

IMPERIAL INDUSTRIES INC  
Form 10-Q  
November 14, 2008

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

**ý QUARTERLY REPORT PURSUANT TO SECTIONS 13 OR 15 (d) OF THE  
SECURITIES EXCHANGE ACT OF 1934.**

**For the quarterly period ended September 30, 2008**

**OR**

**“ 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 1-7190**

\_\_\_\_\_  
**IMPERIAL INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

\_\_\_\_\_  
**Delaware** **65-0854631**  
(State or Other Jurisdiction (I.R.S. Employer  
of Incorporation) Identification No.)  
**3790 Park Central Boulevard North, Pompano Beach FL 33064**

(Address of principal executive offices) (Zip Code)

**(954) 917-4114**

Registrant's telephone number, including area code

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

Large accelerated filer  Accelerated filer  Smaller reporting company

Non-accelerated filer  (Do not check if a smaller reporting company)

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

Indicate the number of shares of Imperial Industries, Inc. Common Stock (\$.01 par value) outstanding as of November 12, 2008: 2,517,335.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

**Page No.**

**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

3

Consolidated Balance Sheets

September 30, 2008 (Unaudited) and December 31, 2007

3

Consolidated Statements of Operations (Unaudited)

Nine Months and Three Months Ended September 30, 2008 and 2007

4

Consolidated Statements of Cash Flows (Unaudited)

Nine Months Ended September 30, 2008 and 2007

5

Notes To Consolidated Financial Statements (Unaudited)

7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

19

Item 4. Controls and Procedures

27

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings

28

Item 1A. Risk Factors

28

Item 6. Exhibits

30

SIGNATURES

31

- 2 -

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**PART I. FINANCIAL INFORMATION****Item 1.****Financial Statements****IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

|   | <b>September 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---|-------------------------------|------------------------------|
| ASSETS                                      | (Unaudited)                   |                              |
| Current assets:                             |                               |                              |
| Cash and cash equivalents                   | \$ 529,000                    | \$ 1,007,000                 |
| Restricted cash                             | 179,000                       | 157,000                      |
| Trade accounts receivable, net              | 5,988,000                     | 5,069,000                    |
| Inventories                                 | 5,674,000                     | 4,583,000                    |
| Deferred income taxes                       |                               | 1,023,000                    |
| Income tax receivable                       | 1,126,000                     | 884,000                      |
| Other current assets                        | 619,000                       | 537,000                      |
| Total current assets                        | 14,115,000                    | 13,260,000                   |
| Property, plant and equipment, at cost, net | 6,148,000                     | 6,376,000                    |
| Other assets                                | 483,000                       | 564,000                      |
| Total assets                                | \$ 20,746,000                 | \$ 20,200,000                |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                               |                              |
| Current liabilities:                        |                               |                              |
| Accounts payable                            | \$ 4,452,000                  | \$ 1,578,000                 |
| Accrued expenses and other liabilities      | 1,167,000                     | 1,416,000                    |
| Payable to former preferred stockholders    | 82,000                        | 82,000                       |
| Deferred gain                               |                               | 127,000                      |
| Notes payable - line of credit              | 4,651,000                     |                              |
| Current portion of long-term debt           | 1,231,000                     | 965,000                      |
| Total current liabilities                   | 11,583,000                    | 4,168,000                    |
| Long-term debt, less current maturities     | 1,472,000                     | 2,343,000                    |

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|   |               |               |
|---|---------------|---------------|
| Notes payable line of credit              |               | 1,135,000     |
| Deferred income taxes                     |               | 329,000       |
| Deferred compensation                     | 282,000       | 284,000       |
| Total liabilities                         | 13,337,000    | 8,259,000     |
| Commitments and contingencies             |               |               |
| Stockholders equity:                      |               |               |
| Common stock                              | 25,000        | 25,000        |
| Additional paid-in capital                | 14,760,000    | 14,696,000    |
| Accumulated deficit                       | (7,376,000 )  | (2,780,000 )  |
| Total stockholders equity                 | 7,409,000     | 11,941,000    |
| Total liabilities and stockholders equity | \$ 20,746,000 | \$ 20,200,000 |

See accompanying notes to consolidated financial statements.

## IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

|   | Nine Months Ended |               | Three Months Ended |               |
|---|-------------------|---------------|--------------------|---------------|
|   | September 30,     |               | September 30,      |               |
|   | 2008              | 2007          | 2008               | 2007          |
| Net Sales                                       | \$ 32,157,000     | \$ 43,941,000 | \$ 11,182,000      | \$ 13,834,000 |
| Cost of Sales                                   | 23,930,000        | 31,315,000    | 8,786,000          | 10,008,000    |
| Gross profit                                    | 8,227,000         | 12,626,000    | 2,396,000          | 3,826,000     |
| Selling, general and<br>administrative expenses | 12,947,000        | 12,466,000    | 4,062,000          | 3,965,000     |
| Operating (loss) income                         | (4,720,000 )      | 160,000       | (1,666,000 )       | (139,000 )    |
| Other income (expense):                         |                   |               |                    |               |
| Interest expense                                | (328,000 )        | (329,000 )    | (125,000 )         | (105,000 )    |
| Gain on litigation settlement                   |                   | 183,000       |                    |               |
| Miscellaneous income (expense)                  | 67,000            | 129,000       | (19,000 )          | 36,000        |
|   | (261,000 )        | (17,000 )     | (144,000 )         | (69,000 )     |
| (Loss) income before income<br>taxes            | (4,981,000 )      | 143,000       | (1,810,000 )       | (208,000 )    |
| Income tax benefit                              | 385,000           | 14,000        |                    | 136,000       |
| Net (loss) income                               | \$ (4,596,000 )   | \$ 157,000    | \$ (1,810,000 )    | \$ (72,000 )  |
| Net (loss) income per common<br>share - basic   | \$ (1.83 )        | \$ .06        | \$ (.72 )          | \$ (.03 )     |
| Net (loss) income per common<br>share - diluted | \$ (1.83 )        | \$ .06        | \$ (.72 )          | \$ (.03 )     |

