ROYAL APPLIANCE MANUFACTURING CO
Form 10-Q
November 09, 2001

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the quarterly period ended SEPTEMBER 30, 2001.

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the transition period from ______ to _____ .

Commission file number 0-19431

ROYAL APPLIANCE MFG. CO.

(Exact name of registrant as specified in its charter)

OHIO	34-1350353
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

7005 COCHRAN ROAD, GLENWILLOW, OHIO	44139
(Address of Principal Executive Offices)	Zip Code

(440) 996-2000

(Registrant's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer's classes of common shares, as of the latest practicable date.

Common Shares, without par value	13,783,252
(Class)	(Outstanding at November 7, 2001)

The Exhibit index appears on sequential page 17.

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

INDEX

*Numbered in accordance with Item 601 of Regulation S-K

Part I - FINANCIAL INFORMATION
Item 1 - FINANCIAL STATEMENTS

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(DOLLARS IN THOUSANDS)

	September 30, 2001	December 31, 2000
ASSETS	(Unaudited)	
Current assets:		
Cash	$ 1,095	$ 704
Trade accounts receivable, net	48,762	42,097
Inventories	60,538	45,470
Refundable and deferred income taxes	4,806	4,735
Prepaid expenses and other	1,748	1,573
Total current assets	116,949	94,579
Property, plant and equipment, at cost:		
Land	1,541	1,541
Building	7,777	7,777
Molds, tooling, and equipment	53,004	48,650
Furniture, office and computer equipment and software	15,123	12,721
Assets under capital leases	3,171	3,171
Leasehold improvements and other	7,400	5,067
	88,016	78,927
Less accumulated depreciation and amortization	(47,048)	(37,119)
	40,968	41,808
Tooling deposits	3,250	807
Other	2,553	1,358
Total assets	$ 163,720	$ 138,552
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 33,726	$ 22,209
Accrued liabilities:		
Advertising and promotion	10,954	13,103
Salaries, benefits, and payroll taxes	5,707	3,355
Warranty and customer returns	9,750	9,800
Income taxes	1,192	--
Other	5,741	6,091
Current portions of capital lease obligations and notes payable	143	136
Total current liabilities	67,213	54,694
Revolving credit agreement	54,100	46,400

Capitalized lease obligations, less current portion	2,028	2,137
Total long-term debt	56,128	48,537
Deferred income taxes	3,811	4,268
Total liabilities	127,152	107,499
Commitments and contingencies (Note 4)	--	--
Shareholders' equity:		
Common shares, at stated value	213	212
Additional paid-in capital	43,759	43,038
Retained earnings	66,716	61,165
	110,688	104,415
Less treasury shares, at cost (11,945,700 and 11,780,500 shares at September 30, 2001 and December 31, 2000, respectively)	(74,120)	(73,362)
Total shareholders' equity	36,568	31,053
Total liabilities and shareholders' equity	$ 163,720	$ 138,552

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

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Part I - FINANCIAL INFORMATION
Item 1 - FINANCIAL STATEMENTS

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Net sales	$112,726	$ 96,129	$297,695	$281,674
Cost of sales	85,042	74,351	231,173	220,990

Gross margin	27,684	21,778	66,522	60,684
Advertising and promotion	10,495	8,130	27,136	29,627
Other selling	2,767	2,164	7,451	6,485
General and administrative	5,106	4,658	14,734	13,096
Engineering and product development	2,065	1,624	5,718	4,696
Income from operations	7,251	5,202	11,483	6,780
Interest expense, net	674	986	1,897	2,408
Receivable securitization and other expense (income), net	350	436	1,065	1,267
Income before income taxes	6,227	3,780	8,521	3,105
Income tax expense	2,142	435	2,970	185
Net income	$ 4,085	$ 3,345	$ 5,551	$ 2,920
BASIC				
Weighted average number of common shares outstanding (in thousands)	13,649	14,592	13,786	15,454
Earnings per share	$ .30	$ .23	$ .40	$ .19
DILUTED				
Weighted average number of common shares and equivalents outstanding (in thousands)	14,269	15,247	14,350	15,943
Earnings per share	$ .29	$ .22	$ .39	$ .18

