ROYAL APPLIANCE MANUFACTURING CO
Form 10-Q
August 13, 2002

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 JUNE 30, 2002.

[ ] 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	12,816,452

(Class)	(Outstanding at August 12, 2002)

The Exhibit index appears on sequential page 21.

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)

	June 30, 2002	December 31, 2001
ASSETS	(Unaudited)	
Current assets:		
Cash	$ 1,966	$ 3,421
Trade accounts receivable, net	29,935	35,986
Inventories	55,796	50,807
Deferred income taxes	5,027	4,549
Prepaid expenses and other	2,625	1,636
Total current assets	95,349	96,399
Property, plant and equipment, at cost:		
Land	1,541	1,541
Building	7,777	7,777
Molds, tooling, and equipment	50,048	52,031
Furniture, office and computer equipment and software	15,200	12,154
Assets under capital leases	3,171	3,171
Leasehold improvements and other	7,058	7,456
	84,795	84,130
Less accumulated depreciation and amortization	(49,358)	(46,556)
	35,437	37,574
Computer software and tooling deposits	1,801	4,405
Other	2,727	2,066
Total assets	$ 135,314	$ 140,444
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade accounts payable	$ 33,443	$ 27,433
Accrued liabilities:		
Advertising and promotion	7,132	11,196
Salaries, benefits, and payroll taxes	3,311	7,258
Warranty and customer returns	9,300	9,950
Income taxes	-	1,370
Other	6,853	6,479
Current portions of capital lease obligations	156	147
Total current liabilities	60,195	63,833

Revolving credit facility	33,300	32,000
Capitalized lease obligations, less current portion	1,910	1,978
Total long-term debt	35,210	33,978
Deferred income taxes	4,011	4,011
Total liabilities	99,416	101,822
Commitments and contingencies (Note 3)	-	-
Shareholders' equity:		
Common shares, at stated value	215	214
Additional paid-in capital	45,078	44,167
Retained earnings	69,245	70,489
	114,538	114,870
Less treasury shares, at cost (12,837,600 and 12,365,700 shares at June 30, 2002 and December 31, 2001, respectively)	(78,640)	(76,248)
Total shareholders' equity	35,898	38,622
Total liabilities and shareholders' equity	$ 135,314	$ 140,444

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 OPERATIONS
(Unaudited)
(Dollars in thousands, except per share amounts)

	Three Months Ended June 30,		Six Mon Jun
	2002	2001	2002
Net sales	$ 89,390	$ 79,512	$ 180,554
Cost of sales	73,046	64,243	145,862
Gross margin	16,344	15,269	34,692

Selling, general and administrative expenses	18,095	15,662	35,844
(Loss) income from operations	(1,751)	(393)	(1,152)
Interest expense, net	291	484	619
Receivable securitization and other expense, net	12	200	153
(Loss) income before income taxes	(2,054)	(1,077)	(1,924)
Income tax (benefit) expense	(725)	(369)	(680)
Net (loss) income	$ (1,329)	$ (708)	$ (1,244)
BASIC			
Weighted average number of common shares outstanding (in thousands)	13,049	13,812	13,146
(Loss) earnings per share	$ (0.10)	$ (0.05)	$ (0.09)
DILUTED			
Weighted average number of common shares and equivalents outstanding (in thousands)	13,049	13,812	13,146
(Loss) earnings per share	$ (0.10)	$ (0.05)	$ (0.09)

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)

	Six Months Ended June 30,	
	2002	2001
Cash flows from operating activities:		
Net (loss) income	$ (1,244)	$ 1,466
Adjustments to reconcile net (loss) income to net cash from operating activities:		

