America; specifically SAB Topic 13A.

Generally, sales are recognized when shipments are made to customers. Rebates, allowances for damaged goods

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### **FLANDERS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in thousands, except per share amounts)**

and other advertising and marketing program rebates, are accrued pursuant to contractual provisions and included in accrued expenses. An insignificant amount of our revenues fall under the percentage-of-completion method of accounting used for long-term contracts. Under this method, sales and gross profit are recognized as work is performed based on the relationship between actual costs incurred

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and total estimated costs at completion. Sales and gross profit are adjusted prospectively for revisions in estimated total contract costs and contract values. Estimated losses are recorded when identified.

### 16. Income taxes

Deferred taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carry forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

### 17. Earnings per share

Basic EPS is calculated by dividing earnings available to common shareholders by the weighted average number of common shares outstanding during each period. Diluted EPS is similarly calculated, except that the denominator includes common shares that may be issued subject to existing rights with dilutive potential, except when their inclusion would be antidilutive.

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### FLANDERS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share amounts)

#### **Note A. Nature of Business and Summary of Significant Accounting Policies**   Continued

### 18. Stock Options

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), Share-Based Payment (SFAS 123R). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation expense in the consolidated financial statements based on their fair values. That expense will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period). We adopted SFAS 123R effective beginning January 1, 2006 using the Modified Prospective Application Method. Under this method, SFAS 123R applies to new awards and to awards modified, repurchased or cancelled after the effective date. Prior to the adoption of SFAS 123(R) we accounted for stock option grants using the intrinsic value method prescribed in APB Opinion No. 25, Accounting for Stock Issued to Employees, and accordingly, recognized no compensation expense for stock option grants.

Compensation cost is also recognized for the unvested portion of awards granted prior to adoption. Prior periods were not restated to reflect the impact of adopting the new standard, and there is no cumulative effect.

As a result of adopting SFAS 123(R), our earnings before income taxes and net earnings for the year ended December 31, 2007 were \$859 and \$516 lower, respectively, than if we had continued to account for stock based compensation under APB Opinion No. 25 for our stock option grants. There was no impact on cash flows from operating or financing activities or basic or diluted earnings per share.

The value of each grant is estimated at the grant date using the Black-Scholes option model with the following weighted average assumptions for options granted in 2007, 2006 and 2005: Dividend rate of 0%; risk-free interest rate of 4.75%, 2.38% and 4.38%, respectively; expected lives of 10, 5, and 5 years respectively; and expected price volatility of 50%, 51% and 110%, respectively.

The unrecognized stock-based compensation expense related to nonvested stock options was \$1,267 and \$0 for the years ended December 31, 2007 and 2006, respectively.

During 2007 and 2006, there was \$0 of cash received from the exercise of stock options.

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At December 31, 2006, the Company has three stock-based compensation plans. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123R, to stock-based employee compensation prior to January 1, 2006.

	<b>2005</b>
Net earnings, as reported	\$ 12,506
Deduct: Total stock-based compensation expense determined under fair value based methods for all awards, net of taxes	(4,112)
Pro forma net earnings	\$ 8,394
Basic earnings per share:	
As reported	\$ .48
Pro forma	\$ .32
Diluted earnings per share	
As reported	\$ .45
Pro forma	\$ .30

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### FLANDERS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in thousands, except per share amounts)

The following table represents our nonvested stock option activity for the year ended December 31, 2007:

	Number of Options	Weighted Average Grant Date Fair Value
Nonvested options - January 1, 2007		\$
Granted	500	\$ 4.99
Vested	(100)	\$ (4.99)
Forfeited		\$
	400	\$
Nonvested options - December 31, 2007		

The aggregate intrinsic value of options outstanding at December 31, 2007, based on the Company's closing stock price of \$5.61 as of the last business day of the period ended December 31, 2007, which would have been received by the optionees had all options been exercised on that date was \$3,923. The aggregate intrinsic value of options exercisable at December 31, 2007, based on the Company's closing stock price of \$5.61 as of the last business day of the period ended December 31, 2007, which would have been received by the optionees had all options exercisable been exercised on that date was \$3,675. The aggregate intrinsic value of options exercised during the years ended December 31, 2007, 2006 and 2005 were \$2,646, 294 and 153, respectively. Intrinsic value is the amount by which the fair value of the underlying stock exceeds the exercise price of the options.

19. Outbound shipping expenses

Outbound shipping expenses are included in operating expenses, not in cost of goods sold. Outbound shipping expenses were \$12,148, \$9,813, and \$9,455 for the years ending December 31, 2007, 2006 and 2005, respectively.

20. Advertising

The costs of advertising are expensed as incurred. Advertising expense was \$5,788, \$2,853, and \$2,543 for the years ending December 31, 2007, 2006 and 2005, respectively.