|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Weighted average shares<br>outstanding - basic   | 2,515,601 | 2,511,181 | 2,517,335 | 2,514,002 |
| Weighted average shares<br>outstanding - diluted | 2,515,601 | 2,536,046 | 2,517,335 | 2,514,002 |

See accompanying notes to consolidated financial statements.



## IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

|  | Nine Months Ended<br>September 30, |            |
|--|------------------------------------|------------|
|  | 2008                               | 2007       |
| Cash flows from operating activities:  |                                    |            |
| Net (loss) income  | \$ (4,596,000 )                    | \$ 157,000 |
| Adjustments to reconcile net (loss) income to net cash (used in)<br>provided<br>by operations: |                                    |            |
| Depreciation   | 945,000                            | 851,000    |
| Amortization   | 26,000                             | 34,000     |
| Provision for doubtful accounts  | 914,000                            | 550,000    |
| Provision for deferred income taxes  | 694,000                            | 239,000    |
| Loss (gain) on disposal of fixed assets  | 25,000                             | (2,000 )   |
| Gain on litigation settlement  |                                    | (183,000 ) |
| Share-based compensation   | 64,000                             |            |
| Deferred compensation  | (2,000 )                           | 73,000     |
| Gain on sale of assets   | (127,000 )                         | (637,000 ) |
| Changes in operating assets and liabilities  |                                    |            |
| Trade accounts receivable  | (1,833,000 )                       | 1,000      |
| Inventories  | (1,091,000 )                       | 576,000    |
| Other current assets   | (82,000 )                          | (287,000 ) |
| Other assets   | 55,000                             | (57,000 )  |
| Accounts payable   | 2,874,000                          | 319,000    |
| Accrued expenses and other liabilities   | (249,000 )                         | (240,000 ) |
| Income taxes receivable  | (242,000 )                         |            |
| Net cash (used in) provided by operations  | (2,625,000 )                       | 1,394,000  |
| Cash flows used in investing activities:   |                                    |            |
| Purchases of property, plant and equipment   | (633,000 )                         | (281,000 ) |
| Proceeds received from sale of property and equipment  | 55,000                             | 2,000      |
| Net cash used in investing activities  | (578,000 )                         | (279,000 ) |
| Cash flows provided by (used in) financing activities:   |                                    |            |

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|   |               |               |
|---|---------------|---------------|
| Proceeds from notes payable line of credit          | 36,752,000    | 45,781,000    |
| Repayments of notes payable line of credit          | (33,236,000 ) | (47,019,000 ) |
| Proceeds from exercise of stock options             |               | 7,000         |
| Repayment of long-term debt, net                    | (769,000 )    | (710,000 )    |
| (Decrease) increase in restricted cash              | (22,000 )     | 703,000       |
| Net cash provided by (used in) financing activities | 2,725,000     | (1,238,000 )  |
| Net decrease in cash and cash equivalents           | (478,000 )    | (123,000 )    |
| Cash and cash equivalents, beginning of period      | 1,007,000     | 850,000       |
| Cash and cash equivalents, end of period            | \$ 529,000    | \$ 727,000    |

See accompanying notes to consolidated financial statements.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(UNAUDITED)**

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2008</b>                                | <b>2007</b> |
| Supplemental disclosure of cash flow information: |  |             |
| Cash paid during the nine months for interest     | \$ 336,000                                 | \$ 329,000  |
| Cash paid during the nine months for income taxes | \$   | \$          |
| Non-cash transactions:                            |  |             |
| Equipment financed                                | \$ 164,000                                 | \$          |

See accompanying notes to consolidated financial statements.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**(1)**

**Interim Consolidated Financial Statements**

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments, consisting solely of normal recurring adjustments, considered necessary for a fair presentation, have been included. Operating results for the nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008 or for future periods. The significant accounting principles used in the preparation of these unaudited interim consolidated financial statements are the same as those used in the preparation of the annual audited consolidated financial statements. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2007.

**(2)**

**Description of Business**

Imperial Industries, Inc. ( Imperial ), and its wholly-owned subsidiaries, Just-Rite Supply, Inc. ( Just-Rite ), Premix-Marbletite Manufacturing Co. ( Premix ), DFH, Inc. ( DFH ), formerly known as Acrocrete, Inc., and Triple I Leasing, Inc., collectively with Imperial (the Company , we , us , and our ), are primarily involved in the manufacture and sale of exterior and interior finishing wall coatings and mortar products for the construction industry, as well as, the purchase and resale of building materials from other manufacturers. Sales of the Company's and other products are made to customers primarily in Florida and the Southeastern United States through independent distributors and Company-owned distribution facilities.

The consolidated financial statements contain the accounts of Imperial and its wholly-owned subsidiaries, Just-Rite, Premix, DFH and Triple I Leasing, Inc. All material intercompany transactions and balances have been eliminated in consolidation.

