

P&F INDUSTRIES INC  
Form 10-K  
March 29, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

**(Mark  
One)**

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

**For the Fiscal Year Ended December 31, 2012**

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

**Commission File Number 1-5332**

**P&F INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

**22-1657413**

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification Number)

**445 Broadhollow Road, Suite 100, Melville, New York 11747**

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(631) 694-9800**

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

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<b>(Title of each class)</b>	<b>(Name of each exchange on which registered)</b>
Class A Common Stock, \$1.00 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: NONE

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

Indicate by check mark 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input type="radio"/>	Accelerated filer <input type="radio"/>	Non-accelerated filer <input type="radio"/>	Smaller reporting company <input checked="" type="radio"/>
(Do not check if a smaller reporting company)			

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

The aggregate market value of the registrant's Class A Common Stock held by non-affiliates of the registrant, based on the last sale price on June 29, 2012 (the last business day of the registrant's most recently completed second fiscal quarter), was approximately \$12,409,000.

As of March 29, 2013 there were 3,674,139 shares of the registrant's Class A Common Stock outstanding.

**Documents Incorporated by Reference**

Part III of this Annual Report on Form 10-K incorporates by reference information from the registrant's definitive Proxy Statement for its 2013 Annual Meeting of Stockholders.

**P&F INDUSTRIES, INC.**

**FORM 10-K**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012**

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## **FORWARD LOOKING STATEMENTS**

The Private Securities Litigation Reform Act of 1995 (the “Reform Act”) provides a safe harbor for forward looking statements made by or on behalf of P&F Industries, Inc. and subsidiaries (the “Company”). The Company and its representatives may, from time to time, make written or verbal forward looking statements, including statements contained in the Company’s filings with the Securities and Exchange Commission, such as this Annual Report on Form 10-K (“Report”), and in its reports to stockholders. Any statements made in the Report that are not historical facts may be deemed to be forward looking statements. Generally, the inclusion of the words “believe,” “expect,” “intend,” “estimate,” “anticipate,” “will,” their opposites and similar expressions identify statements that constitute “forward looking statements” within the meaning of the Reform Act. Any forward looking statements contained herein, including those related to the Company’s future performance, are based upon the Company’s historical performance and on current plans, estimates and expectations. Such forward looking statements are subject to various risks and uncertainties, including those risk factors described in this Report, which may cause actual results to differ materially from the forward looking statements. Forward looking statements speak only as of the date on which they are made, and the Company undertakes no obligation to update publicly or revise any forward looking statement, whether as a result of new information, future developments or otherwise.

## **PART I**

### **ITEM 1. Business**

P&F Industries, Inc. (“P&F”) is a Delaware corporation incorporated on April 19, 1963. P&F and each of its subsidiaries are herein referred to collectively as the “Company.” In addition, the words “we”, “our” and “us” refer to the Company. The Company operates in two primary lines of business, or segments: (i) tools and other products (“Tools”) and (ii) hardware and accessories (“Hardware”).

#### **Tools**

We conduct our Tools business through a wholly-owned subsidiary, Continental Tool Group, Inc. (“Continental”), which in turn currently operates through its wholly-owned subsidiaries, Florida Pneumatic Manufacturing Corporation (“Florida Pneumatic”) and Hy-Tech Machine, Inc. (“Hy-Tech”).

#### **Florida Pneumatic**

Florida Pneumatic imports and sells pneumatic hand tools of its own design, primarily for the retail, industrial and automotive markets. This line of products includes sanders, grinders, drills, saws and impact wrenches. These tools are similar in appearance and function to electric hand tools, but are powered by compressed air, rather than directly by electricity. Air tools, as they are also called, generally are less expensive to operate, offer better performance and weigh less than their electrical counterparts. Florida Pneumatic imports approximately seventy-five types of pneumatic hand tools, most of which are sold at prices ranging from \$50 to \$1,000, under the names “Florida Pneumatic” and “Universal Tool,” as well as under the trade names or trademarks of several private label customers. These Florida Pneumatic products are sold to distributors, retailers and private label customers through in-house sales personnel and manufacturers’ representatives. Users of Florida Pneumatic’s hand tools include industrial maintenance and production staffs, do-it-yourself mechanics, automobile mechanics and auto body personnel.

During 2012, Florida Pneumatic purchased approximately 56% of its pneumatic tools from China, 41% from Taiwan and 1% from Japan and Europe. Florida Pneumatic performs final assembly on certain of its pneumatic tools at its factory in Jupiter, Florida.