21. Reclassifications

Certain account balances for 2006 have been reclassified with no effect on net earnings or retained earnings to be consistent with the classification adopted for the year ended December 31, 2007.

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note A. Nature of Business and Summary of Significant Accounting Policies** Continued

22. Impact of Recently Issued Accounting Pronouncements

In February 2006, FASB issued SFAS No. 155. This accounting standard permits fair value re-measurement for any hybrid financial instrument containing an embedded derivative that otherwise would require bifurcation; clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133; establishes a requirement to evaluate interests in securitized financial assets to identify them as freestanding derivatives or as hybrid financial instruments containing an embedded derivative requiring bifurcation; clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument pertaining to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year beginning after September 15, 2006. SFAS No. 155 did not have a material effect on our results of operations or financial position.

In March 2006, the FASB issued SFAS No. 156, which addresses the accounting for servicing assets and liabilities. SFAS No. 156 is effective at the beginning of an entity's first fiscal year beginning after September 15, 2006. SFAS No. 156 did not have a material effect on our results of operations or financial position.

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), effective for fiscal years beginning after December 15, 2006. FIN 48 requires a two-step approach to determine how to recognize tax benefits in the financial statements where recognition and measurement of a tax benefit must be evaluated separately. A tax benefit will be recognized only if it meets a more-likely-than-not recognition threshold. For tax positions that meet this threshold, the tax benefit recognized is based on the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. See Note I Income Taxes below for the impact this had on the Company.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) 157 Fair Value Measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and expanded disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS No. 157 on our result of operations and financial position.

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) 158 Employers Accounting for Defined Benefit Pension and Other postretirement Plans an amendment of FASB Statements no. 87, 88, 106,

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and 132(R). SFAS 158 improves financial reporting by requiring an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position. Also, requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. An employer that is a business entity and sponsors one or more single-employer defined benefit plans is required to recognize the funded status of a benefit plan in its statement of financial position; recognize other components not recognized by FASB 87 or 106; measure defined benefit plan assets and obligations as of the date of the employer's fiscal year-end statement of financial position.; and disclose additional information. Publicly traded companies are required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. SFAS No. 158 did not have a material effect on our results of operations or financial position.

On September 13, 2006, the Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin (SAB) 108, interpretive guidance on how errors that carryover or reversal of prior year misstatements should be considered from a materiality perspective and be considered in quantifying a current year misstatement. The SEC staff believes that public companies should use both the current year income statement approach and the

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#### **FLANDERS CORPORATION AND SUBSIDIARIES** **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** (Dollars in thousands, except per share amounts)

balance sheet approach. Then evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 also discusses when it would be appropriate to record a one-time cumulative adjustment for prior year misstatements that were considered immaterial along with required disclosures. SAB 108 did not have a material effect on our results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is in the process of evaluating the effect, if any, the adoption of SFAS No. 159 will have on its financial statements.

In January 2008, the FASB posted SFAS No. 133 Implementation Issue No. E23, Issues Involving the Application of the Shortcut Method under Paragraph 68. This standard addresses issues pertaining to the application of the shortcut method in accounting for hedges when the settlement of a hedged item occurs subsequent to the interest rate swap trade date. It also addresses hedging relationships when the transaction price of an interest rate swap is zero. This standard is effective for hedging relationships designated on or after January 1, 2008 and requires the reassessment of preexisting hedges utilizing the shortcut method under this new guidance. We are currently evaluating this standard but we do not anticipate that the adoption of this standard will have a material effect on our results of operations or financial position.

#### **Note B. Inventories**

Inventories consist of the following at December 31:

	<u>2007</u>	<u>2006</u>
Finished goods	\$ 27,209	\$ 31,786
Work in progress	3,254	5,535
Raw materials	19,631	23,241

	50,094	60,562
Less allowances	2,858	1,623
	<u>          </u>	<u>          </u>
	\$ 47,236	\$ 58,939
	<u>          </u>	<u>          </u>

**Note C. Other Assets**

Other assets consist of the following at December 31:

	<u>2007</u>	<u>2006</u>
Real estate held for sale	\$ 52	\$ 52
Notes receivable	3,530	910
Deposits	563	421
Deferred expenses	154	365
Investment, at cost	410	405
	<u>          </u>	<u>          </u>
	\$ 4,709	\$ 2,153
	<u>          </u>	<u>          </u>

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
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Notes receivable consists of the following at December 31,