**(3)**

**Going Concern**

The accompanying unaudited consolidated financial statements have been prepared and are presented assuming the Company's ability to continue as a going concern. The industry in which the Company is operating has been impacted by a number of adverse factors over the past 27 months. As a result, the Company has incurred losses for the nine

months and three months ended September 30, 2008 and the year ended December 31, 2007. Our independent registered public accounting firm issued its report dated March 31, 2008 in connection with the audit of our financial statements as of December 31, 2007 that included an explanatory paragraph describing the existence of conditions that raise substantial doubt about our ability to continue as a going concern.

The accompanying unaudited consolidated financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result from the outcome of this uncertainty.

In order to address the need to satisfy that Company's continuing obligations and realize its long term strategy, management has implemented various strategic initiatives and is considering additional alternatives to improve its operating and financial results, which we believe will be sufficient to provide the Company with the ability to continue as a going concern, including the following:

.

We began selling a broader range of products in certain facilities with the objectives of generating more sales from existing customers and attracting new customers. As a result, we have invested in inventory and new sales personnel in an effort to gain these additional new product sales to improve operating results. We have been successful with these initiatives at some of the Company's facilities. However, economic conditions have continued to deteriorate and, as a result, management determined to close certain poorly performing facilities to decrease costs and reduce inventories to improve working capital.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

We are continuing to evaluate and implement cost reduction initiatives to reduce unnecessary costs in our operations and close underperforming facilities to conserve working capital.

We have implemented more stringent credit and collection procedures and controls in an attempt to reduce days outstanding of trade accounts receivable and improve working capital.

We are seeking additional financing through the sale of real property, refinancing our existing mortgages on our real properties and through obtaining new mortgage financing from other lenders on our real properties to take advantage of what we believe is significant equity in these properties. In addition, we are seeking financing from other sources, including the possibility of refinancing our equipment, or the infusion of equity, to generate additional funds for operations and to take advantage of lower interest rates.

There is no assurance that we will be able to successfully complete any or all of the above actions because of the extended deterioration in construction market conditions due to unprecedented adverse economic conditions impacting our general economy.

(4)

**Reclassifications**

Certain prior period amounts have been reclassified to conform with the current year presentation.

(5)

**Recent Accounting Pronouncements**

In September 2006, FASB issued SFAS No. 157, Fair Value Measurements ( SFAS No. 157 ). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS No. 157 does not impose fair value measurements on items not already accounted for at fair value; rather it applies, with certain exceptions, to other accounting pronouncements that either require or permit fair value measurements. Under SFAS No. 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market. The standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In February 2008, the FASB issued FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 ( FSP FAS 157-2 ), which delays the effective date of SFAS No. 157 for all non-financial assets and

liabilities, except those that are recognized or disclosed at fair value in the consolidated financial statements on a recurring basis, until fiscal years beginning after November 15, 2008. These non-financial items include assets and liabilities such as non-financial assets and liabilities assumed in a business combination, reporting units measured at fair value in a goodwill impairment test and asset retirement obligations initially measured at fair value. The Company adopted the provisions of SFAS No. 157 for assets and liabilities recognized at fair value on a recurring basis effective January 1, 2008. The partial adoption of SFAS No. 157 did not have a material impact on the Company's consolidated financial statements. The Company does not expect the adoption of the remaining provisions of SFAS 157 to have a material effect on the Company's consolidated financial statements. This standard requires that a Company measure its financial assets and liabilities using inputs from the three levels of the fair value hierarchy. A financial asset or liability classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The three levels are as follows:

.  
Level 1 Inputs are unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

.  
Level 2 Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

.  
Level 3 Unobservable inputs reflect the Company's judgments about the assumptions market participants would use in pricing the asset or liability since limited market data exists. The Company develops these inputs based on the best information available, including the Company's own data.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

As of January 1, 2008 and September 30, 2008, the Company has no financial assets or liabilities that are measured at fair value.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The provisions of SFAS No. 159 were effective for the Company beginning January 1, 2008. The adoption of SFAS No. 159 did not have any impact on the Company's results of operations or financial position.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations and SFAS No. 160, Non-controlling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51. SFAS No. 141 (revised 2007) will change how business acquisitions are accounted for and will impact financial statements on both the acquisition date and in subsequent periods. SFAS No. 160 will change the accounting and reporting for minority interests, which will be re-characterized as non-controlling interests and classified as a component of equity. SFAS No. 141 (revised 2007) and SFAS No. 160 are effective for the Company beginning in the first quarter of 2009. Early adoption is not permitted. The Company is currently evaluating the impact that SFAS No. 141 (revised 2007) and SFAS No. 160 will have on its consolidated financial statements.

**(6)**

**Sale of Certain Assets and Closure of Facilities**

*(a)*

*Manufacturing Facility*

On July 25, 2005, DFH entered into an agreement with Degussa Wall Systems, Inc. and Degussa Construction Chemical Operations, Inc. (collectively now known as BASF Construction Chemicals, LLC) (BASF) to sell certain assets associated with its manufacturing facility in Kennesaw, Georgia (the BASF Sales Agreement). BASF acquired certain assets of DFH and its affiliate, Premix. The assets consisted of certain equipment, customer lists, trademarks, proprietary rights, including product formulas, code approvals and books and records associated with DFH's manufacturing operations in Kennesaw, Georgia (the Assets). DFH also agreed to cease the manufacture of products by December 31, 2005 that had been formerly used in exterior insulation finish wall systems (EIFS) applications and closed that facility shortly thereafter.