Florida Pneumatic also markets, through its Berkley Tool division (“Berkley”), a product line which includes pipe and bolt dies, pipe taps, wrenches, vises and stands, pipe and tubing cutting equipment, hydrostatic test pumps, and replacement electrical components for a widely-used brand of pipe cutting and threading machines. Florida Pneumatic markets Berkley’s products through industrial distributors and contractors. Florida Pneumatic sources its Berkley product line from China and Israel, as well as domestic sources. Florida Pneumatic also assembles and markets a line of compressor air filters, for which it imports components from Mexico.

There are redundant supply sources for nearly all products purchased.

The primary competitive factors in the pneumatic hand tool market are price, service and brand-name awareness. The primary competitive factors in Berkley’s business are price and service. Florida Pneumatic’s products are sold off the shelf, and no material backlog of orders exists. The business is not seasonal, but it may be subject to significant periodic changes resulting from holiday sales promotions by customers.

### **Hy-Tech**

Hy-Tech manufactures and distributes its own line of industrial pneumatic tools under the “ATP” brand. Under the ATP brand, Hy-Tech produces and sells over sixty types of tools, which include impact wrenches, grinders, drills, and motors and are sold at prices ranging from \$450 to \$28,000. Further, it also manufactures tools to customer unique specifications. Users of ATP parts and tools include refineries, chemical plants, power generation, heavy construction, oil and mining companies. In addition, Hy-Tech manufactures an extensive line of pneumatic tool replacement parts that are sold competitively to the original equipment manufacturer. It also manufactures and distributes high pressure stoppers for hydrostatic testing fabricated pipe under the “Thaxton” brand name. It also produces a line of siphons under the “Eureka” name.

Hy-Tech products are sold through its in-house sales force as well as manufacturer representatives. Hy-Tech’s products are sold off the shelf and also are produced to customer’s specifications.

The business is not seasonal but may be subject to periodic schedule changes in refineries, power generations and chemical plants. The primary competitive factors in the industrial pneumatic tool market are quality, breadth of products and availability of products, customer service and technical support.

Other than a line of sockets that are imported from Israel, all Hy-Tech products are made in the United States of America.

## **Hardware**

We conduct our Hardware business through a wholly-owned subsidiary, Countrywide Hardware, Inc. (“Countrywide”). Countrywide conducts its business operations through its wholly-owned subsidiary, Nationwide Industries, Inc. (“Nationwide”). Prior to June 2010, we also conducted a stair parts business through certain subsidiaries of Countrywide.

### **Nationwide**

Nationwide is a developer, importer, and manufacturer of fencing hardware, patio products, and door and window accessories including rollers, hinges, window operators, sash locks, custom zinc castings and door closers. Nationwide’s products are sold through in-house sales personnel and independent manufacturers’ representatives to distributors, dealers, retailers and OEM customers. Additionally, Nationwide markets a kitchen and bath product line. End users of Nationwide’s products include contractors, home builders, pool and patio enclosure contractors, plumbers, OEM/private label customers and general consumers. Nationwide currently out-sources the manufacturing of approximately 90% of its product with several overseas factories located in China and Taiwan, while retaining design, quality control, and patent and trademark control. There are redundant supply sources for most products. Nationwide manufactures approximately 10% of its products sold including rollers, hinges and pool enclosure products at its facility in Tampa, Florida. Nationwide also provides value-add services for the entire product line with local packaging, kitting, rework and fabrication operations performed in its Tampa location.

Nationwide’s sales are moderately seasonal, with revenues typically increasing during the home construction activity, which generally occurs during the spring and summer months. The majority of Nationwide’s products are sold off the shelf. The primary competitive factors affecting Nationwide are quality, breadth of products and availability of products, customer service and technical support.

### **Former Stair Parts Business**



Prior to June 2009, Countrywide's subsidiaries, Woodmark International, L.P. ("Woodmark") and Pacific Stair Products, Inc. ("PSP") each operated a stair parts business. Additionally, Woodmark was also an importer of kitchen and bath hardware and accessories. In June 2009 pursuant to the transactions (the "WMC transactions") that formed the business of WM Coffman LLC (now known as Old Stairs Co ("WMC")), Woodmark and PSP contributed stair parts-related assets to WMC in return for members' equity. Concurrently, Woodmark transferred its kitchen and bath business to Nationwide. Accordingly, effective with the WMC transactions, the stair parts business became exclusively the business of WMC, and Woodmark and PSP no longer functioned as operating units. As part of the WMC transactions WMC acquired substantially all of the assets of Coffman Stairs, LLC, which operated a competitive stair parts business.