Depreciation and amortization	8,829	7,316
Compensatory effect of stock awards	555	275
Deferred income taxes	(478)	(562)
(Increase) decrease in assets:		
Trade accounts receivable, net	6,051	17,059
Inventories	(4,989)	(6,229)
Prepaid expenses and other	(989)	(83)
Other	(1,153)	(1,769)
Increase (decrease) in liabilities:		
Trade accounts payable	6,010	(3,291)
Accrued advertising and promotion	(4,064)	(3,816)
Accrued salaries, benefits, and payroll taxes	(3,947)	1,083
Accrued warranty and customer returns	(650)	(200)
Accrued income taxes	(1,370)	(663)
Accrued other	374	(468)
Total adjustments	4,179	8,652
Net cash from operating activities	2,935	10,118
Cash flows from investing activities:		
Purchases of tooling, property, plant, and equipment, net	(6,199)	(5,653)
Decrease (increase) in tooling deposits and other	2,604	(2,292)
Net cash from investing activities	(3,595)	(7,945)
Cash flows from financing activities:		
Proceeds (payments) on bank debt, net	1,300	(1,100)
Proceeds from exercise of stock options	356	7
Payments on capital lease obligations	(59)	(66)
Repurchase of common stock	(2,392)	(553)
Net cash from financing activities	(795)	(1,712)
Net (decrease) increase in cash	(1,455)	461
Cash at beginning of period	3,421	704
Cash at end of period	$ 1,966	$ 1,165
Supplemental disclosure of cash flow information: Cash payments for:		
Interest	$ 691	$ 1,389
Income taxes, net of refunds	$ 1,169	$ 2,054

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 statements of financial position as of June 30, 2002 and December 31, 2001, and the related statements of operations and cash flows as of, and for the interim periods ended, June 30, 2002 and 2001. These condensed financial statements should 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 six month periods ended June 30, 2002, 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 of America requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates. Significant estimates include the allowance for doubtful accounts, the reserve for returns and allowances, reserve for inventory obsolescense and depreciation and amortization, among others.

Certain prior year amounts have been reclassified to conform to the 2002 presentation.

Net (loss) income per common 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 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."

In fiscal 2001, the Emerging Issues Task Force ("EITF") issued EITF No. 00-14, "Accounting for Certain Sales Incentives," and EITF No. 00-25, "Vendor Income Statement Characterization of Consideration to a Purchaser of the Vendor's Products or Services." These pronouncements address the recognition, measurement and statement of operations classification for certain sales incentives and are effective January 1, 2002. The Company adopted these pronouncements in the first quarter of fiscal 2002 and as a result certain items previously included in selling, general and administrative expenses were reclassified as a reduction of net sales. Additionally, prior period amounts were reclassified to conform to the new requirements. The impact of these two issues resulted in a reduction of net sales of $891 and $935 for the quarters ended June 30, 2002 and 2001, respectively and $1,589 and $2,397 for the six-month periods ended June 30, 2002 and 2001, respectively. These amounts, consisting principally of promotional allowances to the Company's retail customers, were previously recorded as selling, general and administrative expenses; therefore, there was no impact to net income or loss for either period.

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

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.

NOTE 1: BASIS OF PRESENTATION (CONTINUED)

The Company has used 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. Outstanding as of June 30, 2002 and December 31, 2001 were $990 and $0, respectively, in contracts to purchase foreign currency forward. There is no significant unrealized gain or loss on these contracts. All contracts have terms of three months or less.

Costs incurred for producing and communicating advertising are expensed during the period aired, including costs incurred under the Company's cooperative advertising program.

NOTE 2: INVENTORIES

Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) method. Inventories at June 30, 2002, and December 31, 2001, consisted of the following:

	June 30	December 31
Finished goods	$48,907	$43,277

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

Work in process and purchased parts	6,889	7,530
	$55,796	$50,807

NOTE 3: COMMITMENTS AND CONTINGENCIES

At June 30, 2002, the Company estimates having contractual commitments for future advertising and promotional expense of approximately $9,000 including commitments for television advertising through December 31, 2002. Other contractual commitments for items in the normal course of business total approximately $2,900.

The Company is self-insured with respect to workers' compensation benefits in Ohio and carries excess workers' compensation insurance covering aggregate claims exceeding $350 per occurrence.