As part of the transaction, Just-Rite entered into a three-year distribution agreement with BASF (the Distribution Agreement) to sell products previously manufactured and sold by DFH and now manufactured by BASF. Just-Rite agreed to purchase at least \$16,000,000 of products manufactured by BASF under the Acrocrete brand name over the term of the Distribution Agreement. Because there were minimum purchase requirements the failure of which to reach would have required a refund of a portion of the purchase price, we recorded a deferred gain of \$1,035,000 on the sale to BASF. In the second quarter of 2007, we surpassed the minimum threshold and in the first quarter of 2008, we



surpassed the \$16,000,000 purchase requirement. We recognized income from the sale of the assets as a component of selling, general and administrative expenses of \$128,000 for the nine months ended September 30, 2008 and \$637,000 and \$349,000 for the nine and three months ended September 30, 2007, respectively.

(b)

*Distribution Facilities*

Due to the slowdown in the residential and commercial construction industry and related decline in demand for our product, we permanently closed three satellite distribution facilities in St. Augustine, Brooksville and Ocala, Florida in December 2007 and two distribution facilities in Panama City Beach, Florida and Norcross, Georgia in May 2008 and September 2008, respectively. As a result of these closures, we recorded closure costs of \$159,000 and \$560,000 in selling, general and administrative expenses and in accrued expenses and other liabilities at September 30, 2008 and December 31, 2007, respectively. At September 30, 2008, the balance remaining in accrued expenses and other liabilities was \$435,000. Additionally, we are closing the Tampa, Florida facility in November 2008, and we expect to incur approximately \$25,000 in additional closure costs during the fourth quarter of 2008.

## IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Costs incurred and the remaining accrual related to closing distribution facilities are as follows:

|                   | <b>Costs<br/>Accrued<br/>for the<br/>Year Ended<br/>December 31,<br/>2007</b> | <b>Add Costs<br/>Incurred<br/>During the<br/>Nine Months<br/>Ended<br/>September<br/>30,<br/>2008</b> | <b>Less Cash<br/>Payments<br/>During the<br/>Nine Months<br/>Ended<br/>September 30,<br/>2008</b> | <b>Remaining<br/>Accrual as<br/>of<br/>September<br/>30, 2008</b> |
|-------------------|---|---|---|---|
| Lease costs *     | \$ 552,000  | \$ 114,000  | \$ (259,000 )   | \$ 407,000  |
| Surplus equipment | 7,000   | 3,000   | (7,000 )  | 3,000   |
| Miscellaneous     | 1,000   | 42,000  | (18,000 )   | 25,000  |
|                   | <b>\$ 560,000</b>   | <b>\$ 159,000</b>   | <b>\$ (284,000 )</b>  | <b>\$ 435,000</b>   |

\*

Lease costs are expected to be incurred over the years 2008 through 2012 and are reduced by estimated sublease rental of \$232,000 over the years 2009 through 2012. Any adjustments to such estimates will be recorded in the period in which the Company becomes aware of such revisions.

(7)

### Trade Account Receivables

Trade accounts receivable consisted of the following at:

|                                 | <b>September 30,<br/>2008</b> | <b>December 31,<br/>2007</b> |
|---------------------------------|-------------------------------|------------------------------|
| Accounts receivable, gross *    | \$ 7,587,000                  | \$ 6,363,000                 |
| Allowance for doubtful accounts | (1,599,000 )                  | (1,294,000 )                 |
|                                 | <b>\$ 5,988,000</b>           | <b>\$ 5,069,000</b>          |

\*

Accounts receivable includes notes receivable due from customers of approximately \$667,000 with due dates ranging from June 2008 to September 2010 and interest rates ranging from 7% to 18%.

(8)

### **Inventories and Rebates**

Just-Rite has an arrangement with a buying group and certain vendors providing for inventory purchase rebates ( vendor rebates ) based principally upon achievement of certain volume purchasing levels during the year. Just-Rite accrues the estimated receipt of vendor rebates as a reduction of the cost of inventory purchases based on progress towards earning the vendor rebates taking into consideration cumulative purchases throughout the year.

We recorded vendor rebates in cost of sales of \$298,000 and \$81,000 for the nine and three months ended September 30, 2008, respectively, as compared to \$495,000 and \$142,000 in the same period in 2007. At September 30, 2008 and December 31, 2007, we recorded rebates in contra inventory accounts of \$6,000 and amounts due from vendors in other current assets of \$118,000 and \$261,000, respectively.

Inventories are valued at the lower of cost or market and cost is determined using the average cost basis. We record a provision to write down obsolete and slow moving inventory to estimated net realizable value when cost exceeds estimated net realizable value. The provision is determined by identifying obsolete and slow moving inventory by comparing quantity on hand to historical and projected sales activity. We also consider future sales and price levels at which certain high dollar inventory is expected to be sold in the normal course of business. This information is aggregated and the estimated provision is determined. Judgment is required in evaluating these factors and in determining the appropriate amounts to record in the provision. Accelerating the disposal process or incorrect estimates of future sales potential may cause the actual results to differ from the estimates at the time such inventory is disposed or sold. We believe that our procedures for estimating such amounts are reasonable and historically have not resulted in material adjustments in subsequent periods. However, if actual market conditions

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)**

are less favorable than those assumed by management, additional inventory write-downs may be required. As a result, our financial condition, results of operations and cash flow could be adversely affected.