WMC was not able to achieve the revenue levels anticipated prior to the WMC transactions and, as a result, never produced positive cash flows. This caused, among other things, defaults on WMC's loan agreement with its bank, PNC, National Association ("PNC"). PNC, the primary lender and source of credit to WMC, foreclosed upon the assets of WMC. As a result of the aforementioned facts, in June 2010 WMC ceased operations. The Company no longer includes WMC in its Consolidated Financial Statements. See Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations – Off Balance Sheet Arrangements and Note 3 to Consolidated Financial Statements for further discussion.

### **Significant Customer**

See Management's Discussion and Analysis – Liquidity and Capital Resources – Significant Customer.

### **Employees**

We employed 150 full-time employees as of December 31, 2012. At various times during the year our operating units may employ seasonal help. During 2012, we employed part-time or seasonal staff as necessary. None of the Company's employees are represented by a union.

## ITEM 1A. Risk Factors

A wide range of factors could materially affect our performance. In addition to the factors affecting specific business operations identified in connection with the description of these operations and the financial results of these operations elsewhere in this report, the following factors, among others, could adversely affect our results of operations or financial position:

*Substantial debt and debt service requirements;* The amount of our debt could have important consequences. For example, it could: increase our vulnerability to general adverse economic and industry conditions; limit our ability to fund future capital expenditures, working capital and other general corporate requirements; require us to dedicate a substantial portion of our cash flow from operations to make interest and principal payments on our debt; limit our flexibility in planning for, or reacting to, changes in our business; place us at a competitive disadvantage compared with competitors that have less debt; and limit our ability to borrow additional funds, even when necessary to maintain adequate liquidity.

*Compliance with covenants under our credit facility.* Our asset based credit facility contains affirmative and negative covenants including financial covenants, and default provisions. A breach of any of these covenants could result in a default under our credit agreement. Upon the occurrence of an event of default under our current credit agreement, the lenders could elect to declare all amounts outstanding to be immediately due and payable and terminate all commitments to extend further credit. If the lenders were to accelerate the repayment of borrowings, we may not have sufficient assets to repay our asset based credit facility and our other indebtedness. Also, should there be an event of default, or a need to obtain waivers following an event of default, we may be subject to higher borrowing costs and/or more restrictive covenants in future periods.

*Significant volatility and disruption in the global capital and credit markets.* Volatility in the global capital and credit markets has in recent years resulted in a tightening of business credit and liquidity, a contraction of consumer credit, business failures, increased unemployment and declines in consumer confidence and spending. If global economic and financial market conditions deteriorate or remain weak for an extended period of time, it could have a material adverse effect on our financial condition and results of operations. In particular, lower consumer spending may result in reduced demand and orders for certain of our products, order cancellations, lower revenues, increased inventories, and lower gross margins. Further, if our customers experience difficulty obtaining financing in the capital and credit markets to purchase our products, this could result in further reduced orders for our products, order cancellations, inability of customers to timely meet their payment obligations to us, extended payment terms, higher accounts receivable, reduced cash flows, greater expense associated with collection efforts and increased bad debt expense; and a severe financial difficulty experienced by our customers may cause them to become insolvent or cease business operations.

*The strength of the retail economy in the United States.* Our business is subject to economic conditions in major markets, including recession, inflation, deflation, general weakness in retail, industrial, and housing markets. The strength of such markets are a function of many factors beyond our control, including interest rates, employment levels, availability of credit and consumer confidence. Such economic conditions have had, and may continue to

have, an adverse effect on our results of operations and financial position.

*Supply chain disruptions.* Any difficulty or inability on the part of manufacturers of our products or other participants in our supply chain in obtaining sufficient financing to purchase raw materials or to finance general working capital needs may result in delays or non-delivery of shipments of our products.

*Our ability to maintain mutually beneficial relationships with key customers.* We have several key customers, one of which constituted approximately 20.8% of our consolidated revenues for 2012. Loss of key customers or a material negative change in our relationships with our key customers (including as a result of a negative change in the financial position of such key customers) could have a material adverse effect on our business, results of operations or financial position.