The accompanying notes are an integral part of these financial statements

Part I - FINANCIAL INFORMATION
Item 1 - FINANCIAL STATEMENTS

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

Nine Months

	Ended September 30, 2001	2000
Cash flows from operating activities:		
Net income	$ 5,551	$ 2,920
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	11,061	11,474
Compensatory effect of stock options	412	247
Gain on sale of property, plant and equipment, net	--	(32)
Deferred income taxes	(839)	(872)
(Increase) decrease in assets:		
Trade accounts receivable, net	(6,665)	10,081
Inventories	(15,068)	(4,104)
Refundable and accrued income taxes	1,503	(3,366)
Prepaid expenses and other	(175)	(1,601)
Other	(1,706)	(1,026)
Increase (decrease) in liabilities:		
Trade accounts payable	11,517	4,703
Accrued advertising and promotion	(2,149)	(7,509)
Accrued salaries, benefits, and payroll taxes	2,352	(4,674)
Accrued warranty and customer returns	(50)	(550)
Accrued other	(350)	908
Total adjustments	(157)	3,679
Net cash from operating activities	5,394	6,599
Cash flows from investing activities:		
Purchases of tooling, property, plant, and equipment, net	(9,710)	(12,440)
(Increase) decrease in tooling deposits	(2,443)	2,916
Proceeds from sale of plant and equipment, net	--	32
Net cash from investing activities	(12,153)	(9,492)
Cash flows from financing activities:		
Proceeds from bank debt, net	7,700	19,500
Payments on note payable	--	(224)
Payments on capital lease obligations	(102)	(246)
Proceeds from exercise of stock options	310	139
Repurchase of common stock	(758)	(17,703)
Net cash from financing activities	7,150	1,466
Net increase (decrease) in cash	391	(1,427)
Cash at beginning of period	704	1,427
Cash at end of period	$ 1,095	$ --

Supplemental disclosure of cash flow information:
Cash payments for:

Interest	$ 1,993	$ 2,616
Income taxes, net of refunds	$ 2,306	$ 4,413

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

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

NOTE 1: BASIS OF PRESENTATION

The financial information for Royal Appliance Mfg. Co. and Subsidiaries (the Company) included herein is unaudited; however, such information reflects all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the consolidated balance sheets as of September 30, 2001 and December 31, 2000, and the related statements of operations and cash flows as of, and for the interim periods ended, September 30, 2001 and 2000. It is suggested that these condensed financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's latest annual report (Form 10-K).

The results of operations for the three and nine month periods ended September 30, 2001, are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

Earnings per share is computed based on the weighted average number of common shares outstanding for basic earnings per share and on the weighted average number of common shares and common share equivalents outstanding for diluted earnings per share.

The Company's revenue recognition policy is to recognize revenues when products are shipped. The Company's return policy is to replace, repair or issue credit for product under warranty. Returns received during the current period are expensed as received and a provision is provided for estimated future returns based on current shipments. All sales are final upon shipment of goods to the customers. The Company's revenue recognition policy is in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements."

International operations, primarily Canadian, are conducted in their local currency. Assets and liabilities denominated in foreign currencies are translated at current exchange rates, and income and expenses are translated using weighted average exchange rates. The net effect of currency gains and losses realized on these business transactions is included in the determination of net income.