	<u>2007</u>	<u>2006</u>
Note receivable, which bears interest at 9% per annum. \$4 due each week beginning July1, 2004.	\$ 49	\$ 224
Senior note receivable, which is interest free for first year and 5% per annum thereafter. \$6.5 due each month beginning January 31, 2005.	274	352
Junior note receivable, which is interest free. \$5 due each quarter beginning March 31, 2005.	245	265
Note Receivable, which bears interest at the rate of 6.5% per annum. \$5.7 due each month beginning October 14 <sup>th</sup> , 2007.	494	
Note Receivable, which bears interest at the rate of 6.5% per annum. \$20 due each month beginning December 4 <sup>th</sup> , 2007.	1,772	
Note Receivable, which bears interest at the rate of 6.5% per annum. \$3.6 due each month beginning December 4 <sup>th</sup> , 2007.	315	
	<u>          </u>	
	258	

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Note Receivable, which bears interest at the rate of prime plus 1.5%. \$4.3 due each month beginning February 21<sup>st</sup>, 2003.

Various other notes receivable	393	420
Less: Current portion of notes receivable	(270)	(351)
Total	<u>\$ 3,530</u>	<u>\$ 910</u>

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

**Note D. Intangible Assets**

Intangible assets consist of the following at December 31:

	<u>2007</u>	<u>2006</u>
Goodwill	\$ 3,031	\$ 5,002
Trademarks and trade names, net of accumulated amortization of \$903 and \$1,256 in 2007 and 2006, respectively	\$ 841	\$ 973
	<u>\$ 3,872</u>	<u>\$ 5,975</u>

Amortization expense was \$131, \$147 and \$141 in 2007, 2006 and 2005, respectively. Estimated amortization expense for each of the ensuing years through December 31, 2011 is as follows:

2008	\$ 128
2009	\$ 103
2010	\$ 91
2011	\$ 91
2012	\$ 91

**Note E. Property and Equipment**

Property and equipment and estimated useful lives consist of the following at December 31:

	<u>2007</u>	<u>2006</u>	<u>Estimated Useful Lives</u>
Land	\$ 1,124	\$ 1,673	
Buildings	30,656	40,155	15-40 years
Machinery and equipment	67,395	72,097	5 -15 years
Office equipment	10,202	10,309	5-7 years



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Vehicles	1,699	2,026	5 years
Construction in progress	4,624	15,641	
	115,700	141,901	
Less accumulated depreciation	54,232	64,604	
	\$ 61,468	\$ 77,297	

Total depreciation expense charged to operations totaled \$7,073, \$7,717, and \$8,170 for 2007, 2006 and 2005, respectively.  
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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**Note F. Accrued Expenses**

Accrued expenses at December 31, 2007 and 2006 were as follows:

	<u>2007</u>	<u>2006</u>
Vendor Rebates	\$ 7,226	\$ 4,282
Bank overdraft	\$ 2,394	\$ 1,646
Other accrued expenses	\$ 14,973	\$ 12,839
	<u>\$ 24,593</u>	<u>\$ 18,767</u>

**Note G. Pledged Assets and Debt**

A summary of the Company's debt, and collateral pledged thereon, consists of the following at December 31:

	<u>2007</u>	<u>2006</u>
<b>Long-term debt:</b>		
Prime plus 0 to .50 percent (7.75% at December 31, 2007) revolving line of credit; interest rate dependent on fixed charge coverage*.	\$ 16,019	\$ 20,866
Prime plus 0 to .50 percent term note agreement; interest rate dependent on fixed charge coverage*.	0	1,168
LIBOR plus 2.25% note (mortgage) payable to a bank, due in monthly payments of \$14 including interest, collateralized by certain land, building and improvements, due October 2007.	1,784	1,877
Prime plus 0 to .50 percent term note agreement due to bank; interest rate dependent on fixed charge coverage*.	0	3,583
	3,920	4,190

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6.5 percent note payable to a regional development authority, due in varying quarterly installments, plus interest, through December 2017, collateralized by a security agreement and financing statement on real and personal property.

Note payable to a bank with interest at prime plus 0.25 percent, with rate adjusted annually (7.50% at December 31, 2007), due in monthly payments of \$7 including interest through June 2017, collateralized by a deed of trust on real property.	565	604
Industrial revenue bond with a variable tax exempt interest rate as determined by a remarketing agent, with rate effectively fixed at 5.14% by an interest-rate swap, balance due April 1, 2015, collateralized by a \$4,000 letter of credit.	4,000	4,000
Industrial revenue bond with a variable tax exempt interest rate as determined by a remarketing agent, with rate effectively fixed at 5.14% by an interest-rate swap, balance due April 1, 2013, collateralized by a \$4,500 letter of credit.	4,500	4,500
Prime plus 2.0 percent revolving line of credit up to \$100, canceled in 2007.	0	100
Various obligations under capital lease agreements	1,560	1,992
	\$ 32,348	\$ 42,880
Less current maturities	2,736	5,075
	29,612	37,805
Less long-term capital lease obligations, less current maturities	943	1,372
	\$ 28,669	\$ 36,433