*Adverse changes in currency exchange rates or raw material commodity prices.* A majority of our products are manufactured outside the United States, of which a significant amount is purchased in the local currency. As a result, we are exposed to movements in the exchange rates of various currencies against the United States dollar which could have an adverse effect on our results of operations or financial position. We believe our most significant foreign currency exposures are the Taiwan dollar (“TWD”) and the Chinese Renminbi (“RMB”). Purchases from Chinese sources are made in U.S. dollars. However, if the RMB were to be revalued against the dollar, there could be a significant negative impact on the cost of our products.

*Impairment of long-lived assets and goodwill.* The inability of certain of our subsidiaries to generate future cash flows sufficient to support the recorded amounts of goodwill, other intangible assets and other long-lived assets related to those subsidiaries could result in future impairment charges.

*Unforeseen interruptions in the manufacturing ability of certain foreign suppliers.* Our foreign suppliers may encounter interruption in their ability to continue to provide us with products on a short-term or long-term basis. Although we believe that there are redundant sources available and maintain multiple sources for certain of our products, there may be costs and delays associated with securing such sources and there can be no assurance that such sources would provide the same quality of product at similar prices.

*Unforeseen inventory adjustments or changes in purchasing patterns.* We make purchasing decisions based upon a number of factors including an assessment of market needs and preferences, manufacturing lead times and cash flow considerations. To the extent that our assumptions result in inventory levels being too high or too low, there could be a material adverse effect on our business, results of operations or financial position.

*Market acceptance of new products.* There can be no assurance that the market continues its acceptance of the new products we introduced in recent years or will accept new products introduced or scheduled for introduction, in 2013. There can also be no assurance that the level of sales generated from these new products relative to our expectations will materialize, based on existing investments in productive capacity and commitments by us to fund advertising and product promotions in connection with the introduction of these new products.

*Increased competition.* The domestic markets in which we sell our products are highly competitive on the basis of price, quality, availability, post-sale service and brand-name awareness. A number of competing companies are well-established manufacturers that compete on a global basis.

*Price reductions.* Price reductions taken by us in response to customer and competitive pressures, as well as price reductions or promotional actions taken in order to drive demand, may not result in anticipated sales necessary to offset the associated costs.

*Interest rates.* Interest rate fluctuations and other capital market conditions could have a material adverse effect on our business, results of operations or financial position.

*Litigation and insurance.* The effects of litigation and product liability exposure, as well as other risks and uncertainties described from time to time in our filings with the Securities and Exchange Commission and public announcements could have a material adverse effect on our business, results of operations or financial position. Further, while we maintain insurance policies to protect against most potential exposures, events may arise against which we may not be adequately insured.

*Retention of key personnel.* Our success depends to a significant extent upon the abilities and efforts of our key personnel. The loss of the services of any of our key personnel or our inability to attract and retain qualified personnel in the future could have a material adverse effect on our business, results of operations or financial position.

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*Acquisition of businesses.* Part of our business strategy is to opportunistically acquire complementary businesses and dispose of non-complementary businesses. If we fail to develop and integrate any acquired business or dispose of any businesses effectively, our earnings may be adversely affected. In addition, our management team will need to devote substantial time and attention to the acquisition and integration of the acquired businesses, which could distract them from their other duties and responsibilities.

*Regulatory environment.* We cannot anticipate the impact of changes in laws and regulations, including changes in accounting standards, taxation requirements, including tax rate changes, new tax laws and revised tax law interpretations, and environmental laws, in both domestic and foreign jurisdictions.

*Our financial position, cash flow or results may be adversely affected by the threat of terrorism and related political instability and economic uncertainty.* The threat of potential terrorist attacks on the United States and throughout the world and political instability has created an atmosphere of economic uncertainty in the United States and in foreign markets. Our results may be impacted by the macroeconomic effects of those events. Also, a disruption in our supply chain as a result of terrorist attacks or the threat thereof may significantly affect our business and its prospects. In addition, such events may also result in heightened domestic security and higher costs for importing and exporting shipments of components and finished goods. Any of these occurrences may have a material adverse effect on our financial position, cash flow or results in any reporting period.

*Information technology system failures and attacks could harm our business.* Our business is dependent on the efficient functioning of our information technology systems and operations, which are vulnerable to damage or interruption from such factors as fires, natural disasters, telecommunications failures, computer viruses and worms, hacking, software defects, as well as human error. Despite our precautions, problems could result in interruptions in services and materially and adversely affect our business, financial condition and results of operations.