The Company uses forward exchange contracts to reduce fluctuations in foreign currency cash flows related to receivables denominated in foreign currencies. The terms of the currency instruments are consistent with the timing of the transactions being hedged. The purpose of the Company's foreign currency management activity is to protect the Company from the risk that the eventual cash flows from the foreign currency denominated transactions may be adversely affected by changes in exchange rates. Gains and losses on forward exchange contracts are deferred and recognized in income when the related transactions being hedged are recognized. Such gains and losses are generally reported on the same financial line as the hedged transaction. The Company does not use derivative financial instruments for trading or speculative purposes. There were no foreign currency forward contracts outstanding as of September 30, 2001. All contracts have terms of four months or less.

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ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

NOTE 2: INVENTORIES

Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) method. Inventories at September 30, 2001, and December 31, 2000, consisted of the following:

	September 30, 2001	December 31, 2000
Finished goods	$51,189	$37,832
Work in process and purchased parts	9,349	7,638
	$60,538	$45,470

NOTE 3: ASSETS TO BE DISPOSED OF

Based upon a plan established in January 2001, the Company discontinued operations at its former distribution and assembly center during the second quarter of 2001. The property has been listed with a real estate broker and the Company believes that the property will be sold for a price that exceeds the net book value as of September 30, 2001.

As of September 30, 2001, the building and related land and improvements are classified as "Assets to be Disposed Of" in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of

Long-Lived Assets to be Disposed Of." As such, there is no need to continue to depreciate these assets. For financial statement purposes, the asset value, including related accumulated depreciation, is included in Property, Plant and Equipment, at cost in the Consolidated Balance Sheets. As of September 30, 2001, the net book value of this facility was $7,731.

NOTE 4: COMMITMENTS AND CONTINGENCIES

At September 30, 2001, the Company estimates having contractual commitments for future advertising and promotional expense of approximately $8,000, including commitments for television advertising through December 31, 2001. Other contractual commitments for items in the normal course of business total approximately $3,000.

The Hoover Company (Hoover) filed a lawsuit in federal court, in the Northern District of Ohio (case #1:00cv 0347), against the Company on February 4, 2000, under the patent, trademark, and unfair competition laws of the United States. The claim asserts the Company's Dirt Devil(R) Easy Steamer infringes certain patents held by Hoover. Hoover seeks damages, injunction of future production, and legal fees. The Company is vigorously defending the suit and believes that it is without merit. If Hoover were to prevail on all of its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company is involved in various other claims and litigation arising in the normal course of business. In the opinion of management, the ultimate resolution of these actions will not materially affect the consolidated financial position, results of operations, or cash flows of the Company.

NOTE 5: DEBT

At September 30, 2001, the Company had a reducing collateralized revolving credit facility with availability of up to $72,000 and a maturity date of March 7, 2003. Under the agreement, pricing options of the bank's base lending rate and LIBOR rate are based on a defined formula. In addition, the Company pays a commitment fee based on a defined formula on the unused portion of the facility. The revolving credit facility contains covenants which require, among other things, the achievement of minimum net worth levels and the maintenance of certain financial ratios. The Company was in compliance with all applicable covenants as of September 30, 2001. The revolving credit facility is collateralized by the assets of the Company and prohibits the payment of cash dividends. As long as the Company remains in compliance with all covenants, the revolving credit facility permits additional share repurchases up to $40,000, of which $20,823 was utilized through September 30, 2001.

The Company also utilizes a revolving trade accounts receivable securitization program to sell without recourse, through a wholly-owned subsidiary, certain trade accounts receivable. Under the program, the maximum amount allowed to be sold at any given time through September 30, 2001, was $35,000. At September 30, 2001, the Company had received approximately $18,700 from the sale of trade accounts receivable that has not yet been collected. The proceeds from the sales were used to reduce borrowings under the Company's revolving credit facility. Costs of the program, which primarily consist of the purchaser's financing cost of issuing commercial paper backed by the receivables, totaled $877 and $1,061 for the nine months ended September 30, 2001 and 2000, respectively, and have been classified as "Receivable securitization and other expense (income), net" in the accompanying Consolidated Statements of Operations. The Company, as agent for the purchaser of the receivables, retains collection and administrative responsibilities for the purchased receivables. Additionally, the revolving trade accounts receivable securitization program limits stock repurchases to $6,000 for 2001, of which $758 was utilized through September 30, 2001.