NOTE 3: COMMITMENTS AND CONTINGENCIES (CONTINUED)

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 Complaint asserts that the Company's Dirt Devil Easy Steamer infringes three utility patents and two design patents held by Hoover, and also that the Easy Steamer design infringes the trade dress of Hoover's carpet extractor products. Recently, the Court has dismissed charges of infringement against Royal regarding one of the three utility patents, and has found that the Dirt Devil Easy Steamer infringes one claim of a second utility patent. The Court refused to grant summary judgment of infringement regarding the third utility patent, and also reserved judgment as to the validity of both of the remaining utility patents. Royal has motions currently pending to dismiss the charges of infringement of the design patents and the trademark claims. The trial date of November 4, 2002, has been established. Hoover seeks damages, injunction on future production, and legal fees. The Company is vigorously defending the suit and believes it is without merit. In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies", a loss is reasonably possible, however, no range of potential loss can be estimated at this time. If Hoover were to prevail on all its remaining claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:01cv 2775), against The Hoover Company (Hoover) on December 10, 2001, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that Hoover infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 0338), against Bissell Homecare, Inc. (Bissell) on February 22, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that Bissell infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

Bissell Homecare, Inc. (Bissell) filed a lawsuit in federal court, in the Eastern District of Michigan (case #02cv71079), against the Company on March 20, 2002, under the patent, trademark, and unfair competition laws of the United States. On April 25, 2002, the Company filed a motion to transfer the case from the Eastern District of Michigan to the Northern District of Ohio. On June 19, 2002, the Court transferred the case (now #1:02cv 1358) to the Northern District of Ohio. The Complaint asserts that the Company's Dirt Devil Easy Steamer and Platinum Force Extractor products infringe certain design and utility patents held by Bissell. Bissell seeks damages, injunction on future production, and legal fees. The Company is vigorously defending the suit and believes it is without merit. If Bissell were to prevail on all its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

Black & Decker Inc. and Black & Decker (U.S.) Inc. (B&D) filed a lawsuit in federal court, Northern District of Illinois (case #02C 1765) against the Company on March 8, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that the Company's Roommate and Touch-Up vacuum cleaners infringe upon certain patents held by B&D. The Company settled this suit with a payment of $300,000 during the quarter ended June 30, 2002 with a remaining $300,000 due in January 2003. Under the settlement the Company has the right to continue to sell the products through the third quarter of 2003.

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

NOTE 3: COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 1127), against White Consolidated, Ltd. (Eureka) on June 14, 2002, under the patent, trademark and unfair competition laws of the United Sates. The Complaint asserts that Eureka infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

The Company is involved in various other claims and litigation arising in the normal course of business. The Company has product liability and general liability insurance policies in amounts management believes to be reasonable. There can be no assurance, however, that such insurance will be adequate to cover all potential product or other liability claims against the Company. 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 4: DEBT

At June 30, 2002, the Company has a collateralized revolving credit facility with availability of up to $70,000 and a maturity date of April 1, 2005. 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 June 30, 2002. The revolving credit facility is collateralized by the assets of the Company. As long as the Company remains in compliance with all covenants, the revolving credit facility permits share repurchases and dividends based on a defined formula up to $19,970 as of June 30, 2002.

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 is $30,000, seasonally adjusted to $35,000 from September to December. At June 30, 2002, the Company had received approximately $17,300 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 $277 and $645 for the six months ended June 30, 2002 and 2001, respectively, and have been classified as "Receivable securitization and other expense, 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. The Company is required to maintain certain financial ratios associated with the receivables included within the program. The Company received a waiver from the bank with respect to non-compliance with delinquency ratios related to receivables included within the program for June and July 2002.

NOTE 5: 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 August 9, 2002, the Company has repurchased approximately 1,322 shares for an aggregate purchase price of approximately $6,900 under the program that is scheduled to expire in December 2002.