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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Aggregate maturities required on long-term debt and capital lease obligations as of December 31, 2007 are due in future years as follows:

Year Ending December 31,	
2008	\$ 2,736
2009	17,033
2010	574
2011	450
2012	472
Later years	11,083
	11,083

\$ 32,348

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\* Our current revolving credit agreement with a bank provides a maximum line of credit of \$36 million (subject to availability) and bears interest at either (i) LIBOR plus between 1.75% and 2.25%, dependent on the Company's fixed charge coverage during the prior twelve months; or (ii) the bank's base rate, plus between 0% and .5%, dependent on the Company's fixed charge coverage during the prior twelve months. Up to \$11 million of this credit facility may be used to issue letters of credit. The revolving credit agreement is part of a combined facility with a bank that also includes an \$11 million facility to guarantee letters of credit. The line of credit is due in 2009. The combined facility is collateralized by substantially all of the Company's assets, is guaranteed by the Company's majority stockholder and restricts capital expenditures, payment of dividends and share repurchases. As of December 31, 2007 the financial covenants of the Company have been waived.

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
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**Note H. Leases**

The Company leases certain facilities and equipment under long-term non-cancelable operating leases, which may be renewed in the ordinary course of business, including a building lease with a related party. The Company leases certain manufacturing and warehousing space under a capital lease with an original term of ten years with two consecutive ten-year renewal options. Leased capital assets are included in property and equipment as follows at December 31:

	2007	2006
Buildings	\$ 3,700	\$ 3,700
Machinery and equipment	707	490
Office equipment	204	204
Accumulated depreciation	(1,249)	(1,221)
	\$ 3,362	\$ 3,173

Future minimum payments, by year and in aggregate, under capital leases and operating leases consist of the following at December 31, 2007:

Year Ending December 31,	Capital leases	Operating leases
2008	\$ 736	\$ 5,686
2009	722	5,758

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2010	209	4,982
2011	52	4,101
2012	47	3,805
Later years	0	44,007
	<u>          </u>	<u>          </u>
Total minimum lease payments	\$ 1,766	\$ 68,339
		<u>          </u>
Less amount representing interest	<u>160</u>	
Present value of net minimum payments	1,606	
Current portion	<u>618</u>	
Long-term portion	<u>\$ 988</u>	

Total rent expense charged to operations was approximately \$7,075, \$5,138, and \$3,539 for 2007, 2006 and 2005, respectively.  
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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

**Note I. Income Taxes**

The Company's provision (benefit) for income taxes is as follows for the years ended December 31:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Current:			
Federal	\$ (1,961)	\$ 5,785	\$ 8,834
State	(168)	496	757
Foreign	285	90	34
	<u>(1,844)</u>	<u>6,371</u>	<u>9,625</u>
Deferred:			
Federal	(6,398)	(3,397)	(4,500)
State	(549)	(291)	(386)
	<u>(6,947)</u>	<u>(3,688)</u>	<u>(4,886)</u>
Total provision	\$ (8,791)	\$ 2,683	\$ 4,739

The income tax provision for continuing operations differs from the amount of tax determined by applying the Federal statutory rate as follows:

	2007	2006	2005
Income tax provision at statutory rate:	\$ (10,042)	\$ 2,873	\$ 6,036
Increase (decrease) in income taxes due to:			
Nondeductible expenses	72	32	28
State income taxes net	(878)	378	683
Foreign taxes/Non consolidated subs	(111)	0	0
Interest, Penalties, and Other tax contingencies	1,335	0	0
Credits and adjustments	(812)	(600)	(2,008)
Change in valuation allowance	1,645	0	0
	<u>\$ (8,791)</u>	<u>\$ 2,683</u>	<u>\$ 4,739</u>

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

**Note I. Income Taxes Continued**

The components giving rise to the deferred tax assets and liabilities included in the accompanying consolidated balance sheets at December 31, 2007 and December 31, 2006 were comprised of the following:

	2007	2006
Deferred tax assets/(liabilities):		
Accounts receivable allowance	\$ 1,324	\$ 609
Inventory allowance and capitalization	1,873	1,743
Accrued expenses	710	410
Deferred expenses	(85)	1
State credits	97	400
FIN 48 Interest Current	278	0
Foreign Income	0	169
Net Current Asset	<u>\$ 4,197</u>	<u>\$ 3,332</u>

Deferred tax assets/(liabilities):