NOTE 6: SHARE REPURCHASE PROGRAM

In April 2001, the Company's Board of Directors authorized a common share repurchase program that provides for the Company to purchase, in the open market and through negotiated transactions, up to 3,400 of its outstanding common shares. As of November 7, 2001, the Company has repurchased approximately 229 shares for an aggregate purchase price of $1,068 under the new program that is scheduled to expire in December 2002. One of the Company's credit facilities limits 2001 stock repurchases to $6,000, of which $758 was utilized through September 30, 2001.

ROYAL APPLIANCE MFG. CO. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
(UNAUDITED)
(In thousands, except per share amounts)

NOTE 7: EARNINGS PER SHARE

The Company follows Statement of Financial Accounting Standards ("SFAS") No. 128, Earnings per Share, for the calculation of earnings per share. Basic earnings per share excludes dilution and is computed by dividing income by the weighted average number of common shares outstanding for the period. Diluted earnings per share includes the dilution of common stock equivalents.

	Three months ended September 30,		Nine months ende September 30,	
	2001	2000	2001	20
Net income	$ 4,085	$ 3,345	$ 5,551	$ 2
BASIC:				
Common shares outstanding, net of treasury shares, beginning of period	13,614	15,033	13,729	16
Weighted average common shares issued during period	52	7	130	

Weighted average treasury shares repurchased during period	(17)	(448)	(73)	(1
Weighted average common shares outstanding, net of treasury shares, end of period	13,649	14,592	13,786	15
Net income per common share	$ 0.30	$ 0.23	$ 0.40	$
DILUTED:				
Common shares outstanding, net of treasury shares, beginning of period	13,614	15,033	13,729	16
Weighted average common shares issued during period	52	7	130	
Weighted average common share equivalents	620	655	564	
Weighted average treasury shares repurchased during period	(17)	(448)	(73)	(1
Weighted average common shares outstanding, net of treasury shares, end of period	14,269	15,247	14,350	15
Net income per common share	$ 0.29	$ 0.22	$ 0.39	$

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS)

RESULTS OF OPERATIONS

Net sales increased 17.3% for the third quarter and increased 5.7% for the nine-month period ended September 30, 2001, compared with the same periods in the prior year. The increase in net sales was primarily attributable to the introduction during the third quarter of 2001 of the Company's new Platinum Force line of products, which includes a bagless hand vac, a bagless upright and an upright carpet shampooer. The Company also began shipping its first ever consumer electronics product, the Telezapper(TM), in the third quarter of 2001. Overall sales to the top 5 customers increased in the first nine months of 2001 (all of which are major retailers) as compared to the first nine months of 2000. Sales to the top 5 customers accounted for approximately 72.2% of net sales in the first nine months of 2001 as compared with approximately 67.3% in the first nine months of 2000. The Company believes that its dependence on sales to its largest customers will continue. Recently, many major retailers have experienced significant financial difficulties and some have filed for protection from creditors under applicable bankruptcy laws. The Company sells its products to certain customers that are in bankruptcy proceedings.

Gross margin, as a percent of net sales, increased from 22.7% for the third quarter 2000 to 24.6% in the third quarter 2001 and increased from 21.5% in the first nine months of 2000 to 22.3% in the first nine months of 2001. The gross margin percentage was positively affected by initial shipments of higher margin products, including the Platinum Force line of products and the Telezapper, partially offset by continued retail emphasis on lower price point products.