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

NOTE 6: 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 June 30,		Six months end June 30,	
	2002	2001	2002	20
Net (loss) income	$ (1,329)	$ (708)	$ (1,244)	$ 1
BASIC:				
Common shares outstanding, net of treasury shares, beginning of period	13,017	13,729	13,464	13
Weighted average common shares issued during period	37	166	35	
Weighted average treasury shares repurchased during period	(5)	(83)	(353)	
Weighted average common shares outstanding, net of treasury shares, end of period	13,049	13,812	13,146	13
Net (loss) income per common share	$ (0.10)	$ (0.05)	$ (0.09)	$
DILUTED:				
Common shares outstanding, net of treasury shares, beginning of period	13,017	13,729	13,464	13
Weighted average common shares issued during period	37	166	35	
Weighted average common share equivalents	-	-	-	
Weighted average treasury shares repurchased during period	(5)	(83)	(353)	
Weighted average common shares outstanding, net of treasury shares, end of period	13,049	13,812	13,146	14
Net (loss) income per common share	$ (0.10)	$ (0.05)	$ (0.09)	$

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

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

NOTE 7: RELATED PARTY NOTE RECEIVABLE:

On April 2, 2001, the Company and its Chief Executive Officer (Officer) entered into a Promissory Note Agreement in the principal amount of approximately $543. The non-interest bearing note was used by the Officer to fund the exercise of stock options to purchase 167 common shares of the Company. The promissory note is due and payable in full on April 2, 2008 or, if earlier, within twelve months after the Officer's voluntary termination of employment with the Company. The Officer simultaneously entered into a Stock Pledge Agreement with the Company pledging the 167 common shares as security for the promissory note.

NOTE 8: BUSINESS SEGMENT INFORMATION

The Company has two reportable segments: Consumer Products - Floorcare and Consumer Products - Other. The operations of the Consumer Products - Floorcare segment includes the design, assembly or sourcing, marketing and distribution of a full line of plastic and metal vacuum cleaners. The primary brand names associated with this segment include Dirt Devil and Royal. These products are sold primarily to major mass merchant retailers and independent dealers in North America. The operations of the Consumer Products - Other segment represents business conducted by Privacy Technologies, Inc. and Product Launch Partners, Inc., both of which are wholly owned subsidiaries of the Company. Currently, the primary product line within this segment is the TeleZapper, a telephone attachment that helps reduce unwanted computer-dialed telemarketing calls. These products are sold primarily to major mass merchant retailers and national electronic chains in North America. In August of 2002, the Company licensed the TeleZapper intellectual property to a phone manufacturer for the inclusion in telephones and answering machines.

The Company's reportable segments are distinguished by the nature of products sold. The Company evaluates performance and allocates resources to reportable segments primarily based on net sales and operating income. The accounting policies of the reportable segments are the same as those described in Note 1, the accounting policies footnote. The Company records its federal and state tax assets and liabilities at corporate. There are no intersegment sales.

NOTE 8: BUSINESS SEGMENT INFORMATION (CONTINUED)

Financial information for the Company's Reportable Segments consisted of the following:

	Three months ended June 30,		Six months ended June 30	
	2002	2001	2002	2001
Net Sales				

Consumer Products - Floorcare	$ 82,788	$ 79,512	$ 166,016	$ 182,572
Consumer Products - Other	6,602	-	14,538	-
Consolidated Total	$ 89,390	$ 79,512	$ 180,554	$ 182,572
(Loss) income from Operations				
Consumer Products - Floorcare	$ 312	$ (393)	$ (744)	$ 4,232
Consumer Products - Other	(2,063)	-	(408)	-
Consolidated Total	$ (1,751)	$ (393)	$ (1,152)	$ 4,232
Capital Expenditures				
Consumer Products - Floorcare	$ 1,197	$ 2,360	$ 3,068	$ 4,420
Consumer Products - Other	50	50	50	62
Total for Reportable Segments	1,247	2,410	3,118	4,482
Corporate	191	1,832	477	3,463
Consolidated Total	$ 1,438	$ 4,242	$ 3,595	$ 7,945
Depreciation and Amortization				
Consumer Products - Floorcare	$ 3,380	$ 2,934	$ 6,479	$ 5,951
Consumer Products - Other	153	67	258	67
Total for Reportable Segments	3,533	3,001	6,737	6,018
Corporate	1,029	702	2,092	1,298
Consolidated Total	$ 4,562	$ 3,703	$ 8,829	$ 7,316
Total Assets				
Consumer Products - Floorcare	$ 107,366	$ 111,909	$ 107,366	$ 111,909
Consumer Products - Other	5,299	1,200	5,299	1,200
Total for Reportable Segments	112,665	113,109	112,665	113,109
Corporate	22,649	18,192	22,649	18,192
Consolidated Total	$ 135,314	$ 131,301	$ 135,314	$ 131,301