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Property and equipment	\$ (6,357)	\$ (12,226)
Stock Options	366	0
Interest rate swap	521	466
State Tax expense	196	0
FIN 48 Interest expense	30	0
State net operating loss carry forwards	669	283
State credits	3,401	4,166
	<hr/>	<hr/>
Net Noncurrent Liability	\$ (1,174)	\$ (7,311)
	<hr/>	<hr/>
Current assets	\$ 4,197	\$ 3,332
Noncurrent Liabilities	(1,174)	(7,311)
	<hr/>	<hr/>
Total Deferred Tax	\$ 3,023	\$ (3,979)
	<hr/>	<hr/>

The IRS is currently examining the Company's federal income tax returns of 2002, 2003, 2004, 2005, and 2006. To date the IRS has not proposed any material adjustments for the 2004 through 2006, however, for the 2002 and 2003 examination, the IRS has proposed certain changes, resulting in additional liabilities due. The Company has submitted a petition to the IRS for a redetermination of the changes with the U.S. Tax Court. These liabilities have been included in the Company's FIN 48 liability discussed below.

FIN 48

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition of tax benefits, classification on the balance sheet, interest and penalties, accounting in interim periods, disclosure, and transition. The Company adopted FIN 48 effective January 1, 2007.

The Company is subject to income taxes in the U.S, Mexico and Singapore. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the determination of the ultimate tax effects is uncertain. We record our tax provision based on current and future income taxes that will be due. In the

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

determination of our provision, we have taken certain tax positions in the consideration of the effects of income and expenses that have been recognized and included in the accompanying financial statements that may or may not be recognized in the determination of current or future income taxes. Under Fin 48 we record a liability for these unrecognized tax benefits when we believe that certain positions might be challenged despite our belief that our tax return positions are fully supportable. We review our liability for unrecognized tax benefits quarterly and adjust it in light of changing facts and circumstances, such as the outcome of tax audit. We calculate and accrue potential interest and penalties on our FIN 48 liability.

Included in our deferred income taxes as of January 1, 2007, the effective date of FIN 48, was approximately \$5.6 million relating to unrecognized tax benefits that we have determined were FIN 48 liabilities.

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The reconciliation of our liability for unrecognized tax benefits are as follows (in thousands):

Balance at January 1, 2007	\$ 5,625
Gross increases to tax positions in prior periods	0
Gross decreases to tax positions in prior periods	(400)
Gross increases to current period tax positions	0
Gross decreases to current period tax positions	(0)
Audit settlements paid during 2007	(0)
Decreases related to the lapse of the statute of limitations	(0)
	<hr/>
Balance at December 31, 2007	\$ 5,225
	<hr/>

As of December 31, 2007, the amount of accrued interest and penalties related to unrecognized tax benefits was \$1.0 million net of federal income tax benefits. Interest and penalties for the year ended December 31, 2007 was \$.2 million, net of federal income tax benefits.

In determination of our unrecognized tax benefits that give rise to our FIN 48 liability, we take into account potential audit assessments. We are currently under examination by the Internal Revenue Service for calendar years 2002 through 2006. As previously indicated we are currently disputing proposed audit assessments of approximately \$2 million relating to the 2002 and 2003 IRS audit, assessed in April of 2007. We expect to settle these amounts within the next 12 months. Although the amount of the assessment is still being disputed, we have reserved for this item in our FIN 48 liability. We estimate changes to our unrecognized tax benefits related to the settlement in the next 12 months to be approximately \$4.7 million.

We also may be subject to examination, in the following major jurisdictions for the years specified: Mexico for 2002 through 2006, Singapore for 2000 through 2006, Florida for 2002 through 2006, and North Carolina for 2002 to 2006.

### **Note J. Commitments and Contingencies**

#### 1. Employment Agreements

Messr. Amerson has an employment agreement effective as of December 15, 1995 ( Employment Agreement ). The Employment Agreement, as amended, provides for an annual base salary of \$350 Mr. Amerson and terminates in 2010. The Employment Agreement also provides that the executive shall be entitled to the following termination payments: (i) 100% of his current base salary if the employment is terminated as a result of his death or disability; (ii) up to 200% of his current base salary if the employment is terminated by the Company for any reason other than death, disability or for cause, or (iii) up to 250% of the executive's gross income during the year preceding his termination if the Employment Agreement is terminated by the executive for good reason or by the Company for any reason other than death, disability or cause and the termination occurs within two years after a change of control of the Company has occurred.

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## FLANDERS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in thousands, except per share amounts)

**Note J. Commitments and Contingencies** Continued

2. Litigation

From time to time, the Company is a party as plaintiff or defendant to various legal proceedings related to our normal business operations. In the opinion of management, although the outcome of any legal proceeding cannot be predicted with certainty, the ultimate liability of the Company in connection with its legal proceedings will not have a material adverse effect on the Company's financial position, but could be material to the results of operations in any one future accounting period. The Company makes appropriate reserves for litigation, even if not material. Defense costs are expensed as incurred.