Advertising and promotion expenses increased 29.0% for the third quarter 2001 and decreased 8.4% for the nine months ended September 30, 2001. The increase in advertising and promotion expenses for the quarter was due primarily to increases in media spending and costs associated with the launch of the Platinum Force line of products and the Telezapper. The decrease in advertising and promotion expenses during the first nine months of 2001 was due to planned decreases in media spending. The Company intends to continue emphasizing cooperative advertising and television as its primary methods of advertising and promotion. In general, the Company's advertising expenditures are not specifically proportional to anticipated sales. For example, the amount of advertising and promotional expenditures may be concentrated during critical retail shopping periods during the year, particularly the fourth quarter, and during new product and promotional campaign introductions.

Other selling expenses increased by $603 for the third quarter 2001 and $966 for the nine month period ended September 30, 2001 compared with the same periods in 2000. The increase is primarily due to higher internal sales and marketing personnel compensation, which are the largest components of other selling expenses. Other selling expenses increased as a percentage of sales for the third quarter and nine month period ended September 30, 2001, from 2.3% to 2.5%, compared with the same periods in 2000.

General and administrative expenses increased 9.6% for the third quarter 2001 and increased 12.5% for the nine-month period ended September 30, 2001, compared with the same periods in 2000. General and administrative expenses decreased as a percentage of net sales for the third quarter 2001 from 4.8% to 4.5% and increased for the nine month period ended September 30, 2001, from 4.6% to 4.9%, compared with the same periods in 2000. The principal components are compensation (including benefits), insurance, provision for doubtful accounts, travel, professional services and information technology related expenditures and amortization. The dollar increases in the third quarter and nine-month period ended September 30, 2001, were primarily due to increases in employee related benefit expenses, professional services and information technology related expenditures and amortization.

RESULTS OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (CONTINUED)

Engineering and product development expenses increased by 27.2% for the third quarter 2001 and 21.8% for the nine-month period ended September 30, 2001. The principal components are engineering compensation, outside professional engineering and design services and other related product development expenditures. The amount of outside professional engineering and design services and other related product development expenditures are dependent upon the number and complexity of new product introductions in any given period. The dollar increases in the third quarter and nine-month period ended September 30, 2001, were primarily due to increases in engineering compensation, outside professional engineering and design services, and other related product development expenditures.

Interest expense decreased 31.6% for the third quarter 2001 and decreased 21.2% for the nine-month period ended September 30, 2001, compared with the same periods in 2000. The decrease in interest expense is the result of lower effective borrowing rates partially offset by higher levels of variable rate borrowings to finance working capital, capital expenditures and share repurchases

Receivable securitization and other expense (income), net principally reflects the effect of the cost of the Company's trade accounts receivable securitization program and foreign currency transaction gains or losses related to the Company's North American assets.

Due to the factors discussed above, the Company had income before income taxes for the third quarter and nine months ended September 30, 2001, of $6,227 and $8,521, respectively, as compared to income before income taxes for the third quarter and for the nine months ended September 30, 2000, of $3,780 and $3,105, respectively.

The third quarter results for 2000 included a $930 research and development tax credit related to prior years which increased earnings per share by $.06. The effective tax rate was reduced to 11.5% and 6.0% for the third quarter and nine months ended September 30, 2000, respectively, as a result of the tax credit.

LIQUIDITY AND CAPITAL RESOURCES

The Company has used cash generated from operations and revolving credit proceeds to fund its working capital needs, capital expenditures, and share repurchases. Working capital was $49,736 at September 30, 2001, an increase of 24.7% over December 31, 2000. Current assets increased by $22,370 reflecting in part a $6,665 increase of trade accounts receivable and an increase in inventory of $15,068. Current liabilities increased by $12,519 reflecting, in part, a $11,517 increase in trade accounts payable and $2,352 increase in accrued salaries and benefits, partially offset by a $2,149 decrease in accrued advertising and promotion.

In the first nine months of 2001, the Company utilized $12,153 of cash for capital purchases, including approximately $3,400 tooling related to the new Dirt Devil(R) Platinum Force line of products and approximately $4,700 for computer equipment and software.