*We may in the future be required to include the financial position of our WMC subsidiary in our consolidated financial statements.* The Financial Accounting Standards Board has issued accounting guidance regarding variable interest entities (“VIEs”) that affects the accounting treatment of one of our subsidiaries, WMC. To ascertain if we are required to consolidate this subsidiary, we determine whether it is a VIE and if we are the primary beneficiary in accordance with the accounting guidance, as discussed further in this Annual Report on Form 10-K. Changes in the financial accounting guidance, or changes in circumstances at this subsidiary, could lead us to determine that we have to consolidate the financial position of such entity in the future.

*Liabilities of WMC.* WMC has liabilities on its balance sheet that are not reflected in our consolidated financial statements. While we believe that neither P&F nor any of its subsidiaries other than WMC are legally responsible for any such liabilities, there can be no assurance that one or more creditors of WMC will not institute legal action against P&F or any of its subsidiaries other than WMC, which could result in a material adverse impact on our financial position.

- *Unforeseen events.* We cannot anticipate the impact of unforeseen events, including but not limited to war and pandemic disease, on economic conditions and consumer confidence in our business.

The risk factors described above are not intended to be all-inclusive. There can be no assurance that we have correctly identified and appropriately assessed all factors affecting our business or that the publicly available and other information with respect to these matters is complete and correct. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial also may adversely impact us. Should any risks and uncertainties develop into actual events, these developments could have a material adverse effect on our business, results of operations or financial position.

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

None.

## **ITEM 2. Properties**

Florida Pneumatic owns a 72,000 square foot plant facility located in Jupiter, Florida. Hy-Tech owns a 51,000 square foot plant facility located in Cranberry Township, Pennsylvania and leases a 10,000 square foot facility located in Punxsutawney, Pennsylvania.

Countrywide owns a 56,250 square foot plant facility located in Tampa, Florida in which Nationwide conducts its business. Countrywide leases part of the facility to a non-affiliated tenant.

Each facility described above either provides adequate space for the operations of the respective subsidiary for the foreseeable future or can be modified or expanded to provide some additional space.

The three owned properties described above are subject to mortgages and therefore pledged as collateral against the Company's credit facility, which is discussed in Management's Discussion and Analysis – Liquidity and Capital Resources and Notes to Financial Statements.

The Company's executive office of approximately 5,000 square feet is located in an office building in Melville, New York and is leased from a non-affiliated landlord.

### **ITEM 3. Legal Proceedings**

We are a defendant or co-defendant in various actions brought about in the ordinary course of conducting our business. We do not believe that any of these actions are material to our financial position.

### **ITEM 4. Mine Safety Disclosures**

None

**PART II**

**ITEM 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our Class A Common Stock trades on the Nasdaq Global Market under the symbol PFIN. The range of the high and low closing sales prices for our Class A Common Stock during the last two years were as follows:

<b><u>2012</u></b>	<b>High</b>	<b>Low</b>
First Quarter	\$4.70	\$3.40
Second Quarter	5.05	3.94
Third Quarter	6.24	4.83
Fourth Quarter	6.24	5.50

<b><u>2011</u></b>	<b>High</b>	<b>Low</b>
First Quarter	\$3.74	\$3.22
Second Quarter	4.65	3.58
Third Quarter	5.18	3.81
Fourth Quarter	4.40	3.40

As of March 20, 2013, there were approximately 1,100 holders of record of our Class A Common Stock and the closing sale price of our stock as reported by the Nasdaq Global Market was \$8.55. We have not declared any cash dividends on our Class A Common Stock since our incorporation in 1963 and have no plans to declare any cash dividends in the foreseeable future.

**ITEM 6. Selected Financial Data**

Not required.

**ITEM 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**



## OVERVIEW

Significant results and events in 2012 include:

- Increased annual net revenue by 9.8%, or \$5,330,000.
- Increased annual gross profit by \$1,897,000; however gross margin declined 0.1%.  
Full year 2012 income from continuing operations before taxes, as a percentage of net revenue, increased to 5.6% from 3.7% in the prior year.  
After giving effect to a \$2,250,000 reduction in a valuation allowance on our deferred tax assets, net income improved to \$5,450,000 from \$1,909,000,
- o Diluted earnings per share from continuing operations increased to \$1.45 from \$0.52.
- In December 2012, we amended our credit facility, which included the following:
  - o New expiration- December 2017;
  - o Increased the Revolver Loan borrowing facility to \$20,000,000 from \$15,910,000;
  - o Modified Term Loan,
    - § Extending amortization timeframe.
    - § Reduced the Applicable Margin Rate of interest by 275 basis points.