Finished goods include the cost of raw materials, freight in, direct labor and plant overhead. The increase in finished goods inventory is due primarily to the build-up of new product offerings to position the Company to sell a broader range of products in 2008 and into 2009 in both the residential and commercial construction markets with the objective of generating more sales from our existing customers and to attract new customers. The provision for slow moving inventory decreased due to a concerted effort to move slow moving inventory out of our warehouses which included selling at a discount and disposing of certain products.

Inventories, net, consisted of the following at:

|  | <b>September 30,</b> | <b>December 31,</b> |
|--|----------------------|---------------------|
|  | <b>2008</b>          | <b>2007</b>         |
| Raw materials                                    | \$ 436,000           | \$ 372,000          |
| Finished goods                                   | 5,269,000            | 4,210,000           |
| Packaging materials                              | 233,000              | 369,000             |
| Gross inventory                                  | 5,938,000            | 4,951,000           |
| Provision for obsolete and slow moving inventory | (264,000 )           | (368,000 )          |
|  | \$ 5,674,000         | \$ 4,583,000        |

**(9)****Property, Plant and Equipment**

Property, plant and equipment is stated at cost, less accumulated depreciation. Equipment under capital leases is stated at the present value of minimum lease payments at inception. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

Property, Plant and Equipment consisted of the following at:

|  | <b>September 30,</b> | <b>December 31,</b> | <b>Estimated</b>   |
|--|----------------------|---------------------|--------------------|
|  | <b>2008</b>          | <b>2007</b>         | <b>useful life</b> |
|  |                      |                     | <b>(years)</b>     |

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|  |    |              |    |              |       |
|--|----|--------------|----|--------------|-------|
| Land   | \$ | 559,000      | \$ | 559,000      |       |
| Buildings and improvements                         |    | 2,167,000    |    | 1,925,000    | 10-40 |
| Machinery and equipment                            |    | 4,820,000    |    | 4,505,000    | 3-20  |
| Vehicles   |    | 3,264,000    |    | 3,277,000    | 2-8   |
| Furniture, fixtures, and data processing equipment |    | 871,000      |    | 823,000      | 3-12  |
|  |    | 11,681,000   |    | 11,089,000   |       |
| Less accumulated depreciation                      |    | (5,533,000 ) |    | (4,713,000 ) |       |
|  | \$ | 6,148,000    | \$ | 6,376,000    |       |

(10)

**Notes Payable**

At September 30, 2008 and December 31, 2007, notes payable represent amounts outstanding under a \$9,000,000 line of credit from a commercial lender. The line of credit is collateralized by accounts receivable and inventory and bears interest at a variable rate, at our option, of prime or Libor plus the applicable margin (currently Libor + 3.5%), which is 6.32% at September 30, 2008. The interest rate is subject to change based on the maintenance of certain ratios defined in the credit agreement. If availability on the line of credit falls below \$900,000, the Company must also comply with certain restrictive financial loan covenants or be in default. In March 2008, the maturity date of the line of credit was extended to June 1, 2009 and is subject to annual renewal thereafter. As part of this extension, the line of credit was amended to include an unused line fee of 0.5% per annum and the interest rate was increased to Libor plus 3.5%. As a result of this extension, the line of credit balance is classified as a long-term liability at December 31, 2007 and is classified as a short-term liability at September 30, 2008.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)**

At September 30, 2008 the outstanding balance on the line of credit was \$4,651,000. We were eligible to borrow \$6,775,000 resulting in excess availability of \$2,124,000, prior to the \$900,000 threshold.

**(11)****Product Warranty**

We provide our customers with limited warranties on certain manufactured products. Limited warranties generally range from 5 to 10 years. Warranty reserves are established based on known or probable claims, together with historical experience factors. Management periodically assesses the adequacy of its recorded warranty liability and adjusts the amount as necessary. The warranty reserve at September 30, 2008 and 2007 of \$35,000 and \$45,000, respectively, is included in the balance sheet in accrued expenses and other liabilities.

Product warranty accrual activity was as follows during the nine months ended:

|                    | <b>September 30,</b> |             |
|--------------------|----------------------|-------------|
|                    | <b>2008</b>          | <b>2007</b> |
| Beginning balance  | \$ 44,000            | \$ 42,000   |
| Warranty provision | 22,000               | 16,000      |
| Warranty payments  | (31,000 )            | (13,000 )   |
| Ending balance     | \$ 35,000            | \$ 45,000   |

**(12)****Long-Term Debt**

Long-term debt at September 30, 2008 consists of six mortgage loans which are collateralized by our real properties. The aggregate outstanding balances on such mortgage loans are \$1,156,000, less current installments aggregating \$396,000. These mortgage loans bear interest at variable and fixed rates ranging from 6.0% to 7.0% and include balloon payments maturing between March 2009 and April 2015.

Other long-term debt of \$1,546,000, less current installments of \$835,000, relates principally to equipment, hardware and software financing. The notes bear interest at various annual rates ranging from 5.2% to 10.55%.

**(13)**

## Share-Based Compensation

Prior to May 25, 2006, we had two stock option plans, the Directors' Stock Option Plan (the Directors Plan) and the 1999 Employee Stock Option Plan (the Employee Plan) and collectively with the Directors Plan, the 1999 Plans. The 1999 Plans provided for options to be granted with exercise prices at generally no less than fair market value of the common stock at the grant date. Options granted under the 1999 Plans have a term of up to 10 years and are exercisable six months from the date of grant subject to vesting requirements that may be imposed in individual grants. A total of 225,000 and 100,000 shares were reserved for issuance pursuant to options under the Employee and Directors' Plans, respectively. As of September 30, 2008 and December 31, 2007, no shares were available for future grants under either the Employee Plan or Director Plan.