At September 30, 2001, the Company had a reducing collateralized revolving credit facility with availability of up to $72,000 and a maturity date of March 7, 2003. Under the agreement, pricing options of the bank's base lending rate and LIBOR rate are based on a defined formula. In addition, the Company pays a commitment fee based on a defined formula on the unused portion of the facility. The revolving credit facility contains covenants which require, among other things, the achievement of minimum net worth levels and the maintenance of certain financial ratios. The Company was in compliance with all applicable covenants as of September 30, 2001. The revolving credit facility is collateralized by the assets of the Company and prohibits the payment of cash dividends. As long as the Company remains in compliance with all covenants, the revolving credit facility permits additional share repurchases up to $40,000, of which $20,823 was utilized through September 30, 2001.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS) (CONTINUED)

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

The Company also utilizes a revolving trade accounts receivable securitization program to sell without recourse, through a wholly-owned subsidiary, certain trade accounts receivable. Under the program, the maximum amount allowed to be sold at any given time through September 30, 2001, was $35,000. At September 30, 2001, the Company had received approximately $18,700 from the sale of trade accounts receivable that has not yet been collected. The proceeds from the sales were used to reduce borrowings under the Company's revolving credit facility. Costs of the program, which primarily consist of the purchaser's financing cost of issuing commercial paper backed by the receivables, totaled $877 and $1,061 for the nine months ended September 30, 2001 and 2000, respectively, and have been classified as "Receivable securitization and other expense (income), net" in the accompanying Consolidated Statements of Operations. The Company, as agent for the purchaser of the receivables, retains collection and administrative responsibilities for the purchased receivables. Additionally, the revolving trade accounts receivable securitization program limits stock repurchases to $6,000 for 2001, of which $758 was utilized through September 30, 2001.

In April 2001, the Company's Board of Directors authorized a common share repurchase program that provides for the Company to purchase, in the open market and through negotiated transactions, up to 3,400 of its outstanding common shares. As of November 7, 2001, the Company has repurchased approximately 229 shares for an aggregate purchase price of $1,068 under the new program that is scheduled to expire in December 2002. One of the Company's credit facilities limits 2001 stock repurchases to $6,000, of which $758 was utilized through September 30, 2001.

The Company believes that its revolving credit facilities along with cash generated by operations will be sufficient to provide for the Company's anticipated working capital and capital expenditure requirements for the next twelve months, as well as any additional stock repurchases under the February 2001 repurchase program.

QUARTERLY OPERATING RESULTS

The following table presents certain unaudited consolidated quarterly operating information for the Company and includes all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of such information for the interim periods.

	Three Months Ended						
	Sept. 30, 2001	June 30, 2001	March 31, 2001	Dec. 31, 2000	Sept. 30, 2000	June 30, 2000	March 200
	(Dollars in thousands, except per share amounts)						
Net sales	$112,726	$ 80,447	$104,522	$126,549	$ 96,129	$ 82,075	$103,
Gross margin	27,684	16,204	22,634	31,690	21,778	15,451	23,
Net income (loss)	4,085	(708)	2,174	3,018	3,345	(1,504)	1,
Net income (loss) per	$ 0.29	$ (0.05)	$ 0.15	$ 0.21	$ 0.22	$ (0.10)	$ 0

common share (a) (b)

(a) The sum of 2000 quarterly net income (loss) per share does not equal annual net income (loss) per share due to rounding.

(b) Income (loss) per share is calculated based on the diluted method explained in Note 7 to the Consolidated Financial Statements.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS) (CONTINUED)

QUARTERLY OPERATING RESULTS (CONTINUED)

The Company's business is seasonal. The Company believes that a significant percentage of certain of its products are given as gifts and, therefore, sell in larger volumes during the Christmas shopping season. The Company's continued dependency on its major customers, the timing of purchases by these major customers and the timing of new product introductions cause quarterly fluctuations in the Company's net sales. As a consequence, results in prior quarters are not necessarily indicative of future results of operations. The Company remains cautious about the fourth quarter 2001 because of the continued retail emphasis on lower price point products and retailers' concern about the holiday season due to current economic uncertainties.