## KEY INDICATORS

### Economic Measures

Much of our business is driven by the ebbs and flows of the general economic conditions in both the United States and, to a lesser extent, abroad. Our Tools segment focuses on a wide array of customer types; it does not rely as much on specific economic measures or indicators. The Tools segment tends to track the general economic conditions of the United States, industrial production and general retail sales, all of which have, for the most part, generated slight improvement during 2012 compared to 2011. The key economic measures for the Hardware group are general economic conditions within the United States and, to a lesser extent, the housing market.

Another key economic measure relevant to us is the cost of the raw materials in our products. Key materials include metals, especially various types of steel and aluminum. Also important is the value of the dollar in relation to the Taiwan dollar (“TWD”), as we purchase a significant portion of our products from Taiwan. Purchases from Chinese sources are made in U.S. dollars. However, if the Chinese currency, the Renminbi (“RMB”), were to be revalued against the dollar, there could be a significant negative impact on the cost of our products.

## **Operating Measures**

Key operating measures we use to manage our operating segments are: orders; shipments; development of new products; customer retention; inventory levels and productivity. These measures are recorded and monitored at various intervals, including daily, weekly and monthly. To the extent these measures are relevant, they are discussed in the detailed sections for each operating segment.

## **Financial Measures**

Key financial measures we use to evaluate the results of our business include: various revenue metrics; gross margin; selling, general and administrative expenses; earnings before interest and taxes; operating cash flows and capital expenditures; return on sales; return on assets; days sales outstanding and inventory turns. These measures are reviewed at monthly, quarterly and annual intervals and compared to historical periods as well as established objectives. To the extent that these measures are relevant, they are discussed in the detailed sections below for each operating segment.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”). Certain of these accounting policies require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities, revenues and expenses. On an ongoing basis, we evaluate estimates, including those related to bad debts, inventory reserves, goodwill and intangible assets, warranty reserves and taxes. We base our estimates on historical data and experience, when available, and on various other assumptions that are believed to be reasonable under the circumstances, the combined results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. Our critical accounting policies are further described below.

## **Revenue Recognition**

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or title has passed to our customer or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured. We sell our goods on terms which transfer title and risk of loss at a specified location, typically shipping point, port of loading or port of discharge, depending on the final destination of the goods. Revenue recognition from product sales occurs when all factors are met, including transfer of title and risk of loss, which occurs either upon shipment by us or upon receipt by customers at the location specified in the terms of sale. Other than standard product warranty provisions, our sales arrangements provide for no other post-shipment obligations. We do offer rebates and other sales incentives, promotional allowances or discounts, from time to time and for certain customers, typically related to customer purchase volume, all of which are fixed or determinable and are classified as a reduction of revenue and recorded at the time of sale. We periodically evaluate whether an allowance for sales returns is necessary. Historically, we have experienced minimal sales returns. If we believe there are material potential sales returns, we would provide the necessary provision against sales.

## **Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable are customer obligations due under normal trade terms. We sell our products to retailers, distributors and original equipment manufacturers involved in a variety of industries. We perform continuing credit evaluations of our customers' financial condition, and although we generally do not require collateral, letters of credit may be required from customers in certain circumstances. Management reviews accounts receivable to determine if any receivables will potentially be uncollectible. Factors considered in the determination include, among other factors, number of days an invoice is past due, customer historical trends, available credit ratings information, other financial data and the overall economic environment. Collection agencies may also be utilized if management so determines.

We record an allowance for doubtful accounts based on specifically identified amounts that are believed to be uncollectible. We also may record as an additional allowance a certain percentage of aged accounts receivable, based on historical experience and our assessment of the general financial conditions affecting our customer base. If actual collection experience changes, revisions to the allowance may be required. We have a limited number of customers with individually large amounts due at any given balance sheet date. Any unanticipated change in the creditworthiness of any of these customers could have a material effect on our results of operations in the period in which such changes or events occur. After all reasonable attempts to collect an account receivable have failed, the amount of the receivable is written off against the allowance. Based on the information available, we believe that our allowance for doubtful accounts as of December 31, 2012 was adequate. However, actual write-offs might exceed the recorded allowance.