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of its financial position and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Financial Reporting Release No. 60, which was recently issued by the Securities and Exchange Commission ("SEC"), requires all registrants, including the Company, to include a discussion of "Critical" accounting policies or methods used in the preparation of financial statements. Management believes that the critical accounting policies and areas that require the most significant judgments and estimates to be used in the preparation of the consolidated financial statements are revenue recognition including customer based programs and incentives, allowance for doubtful accounts, useful lives of tooling and other long lived assets and accrued warranty and customer returns.

Revenue Recognition - The Company's revenue recognition policy is to recognize revenues when products are shipped. All sales are final upon shipment of product to the customer. The Company records estimated reductions to net sales for customer programs and incentive offerings including pricing arrangements, promotions and other volume based incentives. If market conditions were to soften, the Company may take actions to increase customer incentives, possibly resulting in a reduction of net sales and gross margins at the time the incentive is offered.

Allowance for Doubtful Accounts - The Company maintains an allowance for trade accounts receivable for which collection on specific customer accounts is doubtful. In determining collectibility, management reviews available customer financial statement information, credit rating reports as well as other external documents and public filings. When it is deemed probable that a specific customer account is uncollectible, that balance is included in the reserve calculation. Actual results could differ from these estimates under different assumptions.

Useful Lives of Tooling - The Company capitalizes the cost of tooling used in the production of its products by third party suppliers and global contract manufacturers. The tooling is depreciated on a straight-line basis over 2-4 years, based on the nature of the product and the estimated product life cycle. The useful lives are reviewed on a quarterly basis by management and useful lives may be shortened if needed. In determining whether or not shortening of useful lives is required, management reviews sell-through data at retail, forecast demand and the timeframe of new product introductions.

Accrued Warranty and Customer Returns - 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 reserve is maintained for future returns from current shipments. Management calculates the reserve utilizing historical return rates by product family. These rates are reviewed and adjusted periodically. Management utilizes judgment for estimating return rates of new products and adjusts those estimates as actual results become available.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (CONTINUED)

RESULTS OF OPERATIONS

Net sales increased 12.4% for the second quarter and decreased 1.1% for the six-month period ended June 30, 2002, compared with the same periods in the prior year. The increase in the second quarter net sales was primarily due to shipments of the TeleZapper, which was introduced in the third quarter of 2001. The decrease in net sales for the six months ended June 30, 2002 was primarily due to lower shipments of carpet extractors and lower average wholesale prices on floorcare products, partially offset by shipments of the TeleZapper. Overall sales to the top 5 customers (all of which are major retailers) decreased in the first six months of 2002, both in terms of dollars and as a percentage of total net sales, accounting for approximately 69.6% as compared with approximately 74.5% in the first six months of 2001. The Company believes that its dependence on sales to its largest customers will continue. Recently, several major retailers have experienced significant financial difficulties and some, including Kmart, have filed for protection from creditors under applicable bankruptcy laws. As of June 30, 2002, the net exposure related to Kmart as well as other customer balances for which management believes that collection is doubtful was included in the calculation of allowance for doubtful accounts. The Company sells its products to certain customers that are in bankruptcy proceedings.