OTHER

The Company believes that the domestic vacuum cleaner industry is a mature industry with modest annual growth in many of its products but with a decline in certain other products. Competition is dependent upon price, quality, extension of product lines, and advertising and promotion expenditures. Additionally, competition is influenced by innovation in the design of replacement models and by marketing and approaches to distribution. The Company's most significant competitors are Hoover, Eureka and Bissell in the upright and carpet shampooer market, and Black & Decker in the hand-held market. These competitors and several others are subsidiaries or divisions of companies that are more diversified and have greater financial resources than the Company.

INFLATION

The Company does not believe that inflation has had a material effect on the Company's results of operations. However, as the Company experiences price increases from its suppliers, which may include increases due to inflation, retail pressures may prevent the Company from increasing its prices. Due to recent economic conditions, the cost of plastic resin and transportation has increased in 2001.

LITIGATION

The Hoover Company (Hoover) filed a lawsuit in federal court, in the Northern District of Ohio (case #1:00cv 0347), against the Company on February 4, 2000, under the patent, trademark, and unfair competition laws of the United States. The claim asserts the Company's Dirt Devil(R) Easy Steamer infringes certain patents held by Hoover. Hoover seeks damages, injunction of future production, and legal fees. The Company is vigorously defending the suit and believes that it is without merit. If Hoover were to prevail on all of its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company is involved in various other claims and litigation arising in the normal course of business. In the opinion of management, the ultimate resolution of these actions will not materially affect the consolidated financial position, results of operations, or cash flows of the Company.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS) (CONTINUED)

ACCOUNTING STANDARDS

The Company implemented Statement of Financial Accounting Standards ("SFAS") No. 133, Accounting for Derivative Instruments and Hedging Activities, in the first quarter of 2001. The implementation of SFAS No. 133 did not have a material impact on its consolidated financial position, results of operations, or cash flows.

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations". This Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset, except for certain obligations of lessees. SFAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company is in the process of determining the effects of this Statement on its business.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This Statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement supersedes FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and the accounting and reporting provisions of APB Opinion NO. 30, "Reporting the Results of Operations". SFAS 144 is effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The Company is in the process of determining the effects of this Statement on its business.

FORWARD-LOOKING STATEMENTS

Forward-looking statements in this release are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those projected. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. Potential risks and uncertainties include, but are not limited to: general business and economic conditions; retail's reaction to a potential slowdown in consumer spending; the financial strength of the retail industry particularly the major mass retail channel; the competitive pricing and aggressive product development environment, particularly in the bagless upright vacuum category within the floor care industry; the impact of private-label programs by mass retailers; the cost and effectiveness of planned advertising, marketing and promotional campaigns; the success at retail and the acceptance by consumers of the Company's new products, including the Company's bagless uprights, carpet shampooers and its first consumer electronics product, the Telezapper(TM), the dependence upon the Company's ability to continue to successfully develop and introduce innovative products; and the uncertainty of the Company's global suppliers to continuously supply sourced finished goods and component parts.

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PART II - OTHER INFORMATION

ITEM 6 - Exhibits and Reports on Form 8-K

Forms 8-K - None

The following documents are furnished as an exhibit and numbered pursuant to Item 601 of Regulation S-K:

None

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SIGNATURES

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

Royal Appliance Mfg. Co.

(Registrant)

/s/ Michael J. Merriman

Michael J. Merriman
Chief Executive Officer, President and Director
(Principal Executive Officer)

Date: November 9,2001 /s/ Richard G. Vasek

Richard G. Vasek
Chief Financial Officer, Vice President -
Finance and Secretary
(Principal Financial Officer)

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INDEX TO EXHIBITS

PAGE NUMBER

None

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