## **Inventories**

Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out method or the weighted average method. Inventory, which includes materials, labor, and manufacturing overhead costs, is recorded net of an allowance for obsolete or unmarketable inventory. Such allowance is based upon both historical experience and management's understanding of market conditions and forecasts of future product demand. In addition, all items in inventory in excess of one year's usage are considered for inclusion in the calculation of inventory obsolescence. If the actual amount of obsolete or unmarketable inventory significantly exceeds the estimated allowance, our cost of sales, gross profit and net earnings would be significantly affected.

## **Goodwill and Other Intangible Assets**

In accordance with authoritative guidance issued by the Financial Accounting Standards Board ("FASB") we test goodwill for impairment on an annual basis in the fourth quarter or more frequently if we believe indicators of impairment might exist. The evaluation of goodwill and other intangible assets requires that management prepare estimates of future operating results for each of our operating units. These estimates are made with respect to future business conditions and estimated expected future cash flows to determine estimated fair value. However, if, in the future, key drivers in our assumptions or estimates such as (i) a material decline in general economic conditions; (ii) competitive pressures on our revenue or our ability to maintain margins; (iii) pricing from our vendors which cannot be passed through to our customers; and (iv) breakdowns in supply chain or other factors beyond our control occur, an impairment charge against our intangible assets may be required.

## **Income Taxes**

We account for income taxes using the asset and liability approach. This approach requires the recognition of current tax assets or liabilities for the amounts refundable or payable on tax returns for the current year, as well as the recognition of deferred tax assets or liabilities for the expected future tax consequences of temporary differences that can arise between (a) the amount of taxable income and pretax financial income for a year, such as from net operating loss carryforwards and other tax credits, and (b) the tax bases of assets or liabilities and their reported amounts in the consolidated financial statements. Deferred tax assets and liabilities are measured using enacted tax rates. The impact on deferred tax assets and liabilities of changes in tax rates and laws, if any, is reflected in the consolidated financial statements in the period enacted. Further, we evaluate the likelihood of realizing benefit from our deferred tax assets by estimating future sources of taxable income and the impact of tax planning strategies. 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.

We file a consolidated Federal tax return. P&F and certain of its subsidiaries file combined tax returns in New York and Texas. All subsidiaries file other state and local tax returns on a stand-alone basis.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while other positions are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are classified as income taxes in the consolidated statement of income.

### **Consolidation of Variable Interest Entities**

On January 1, 2010, we adopted an accounting standard, which replaced the quantitative-based risks and rewards calculation for determining which enterprise, if any, has a controlling financial interest in a variable interest entity. The new approach focuses on identifying which enterprise has the power to direct the activities of a variable interest entity that most significantly impacts the variable interest entity's economic performance and (1) the obligation to absorb losses of the variable interest entity or (2) the right to receive benefits from the variable interest entity.

As a result of adopting this new accounting standard, we determined that, as the result of the facts and circumstances relating to WMC, including the foreclosure, and subsequent disposal and sale of all of its tangible and intangible assets by PNC, we were no longer the primary beneficiary of WMC and we no longer had a controlling financial interest in WMC. As such, we deconsolidate WMC's financial position and results of operations.

**RESULTS OF OPERATIONS****2012 compared to 2011****REVENUE**

The tables below provide an analysis of our revenue for the three and twelve-month periods ended December 31, 2012 and 2011.

All revenues are generated in U.S. dollars and are not impacted by changes in foreign currency exchange rates. Unless otherwise stated below, we believe that our relationships with all our key customers, given the current economic conditions, remain good. Other than the matter discussed in the Liquidity and Capital Resources section of this Management Discussion and Analysis pertaining to a major retail customer within the Tools segment, there were no major trends or uncertainties that had, or could reasonably be expected to have, a material impact on our revenue. Other than matters described below, there was no unusual or infrequent event, transaction or significant economic change that materially affected our results of operations.

**Consolidated**

	Three months ended December 31,		Variance	Variance
	2012	2011	\$	%
Tools				
Florida Pneumatic	\$5,397,000	\$5,592,000	\$(195,000)	(3.5)%
Hy-Tech	4,072,000	3,896,000	176,000	4.5
Tools Total	9,469,000	9,488,000	(19,000 )	(0.2 )

Hardware