Gross margin, as a percent of net sales, decreased from 19.2% for the second quarter 2001 to 18.3% in the second quarter 2002, and decreased from 20.0% for the six months ended June 30, 2001 to 19.2% for the six months ended June 30, 2002. The gross margin percentage was negatively affected in 2002 by lower average wholesale selling prices on the Company's floorcare products due to continued heightened competition. This negative impact on gross margins was partially offset by favorable TeleZapper margins, lower floorcare product returns and lower costs on certain products.

Selling, general and administrative expenses increased 15.5% for the second quarter of 2002 and increased 11.3% for the six-month period ended June 30, 2002, compared with the same periods in 2001. The increase in selling, general and administrative expenses for 2002 was primarily due to increases in advertising and promotional expenditures related to TeleZapper, employee related benefit expenses, professional services associated with litigation and depreciation expense associated with recent upgrades to the Company's information technology.

Interest expense decreased 39.9% for the second quarter 2002, and decreased 49.4% for the six-month period ended June 30, 2002 compared to the same periods in 2001. The decrease in interest expense is the result of lower effective borrowing rates and lower levels of variable rate borrowings to finance working capital, capital expenditures and share repurchases.

Receivable securitization and other expense, 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 a loss before income taxes for the second quarter and six-month period ended June 30, 2002 of $(2,054) and $(1,924), respectively, compared to a loss before income taxes for the second quarter 2001 and income before income taxes for the six-month period ended June 30, 2001 of $(1,077) and $2,294, respectively.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (CONTINUED)

LIQUIDITY AND CAPITAL RESOURCES

The Company used cash generated from operations during the quarter ended June 30, 2002 to fund its capital expenditures and share repurchases. Working capital was $35,154 at June 30, 2002, an increase of 7.9% over December 31, 2001. Current assets decreased by $1,050 reflecting in part a decrease in trade accounts receivable of $6,051, and a $1,455 decrease in cash, substantially offset by an increase in inventory of $4,989, and a $989 increase in prepaid expenses and other. Current liabilities decreased by $3,638, reflecting in part a $4,064 decrease in accrued advertising and promotion, a $3,947 decrease in accrued salaries, benefits, and payroll taxes and a $1,370 decrease in accrued income taxes, partially offset by an increase of $6,010 in accounts payable.

In the first six months of 2002, the Company utilized $3,595 of cash for capital expenditures, including approximately $1,100 of tooling related to a new bagged upright and approximately $1,600 of tooling for various other floorcare products.

At June 30, 2002, the Company had a collateralized revolving credit facility with availability of up to $70,000 and a maturity date of April 1, 2005. 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 June 30, 2002. The revolving credit facility is collateralized by the assets of the Company. As long as the Company remains in compliance with all covenants, the revolving credit facility permits share repurchases and dividends based on a defined formula up to $19,970 as of June 30, 2002.

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 is $30,000, seasonally adjusted to $35,000 from September to December. At June 30, 2002, the Company had received approximately $17,300 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 $277 and $645 for the six months ended June 30, 2002 and 2001, respectively, and have been classified as "Receivable securitization and other expense, 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. The Company is required to maintain certain financial ratios associated with the receivables included within the program. The Company received a waiver from the bank with respect to non-compliance with delinquency ratios related to receivables included within the program for June and July 2002.

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 August 9, 2002, the Company has repurchased approximately 1,322 shares for an aggregate purchase price of approximately $6,900 under the program that is scheduled to expire in December 2002.

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 current repurchase program.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (CONTINUED)

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. Certain prior period amounts have been reclassified to conform to current period presentation (See Note 1 to Notes to Consolidated Financial Statements).

	Three Months Ended				
	June 30, 2002	March 31, 2002	Dec. 31, 2001	Sept. 30, 2001	June 30, 2001
Net sales	$ 89,390	$ 91,164	$127,236	$111,503	$ 79,512
Gross margin	16,344	18,348	32,663	26,461	15,269
Net (loss) income	(1,329)	85	3,773	4,085	(708)
Net (loss) income per share - diluted(a)	$ (0.10)	$ 0.01	$ 0.27	$ 0.29	$ (0.05)

(a) The sum of 2001 quarterly net income (loss) per common share does not equal annual net income per common share due to the change in the weighted average number of common shares outstanding due to share repurchases.