3. Self-Insurance

During all periods presented, workers' compensation claims incurred by employees were fully insured through a high deductible policy with a policy year ending each May. The deductible per employee was \$500 in 2007 and \$500 in 2006, with no limit in the aggregate. The Company continuously monitors and estimates the estimated costs of claims incurred based on historical loss information and other information provided by its carrier's claims management personnel. Included in the liabilities in the accompanying balance sheets are accrued workers' compensation expenses of approximately \$1,000 and \$201 as of December 31, 2007 and 2006, respectively.

The Company provides medical benefits to its employees under a self-insured program. Through June 30, 2002, the Company paid for 100% of an employee's health costs as the services were incurred. In July 2002, the Company changed the program that provides medical benefits to its employees once certain deductibles are met. The benefits to the employees are limited to \$35 per year with a \$1,000 lifetime benefit. The Company estimates the amount of incurred but unreported claims based on historical information. Included in the liabilities in the accompanying balance sheets are estimated accrued health insurance expenses of approximately \$200 and \$200 as of December 31, 2007 and 2006, respectively. The employer's portion of claims charged to operations totaled approximately \$974, \$1,085 and \$971 for 2007, 2006 and 2005, respectively.

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

4. License and Royalty Agreements

The Company has secured licensing and royalty agreements with two companies allowing the Company to use their trade names and brands on its products. Costs associated with these agreements are expensed as incurred.

**Note K. Employee Benefit Plans**

The Company has a defined contribution 401(k) salary reduction plan intended to qualify under section 401(a) of the Internal Revenue Code of 1986 (Salary Savings Plan). The Salary Savings Plan allows eligible employees, as defined in the plan document, to defer up to fifteen percent of their eligible compensation, with the Company contributing an amount determined at the discretion of the Company's Board of Directors. The Company contributed approximately \$96, \$100 and \$97 to the Salary Savings Plan for the years ended December 31, 2007, 2006 and 2005, respectively.

During 1996, the Company adopted the Long Term Incentive Plan (LTI Plan) to assist the Company in securing and retaining key employees and consultants. The LTI Plan authorizes grants of incentive stock options, nonqualified stock options, stock appreciation rights (SARs), restricted stock performance shares and dividend equivalents to officers, key employees of the Company and outside consultants to the Company. There are 1,987,000 shares of Common Stock reserved for award under the LTI Plan. During 2007, 2006 and 2005, the Company awarded options to purchase 0, 0 and 670,000 shares of Common Stock under the LTI Plan, respectively.

During 1996, the Company also adopted the 1996 Director Option Plan which provides for the grant of 50,000 stock options to outside directors of the Company who were elected or appointed after February 1, 1996, and who were not existing directors on the effective date of the plan. Each such outside director who is serving as a director on January 1 of each calendar year will automatically be granted an option to acquire up to 5,000 shares of Common Stock on such date, assuming such outside director had been serving for at least six months prior to the date of grant. During 2007, 2006 and 2005, the Company awarded options to purchase 0, 20,000 and 125,000 shares,



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respectively, of common stock under the 1996 Director Option Plan.

During 2007, the Company adopted the 2007 Equity Incentive Plan. The Company has reserved 2,000,000 shares of its Common Stock for issuance under the 2007 Equity Incentive Plan that expires in 2017. During 2007, the Company awarded options to purchase 620,000 shares of common stock under the 2007 Equity Incentive Plan.

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## FLANDERS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in thousands, except per share amounts)

### **Note L. Extraordinary Items**

In 2006, a warehouse in Texas was destroyed by a fire and a warehouse in Pennsylvania was damaged by a flood. The Company reported an extraordinary gain on the fire of \$4,558 (net of income taxes of \$3,039).

In 2007, a warehouse in Bartow was destroyed by a fire. The Company reported an extraordinary loss on the fire of \$4,345 (net of income taxes of \$2,897). This extraordinary item will be subject to change as the insurance claims process progresses for the claim.

### **Note M. Related Party Transactions and Balances**

On October 3, 2007 the Company entered into a Settlement Agreement and Mutual Release, effective as of September 30, 2007, by and between Steven K. Clark (former Chief Executive Officer); Robert R. Amerson (Current Chief Executive Officer); Harry L. Smith, Jr. (Chief Operating Officer); Wal-Pat, LLC, a North Carolina limited liability company; and Mercury Die Cutting, LLC, a Florida limited liability company. A copy of the Settlement Agreement was filed as a Form 8-K on October 5, 2007 with the Securities and Exchange Commission. The major terms affecting the Company are summarized below:

Mr. Clark transfers his fifty percent (50%) membership interest in Wal-Pat to Mr. Amerson.