In 2006, we adopted our 2006 Stock Award and Incentive Plan (the 2006 Plan). The 2006 Plan includes the following types of equity compensation awards: (i) stock options; (ii) stock appreciation rights; (iii) restricted stock awards; (iv) restricted stock units; (v) other awards based in common stock; (vi) dividend equivalents; (vii) performance shares or other stock-based performance awards; (viii) cash-based performance awards tied to achievement of specific performance objectives; and (ix) shares issuable in lieu of rights to cash compensation.

The 2006 Plan provides for 150,000 new shares of common stock available for equity awards. In addition, the remaining 11,228 shares which were previously available under the Employee Plan (plus any additional shares that may be available due to cancellation of options) have been added to the 2006 Plan and are available for equity awards under such Plan. The 2006 Plan replaced the 1999 Plans for future awards, including awards to directors. The 1999 Plans and 2006 Plan are administered by the Board's Compensation and Stock Option Committee (the Committee), which is comprised of three non-employee directors. The Committee determines who is eligible to participate and the number of shares to be granted.

## IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

In November 2007, the Company awarded an aggregate of 71,000 restricted stock units to key employees, members of management and directors. Each restricted stock unit represents the right to receive one share of the Company's common stock. The awards vest 25% on each anniversary of the grant date so long as the recipient remains with the Company. Shares of common stock are issued as and when the restricted stock units vest. The awards also vest on a change in control of the Company provided certain conditions are met. The Company valued the restricted stock units in accordance with SFAS 123R based on the price of the Company's common stock at the grant date, which was \$3.66, resulting in a total fair value of approximately \$260,000. Share-based compensation expense related to the restricted stock units was \$52,000 and \$16,000 for the nine and three months ended September 30, 2008 and \$0 for the same periods in 2007.

In May 2008, the Company awarded an aggregate of 3,333 shares of common stock to an employee. This award vested 100% on the grant date. The Company valued the award in accordance with SFAS 123R, which was based on the price of the Company's common stock at the grant date, which was \$3.66, resulting in a total fair value of approximately \$12,000 which was recorded as share-based compensation expense for the three months ended June 30, 2008. At September 30, 2008, there were 86,895 shares remaining available for awards under the 2006 Plan.

In October 2008, we re-priced certain stock options previously outstanding and we issued 64,000 new stock options. As a result, we expect to incur approximately \$82,000 in compensation expense in the fourth quarter of 2008. These stock options have a five year term, vested 100% upon grant and have an exercise price of \$0.79. The Company will value the awards in accordance with SFAS 123R, which was based on the price of the Company's common stock at the grant date, which was \$0.79 and will be recorded as share-based compensation expense for the three months ended December 31, 2008.

A summary of the stock option activity under our stock option plans as of September 30, 2008 are presented in the following table:

|   | Number of<br>Shares | Weighted<br>Average<br>Exercise<br>Price Per<br>Share | Weighted<br>Average<br>Remaining<br>Life | Aggregate<br>Intrinsic<br>Value |
|---|---------------------|---|--|---------------------------------|
| Options outstanding at January 1, 2008    | 100,000             | \$ 8.42   | 2.41                                     |                                 |
| Options Granted                           |                     |   |  |                                 |
| Options Exercised                         |                     |   |  |                                 |
| Options Cancelled                         |                     |   |  |                                 |
| Options Outstanding at September 30, 2008 | 100,000             | \$ 8.42   | 1.66                                     |                                 |
| Options Exercisable at September 30, 2008 | 100,000             | \$ 8.42   | 1.66                                     |                                 |



|                                      |         |    |      |      |
|--------------------------------------|---------|----|------|------|
| Options Vested at September 30, 2008 | 100,000 | \$ | 8.42 | 1.66 |
|--------------------------------------|---------|----|------|------|

Cash received from options exercised under the 1999 plans for the nine months ended September 30, 2007 was approximately \$7,000. The actual tax benefit realized for the tax deductions for share-based compensation plans totaled approximately \$15,000 for the nine months ended September 30, 2007. No options were exercised during the nine months ended September 30, 2008.

(14)

#### **Basic and Diluted (Loss) Earnings Per Share**

Basic (loss) earnings per share is computed by dividing net (loss) income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted (loss) earnings per share is computed by dividing net (loss) income available to common stockholders by the weighted-average number of common shares outstanding plus the additional dilutive effect of common stock equivalents outstanding during the year. The dilutive effect of options is calculated using the treasury stock method.

## IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Below are reconciliations between basic and diluted (loss) earnings per common share for the nine months and three months ended September 30, 2008 and 2007 (in thousands except per share amounts):

|  | Nine Months Ended September 30,  |        |            |          |        |           |
|--|----------------------------------|--------|------------|----------|--------|-----------|
|  | 2008                             |        |            | 2007     |        |           |
|  | Loss                             | Shares | Per Share  | Income   | Shares | Per Share |
| Net (loss) income per common share - basic | \$ (4,596 )                      | 2,517  | \$ (1.83 ) | \$ 157   | 2,511  | \$ .06    |
| Effect of dilutive securities - options    |                                  |        |            |          | 25     |           |
| Net (loss) income per common share diluted | \$ (4,596 )                      | 2,517  | \$ (1.83 ) | \$ 157   | 2,536  | \$ .06    |
|  | Three Months Ended September 30, |        |            |          |        |           |
|  | 2008                             |        |            | 2007     |        |           |
|  | Loss                             | Shares | Per Share  | Loss     | Shares | Per Share |
| Net loss per common share - basic          | \$ (1,810 )                      | 2,517  | \$ (.72 )  | \$ (72 ) | 2,514  | \$ (.03 ) |
| Effect of dilutive securities - options    |                                  |        |            |          |        |           |
| Net loss per common share diluted          | \$ (1,810 )                      | 2,517  | \$ (.72 )  | \$ (72 ) | 2,514  | \$ (.03 ) |

All dilutive common stock equivalents are reflected in our (loss) earnings per share calculations. Anti-dilutive common stock equivalents are not included in our (loss) earnings per share calculations. Due to the loss, all common stock equivalents were excluded from the diluted per share calculation for the nine months and three months ended September 30, 2008 because their inclusion would have been anti-dilutive. There were 171,000 and 52,000 shares of anti-dilutive common stock equivalents at September 30, 2008 and 2007, respectively. These stock options had exercise prices ranging from \$1.24 to \$14.75. In addition, there are 71,000 shares of unvested restricted stock units outstanding at September 30, 2008.

(15)

**Stockholders Equity**

(a)

***Preferred stock***

At September 30, 2008 and December 31, 2007, we had authorized 2,000,000 shares of preferred stock, \$0.01 par value per share, of which no shares were issued and outstanding.

(b)

***Common stock***

At September 30, 2008 and December 31, 2007, we had authorized 10,000,000 shares of common stock, \$.01 par value per share, of which 2,517,335 and 2,514,002, respectively, shares are issued and outstanding.

(16)

**Commitments and Contingencies**

(a)

***Contingencies***

***Legal proceedings - EIFS Claims***

Our subsidiary DFH (f/k/a Acrocrete), together with non-affiliated parties, are defendants in seven lawsuits pending in various Southeastern states, brought by homeowners, homeowners associations, contractors and subcontractors, claiming moisture intrusion damage as a result of the use of exterior insulation finish wall systems ( EIFS ), on single and multi-family residences. Our insurance carriers are providing a defense and have accepted coverage under a reservation of rights for six of these claims. With respect to one claim, the insurance carrier has been placed on notice and is expected to accept coverage and pay all defense and indemnity costs once the self insured retention has been exhausted.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

In a former EIFS claim, DFH was a defendant in a lawsuit styled Anthony Derck and Mary Derck v. Stalnaker Construction, Inc. et al. v. Atrium Aluminum Production and Acrocrete, Inc. in the Circuit Court of the First Judicial Circuit in and for Walton County, Florida, Case No. 99-0423-CA. The lawsuit involved claims by plaintiffs against DFH for moisture damages allegedly caused by DFH's EIFS products. A jury trial resulted in a judgment against DFH for \$523,200, which was reduced to \$209,562 by the trial court and was eventually reversed on appeal and remanded for a new final hearing. On April 16, 2007, DFH and the Dercks settled the matter for \$150,000. DFH paid \$50,000 and our insurance carrier agreed to pay the balance. In connection with the settlement, it was agreed that all pending litigation between the Company and our insurance carrier relating to this matter would be dropped. As a result of this settlement, we reversed a portion of the accrual established for this matter resulting in a gain on litigation settlement of \$183,000 in the first quarter of 2007.

Eleven of the more recent EIFS claims that have been filed against DFH, ten of which have subsequently been settled, are subject to insurance policies that have \$50,000 self-insured retention requirements ( S.I.R. ) that did not exist in previous insurance policies with other carriers. Pursuant to the S.I.R. requirement, DFH is required to make payments towards either the defense or indemnity of these claims, including but not limited to the payment of attorneys' fees, costs and settlement payments up to the S.I.R. limit. Once the S.I.R. limit has been satisfied, the applicable insurance carrier is required to defend and indemnify DFH. Any additional costs that are incurred, whether in the form of defense or indemnity payments, are thereafter the sole responsibility of the insurance carrier up to policy limits.

Of the one remaining EIFS case described above, DFH's applicable insurance carrier is expected to accept coverage and is expected to pay all defense and indemnity costs once the S.I.R. has been exhausted. In addition, there previously existed five EIFS cases, all of which have been settled, that DFH believes were covered by insurance policies issued by another carrier which do not contain an S.I.R. This prior insurance carrier, however, denied coverage. Accordingly, on March 7, 2008, DFH filed an action seeking a declaratory judgment against such insurer in Florida state court regarding one of these five EIFS cases. DFH has requested that the court declare as a matter of law that DFH's prior insurer had a duty to defend and indemnify DFH in this EIFS case, as well as, reimburse DFH for all attorneys' fees and costs it has incurred as a result of the insurer's denial of coverage. DFH is vigorously pursuing this litigation against the insurer.

The allegations of defects in EIFS are not restricted to DFH products used in an EIFS application, but rather are an industry-wide issue. The alleged failure of these products to perform has generally been linked to improper application and the failure of adjacent building materials such as windows, roof flashing, decking and the lack of caulking.