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 and other holiday shopping seasons. 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.

OTHER

The Company's Consumer Products - Floorcare business segment's most significant competitors are Hoover, Eureka and Bissell in the upright vacuum and carpet shampooer markets and, Black & Decker and Euro Pro in the hand-held market. Many of these competitors and several others are subsidiaries or divisions of companies that are more diversified and have greater financial resources than the Company. 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 experiences extensive competition, including price pressure and increased advertising by its competitors, in all product lines within the Consumer Products - Floorcare segment. These trends are expected to continue throughout 2002.

The Company's Consumer Products - Other business segment competes with a variety of other consumer products and services. In addition to various state "do not call" lists, the Federal Trade Commission is proposing a national "do not call" list that may have an impact on the sales of the TeleZapper. In August of 2002, the Company licensed the TeleZapper intellectual property to a phone manufacturer for the inclusion in telephones and answering machines.

During the first quarter of 2002, the Company announced a licensing arrangement with The Proctor and Gamble Company for the rights to a new carpet cleaning system. The initial marketing plan for the product has been scaled back, resulting in the Company seeking very limited retail distribution in 2002.

INFLATION

The Company does not believe that inflation by itself 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.

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 Complaint asserts that the Company's Dirt Devil Easy Steamer infringes three utility patents and two design patents held by Hoover, and also that the Easy Steamer design infringes the trade dress of Hoover's carpet extractor products. Recently, the Court has dismissed charges of infringement against Royal regarding one of the three utility patents, and has found that the Dirt Devil Easy Steamer infringes one claim of a second utility patent. The Court refused to grant summary judgment of infringement regarding the third utility patent, and also reserved judgment as to the validity of both of the remaining utility patents. Royal has motions currently pending to dismiss the charges of infringement of the design patents and the trademark claims. The trial date of November 4, 2002, has been established. Hoover seeks damages, injunction on future production, and legal fees. The Company is vigorously defending the suit and believes it is without merit. In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies", a loss is reasonably possible, however, no range of potential loss can be estimated at this time. If Hoover were to prevail on all its remaining claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:01cv 2775), against The Hoover Company (Hoover) on December 10, 2001, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that Hoover infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 0338), against Bissell Homecare, Inc. (Bissell) on February 22, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that Bissell infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

Bissell Homecare, Inc. (Bissell) filed a lawsuit in federal court, in the Eastern District of Michigan (case #02cv71079), against the Company on March 20, 2002, under the patent, trademark, and unfair competition laws of the United States. On April 25, 2002, the Company filed a motion to transfer the case from the Eastern District of Michigan to the Northern District of Ohio. On June 19, 2002, the Court transferred the case (now #1:02cv 1358) to the Northern District of Ohio. The Complaint asserts that the Company's Dirt Devil Easy Steamer and Platinum Force Extractor products infringe certain design and utility patents held by Bissell. Bissell seeks damages, injunction on future production, and legal fees. The Company is vigorously defending the suit and believes it is without merit. If Bissell were to prevail on all its claims, it could have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

Black & Decker Inc. and Black & Decker (U.S.) Inc. (B&D) filed a lawsuit in federal court, Northern District of Illinois (case #02C 1765) against the Company on March 8, 2002, under the patent, trademark, and unfair competition laws of the United States. The Complaint asserts that the Company's Roommate and Touch-Up vacuum cleaners infringe upon certain patents held by B&D. The Company settled this suit with a payment of $300,000 during the quarter ended June 30, 2002 with a remaining $300,000 due in January 2003. Under the settlement the Company has the right to continue to sell the products through the third quarter of 2003.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (CONTINUED)

LITIGATION (CONTINUED)

The Company filed a lawsuit in federal court, in the Northern District of Ohio (case #1:02cv 1127), against White Consolidated, Ltd. (Eureka) on June 14, 2002, under the patent, trademark and unfair competition laws of the United Sates. The Complaint asserts that Eureka infringes certain patents relating to bagless technology held by the Company. The Company seeks damages, injunction on future production, and legal fees.