Mr. Clark exercised, on a cashless exercise basis, a stock option for 1,000,000 shares of Flanders common stock at an exercise price of \$2.50 per share by tendering 543,748 shares of Flanders common stock resulting in a net issuance of 426,522 shares to Mr. Clark. The 573,478 shares were then retired.

Mr. Clark satisfied his obligations under a promissory note due Flanders, which had an outstanding balance of \$5,446 as of September 30, 2007 in consideration of his surrendering 1,183,872 shares of Flanders common stock. These shares were valued at \$4.60, which was the 30-day average market value of Flanders shares. These shares were then retired.

Mr. Clark and Flanders mutually release each other from any obligations created under or related to Mr. Clark's employment agreements with Flanders. Mr. Clark is also released from his noncompetition covenants set forth in his employment agreement.

Flanders transfers certain manufacturing assets with a net book value of approximately \$250 from the Salt Lake City, Utah facility to Mr. Clark.

Mr. Clark resigned as a director as of October 4, 2007.

At December 31, 2007 and 2006, the Company had notes receivable secured by common stock classified as contra-equity of \$0 and \$7,441, respectively, due from various directors, officers, shareholders and employees, with interest thereon at LIBOR plus 1%, maturing at various dates to December 2010.

As of December 31, 2007 the Company has entered into six operating leases expiring either in 2025, 2026 or 2027 with Wal-Pat II. Wal-Pat II is owned by Robert R. Amerson, our Chief Executive Officer. The monthly payments to Wal-Pat II total \$221. The Company made payments of \$3,371, \$2,816 and \$1,067 in 2007, 2006 and 2005, respectively. The Company believes these leases are at prevailing market rates.

The above amounts and transactions are not necessarily indicative of amounts and transactions which would have been incurred if comparable transactions had been entered into with independent parties.

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Dollars in thousands, except per share amounts)

**Note N. Stock Options and Warrants**

During 2007, the Company granted options to purchase: 620,000 shares of common stock under its 2007 Equity Incentive Plan at a weighted average exercise price of \$5.23 per share. All options granted during 2007 were non-qualified fixed price options.

The following table summarizes the activity related to all Company stock options and warrants for 2007, 2006 and 2005:

	Shares (In thousands)		Exercise Price per Share		Weighted Average Exercise Price per Share	
	Warrants	Stock Options	Warrants	Options	Warrants	Options
Outstanding at January 1, 2005		5,015	1.50	8.60		5.28
Granted		795	8.85	11.10		10.75
Exercised		(18)	1.74	1.74		2.54
Canceled or expired						
<hr/>						
Outstanding at December 31, 2005		5,792	1.50	11.10		6.04
Granted		20	11.72	11.72		11.72
Exercised		(38)	2.40	5.21		3.90
Canceled or expired		(22)	2.50	2.50		2.50
<hr/>						
Outstanding at December 31, 2006		5,752	1.50	11.72		6.08
Granted		620	4.99	9.52		5.23
Exercised		(1,105)	1.50	5.21		2.55
Canceled or expired		(2,000)	7.50	11.10		8.68
<hr/>						
Outstanding at December 31, 2007		3,267	1.74	11.72		5.53
<hr/>						
Exercisable at December 31, 2007		2,867	1.74	11.72		5.60
<hr/>						
Exercisable at December 31, 2006		5,752	1.50	11.72		6.08
<hr/>						
Exercisable at December 31, 2005		5,652	1.50	11.10		6.10

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The warrants and options expire at various dates ranging from May 2008 to December 2017. A further summary of information related to options outstanding at December 31, 2007 is as follows:

Range of Exercise Prices	Number Outstanding / Exercisable	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price Outstanding / Exercisable
\$1.74 to 2.52	1,092 / 1,092	1.96	\$2.48 / 2.48
\$3.94 to 6.49	790 / 390	7.68	\$4.98 / 4.96
\$7.50 to 11.72	1,385 / 1,385	3.53	\$8.24 / 8.24

Prior to January 1, 2006, as permitted under accounting principles generally accepted in the United States of America, grants to employees under the LTI Plan and other grants to employees of options were accounted for following APB Opinion No. 25 and related Interpretations. Accordingly, no compensation cost had been recognized for grants to employees under the LTI Plan, since all options granted had an exercise price at or above the quoted market price of the Company's common stock on the date of grant.

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## FLANDERS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Dollars in thousands, except per share amounts)

### Note O. Earnings per Share

The following table shows the shares (in thousands) used in computing net earnings per common share including dilutive potential common stock.

	2007	2006	2005
Common shares outstanding at beginning of year	26,343	26,317	26,303
Net weighted average common shares issued and canceled during year	19	23	6
Weighted average number of common shares used in basic EPS	26,362	26,340	26,309
Dilutive effect of stock options and warrants	0	1,385	1,498
Weighted average number of common shares and dilutive potential shares used in diluted EPS	26,362	27,725	27,807

As of December 31, 2007, 2006 and 2005, options and warrants to purchase 1,385,000, 730,000 and 580,000 shares, respectively, of the Company's common stock described in Note N were excluded from the computation of diluted EPS because the market price of the underlying stock was less than the exercise price. The number of securities that would have had a dilutive effect on earnings per shares, had they not been considered antidilutive was 466.

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**FLANDERS CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except per share amounts)

**Note P. Quarterly Financial Data (Unaudited)**

	Quarters Ended			
	March 31, 2007	June 30, 2007	September 30, 2007	December 31, 2007
Net sales	\$ 60,248	\$ 64,285	\$ 62,578	\$ 57,830
Gross profit	\$ 9,022	\$ 11,623	\$ 6,561	\$ 4,584
Operating Income / (Loss)	\$ (1,961)	\$ 505	\$ (15,190)	\$ (10,075)
Net Earnings / (Loss)	\$ (11)	\$ 802	\$ (16,215)	\$ (4,262)
<b>Net Earnings / (Loss) per share:</b>				
Basic	\$ (.00)	\$ .03	\$ (.61)	\$ (.16)
Diluted	(.00)	.03	(.61)	(.16)
<b>Common stock prices:</b>				
High	\$ 9.52	\$ 7.67	\$ 8.20	\$ 6.86
Low	7.07	6.31	4.39	4.53
	March 31, 2006	June 30, 2006	September 30, 2006	December 31, 2006
Net sales	\$ 50,872	\$ 60,765	\$ 66,400	\$ 60,341
Gross profit	\$ 11,494	\$ 13,805	\$ 13,452	\$ 9,974
Operating income	\$ 2,456	\$ 2,627	\$ 2,696	\$ 78
Net Earnings	\$ 1,984	\$ 2,536	\$ 6,234	\$ (8,704)
<b>Net Earnings per share:</b>				
Basic	\$ .08	\$ .10	\$ .24	\$ (.34)
Diluted	.07	.09	.23	(.32)
<b>Common stock prices:</b>				
High	\$ 12.10	\$ 11.99	\$ 10.36	\$ 10.27
Low	10.29	9.49	8.56	8.42

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**FLANDERS CORPORATION**  
**FINANCIAL STATEMENT SCHEDULE**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTANTING FIRM  
ON SCHEDULE**

Board of Directors  
Flanders Corporation

In connection with our audits of the consolidated financial statements of Flanders Corporation and Subsidiaries referred to in our report dated February 22, 2008, which is included in the Company's Annual Report of Form 10-K for the year ended December 31, 2007 we have also audited Schedule II for each of the three years in the period ended December 31, 2007. In our opinion, this schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Pender Newkirk & Company, LLP

Pender Newkirk & Company, LLC  
Certified Public Accountants  
Tampa, Florida  
March 12, 2008

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**FLANDERS CORPORATION AND SUBSIDIARIES  
SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS  
Years Ended December 31, 2007, 2006 and 2005**

	<u>Balance at Beginning of Period</u>	<u>Additions Charged to Cost and Expense</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
<b>For the year ended December 31, 2007</b>				
Allowance for doubtful accounts	\$ 4,313	\$ 10,638	\$ (11,288) <sup>(1)</sup>	\$ 3,663
Allowance for inventory	1,623	3,133	(1,897)	2,859
<b>Total</b>	<b>\$ 5,936</b>	<b>\$ 13,771</b>	<b>\$ (13,185)</b>	<b>\$ 6,522</b>
<b>For the year ended December 31, 2006</b>				
Allowance for doubtful accounts	\$ 4,018	\$ 3,063	\$ (2,768) <sup>(1)</sup>	\$ 4,313
Allowance for inventory	1,477	146		1,623
<b>Total</b>	<b>\$ 5,495</b>	<b>\$ 3,209</b>	<b>\$ (2,768)</b>	<b>\$ 5,936</b>

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For the year ended December 31, 2005								
Allowance for doubtful accounts	\$	3,300	\$	2,094	\$	(1,376) <sup>(1)</sup>	\$	4,018
Allowance for inventory		1,392		85				1,477
Total	\$	4,692	\$	2,179	\$	(1,376)	\$	5,495

<sup>(1)</sup> Uncollected receivables written-off, net of recoveries.

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