The Company is involved in various other claims and litigation arising in the normal course of business. The Company has product liability and general liability insurance policies in amounts management believes to be reasonable. There can be no assurance, however, that such insurance will be adequate to cover all potential product or other liability claims against the Company. 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.

ACCOUNTING STANDARDS

In fiscal 2001, the Emerging Issues Task Force ("EITF") issued EITF No. 00-14, "Accounting for Certain Sales Incentives," and EITF No. 00-25, "Vendor Income Statement Characterization of Consideration to a Purchaser of the Vendor's Products or Services." These pronouncements address the recognition, measurement and statement of operations classification for certain sales incentives and are effective January 1, 2002. The Company adopted these pronouncements in the first quarter of fiscal 2002 and as a result certain items previously included in selling, general and administrative expenses were reclassified as a reduction of net sales. Additionally, prior period amounts were reclassified to conform to the new requirements. The impact of these two issues resulted in a reduction of net sales of $891 and $935 for the quarters ended June 30, 2002 and 2001, respectively and $1,589 and $2,397 for the six-month periods ended June 30, 2002 and 2001, respectively. These amounts, consisting principally of promotional allowances to the Company's retail customers, were previously recorded as selling, general and administrative expenses; therefore, there was no impact to net income or loss for either period.

The Company expects that the implementation of the above standards will not have a material impact on its consolidated financial position, results of operations or cash flows.

FORWARD-LOOKING STATEMENTS

Forward-looking statements in this Form 10Q 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: the financial strength of the retail industry particularly in the major mass retail channel; the impact of Kmart's recent bankruptcy filing on Royal's future sales and earnings; the impact of an adverse outcome in any of the patent infringement cases; the competitive pricing and aggressive product development environment within the floorcare 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 continued acceptance by consumers of the Company's new products, including the Company's bagless uprights, carpet shampooers, Carpet CPR(TM) 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; the uncertainty of the Company's global suppliers to continuously supply sourced finished goods and component parts; and general business and economic conditions.

PART II - OTHER INFORMATION

ITEM 4 - Submission of Matters to a Vote of Security Holders

(a) The Company's annual meeting of shareholders was held April 25, 2002,

(b) At the annual meeting, the Company's shareholders elected Messrs. Jack Kahl Jr., Michael J. Merriman, and John P. Rochon, as Class I Directors for a two-year term which expires at the annual shareholders meeting in 2004.

The term of office of Messrs. R. Louis Schneeberger, E. Patrick Nalley and Joseph B. Richey II, the Class II Directors, continued after the 2002 meeting; such term expires at the annual shareholders meeting in 2003.

(c) At the annual meeting, the Company's shareholders ratified the appointment of PricewaterhouseCoopers L.L.P. as auditors of the Company for 2002. The holders of 11,664,172 common shares voted to ratify the appointment, the holders of 169,579 common shares voted against the ratification, and the holders of 9,938 common shares abstained.

The following tabulation represents voting for the Class I Directors

Name	FOR	WITHHELD AUTHORITY
Jack Kahl	11,751,759	91,930
Michael J. Merriman	11,750,259	93,430
John P. Rochon	11,734,891	108,798

(d) Not applicable

ITEM 6 - Exhibits and Reports on Form 8-K

The Exhibits filed herewith are set forth on the Index to Exhibits filed as part of this report.

Forms 8-K - None

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

None

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: August 12, 2002

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

INDEX TO EXHIBITS

		PAGE NUMBER
10(q)	Royal Appliance Phantom Stock Plan dated February 11, 2002	
10(r)	Royal Appliance Phantom Stock Plan for Directors dated April 25, 2002	
99.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
99.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	