As insurance markets for moisture intrusion type coverage have all but disappeared, we were forced on March 15, 2004 to renew our existing products liability coverage with an exclusion for EIFS exposure. However, DFH has made a concerted effort to limit its exposure in any such future EIFS claims. For example, DFH instructed its salesmen and independent distributors not to sell acrylic stucco products for EIFS applications to end users in the residential construction market and eliminated warranties of acrylic stucco products used in such applications. In addition, we no longer manufacture such products following the closure of the DFH manufacturing facility in Kennesaw, Georgia in the fourth quarter of 2005, further reducing future exposure to EIFS claims. Following the closure of the DFH manufacturing facility, Just-Rite became a distributor of acrylic stucco products manufactured by Degussa (now

BASF) under the Acrocrete brand. As part of the Distribution Agreement, BASF has agreed to indemnify Just-Rite for any product liability claims for such products.

To date, DFH has not experienced any EIFS claims for any periods that would not be covered by insurance. Due to the uncertainty and unpredictability of litigation, there can be no assurance as to when, or if, any future uninsured claims may be filed, and if they were, to not be material.

*History of Claims*

Historically, there have been over 300 resolved EIFS Claims involving DFH. The average settlement, together with legal fees and expenses in these EIFS claims was approximately \$25,000. With the exception of the Derck case above, and two other claims where DFH contributed an aggregate of approximately \$25,000, DFH s

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

applicable insurance carriers have borne complete responsibility for all amounts and DFH has not had to contribute any cash in connection with the settlement of the resolved EIFS claims not subject to S.I.R. limits. DFH's administrative costs associated with the resolved EIFS claims were not material and there was no material impact on our consolidated results of operations.

We have no reason to believe that, based on such historical experience, the pending EIFS claims which are not subject to S.I.R. limits, will not be similarly resolved and no accrual can reasonably be estimated. The estimated exposure could range from \$0 to some undetermined amount. Management has evaluated the pending EIFS claims and, because of the uncertainty of the ultimate settlement of these cases, which may or may not require payment, management does not believe that a reliable estimate of the loss can be made within the above range and therefore, a loss contingency has not been recorded for any of these claims. Any losses and expenses in excess of insurance coverage could have a material adverse effect on our operating results and financial condition.

Based on the pending EIFS claim that is subject to S.I.R. requirements contained in the underlying insurance policies with one of its insurance carriers, we have established a loss contingency of approximately \$77,000 which is recorded in accrued expenses and other liabilities at September 30, 2008. Due to the uncertainty of litigation, loss contingency estimates will continue to be adjusted in future periods based upon the resolution of claims and reported claims, when applicable.

*General*

DFH, Just-Rite and Premix are engaged in other legal actions and claims arising in the ordinary course of its business, including five claims against Premix (one of which includes Imperial as a defendant) and non-affiliated parties which allege bodily injury due to exposure to asbestos contained in products manufactured in excess of thirty (30) years ago.

We believe that Premix and the Company have meritorious defenses to such claims. The Company has identified at least ten (10) of its prior insurance carriers that have provided product liability coverage to the Company, including potential coverage for alleged injuries relating to asbestos exposure. The majority of these insurance carriers are providing a defense to Premix and the Company under a reservation of rights in all of these asbestos cases. Further, although a few of these underlying insurance carriers have denied coverage to Premix and the Company on the basis that certain exclusions preclude coverage under the subject insurance policies, we believe that Premix and the Company have more than adequate insurance coverage for these asbestos claims and such policies are not subject to S.I.R. requirements. Further, the Company and Premix have substantial umbrella/excess coverage for these claims in addition to the underlying insurance described above. We do not believe the eventual outcome of such litigation will have a material adverse effect on our financial position. None of Premix's or the Company's currently manufactured products contain asbestos.

We are aggressively defending all of the lawsuits and claims described above. While we do not believe these aforementioned claims will have a material adverse effect on our financial position, given the uncertainty and unpredictability of litigation there can be no assurance of no material adverse effect.

*(b)*

***401(k) Plan***

We have a profit sharing retirement plan for our employees that is qualified under Section 401(k) of the Internal Revenue Code. Matching contributions are made based on a percentage of eligible employee compensation deferrals. The contribution is made in cash to the plan on behalf of our employees. For the nine months ended September 30, 2008 and 2007, the aggregate contribution required by us to fund the plan was approximately \$32,000 and \$40,000 respectively, which have been fully funded.

*(c)*

***Lease Commitments***

At September 30, 2008, we have certain property, plant and equipment under long-term operating leases. We will pay aggregate annual rent in 2008 of approximately \$1,100,000 for our current operating leases. The leases expire at various dates ranging from January 2009 to August 2013. Comparable properties at equivalent rentals are available for replacement of these facilities if any leases are not extended. We do not expect to incur any material relocation expenses, if relocation was necessary.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**(d)**

***Product Purchase Commitments***

Just-Rite entered into a three-year Distribution Agreement with BASF in connection with the BASF Sales Agreement. Pursuant to the Distribution Agreement, BASF appointed Just-Rite as its exclusive distributor of certain acrylic stucco products previously manufactured by DFH and thereafter manufactured by BASF. As part of the Distribution Agreement, BASF has agreed to indemnify Just-Rite for any product liability claims for such products thereafter manufactured by BASF. The Distribution Agreement was renewed for an additional year commencing October 1, 2008.

Just-Rite agreed to purchase a minimum of \$16,000,000 of products manufactured by BASF under the Acrocrete brand name over the term of the Distribution Agreement. In the first quarter of 2008, we surpassed the \$16,000,000 purchase requirement and are no longer required to purchase a minimum level of products from BASF.

**(17)**

**Payable to Former Preferred Stockholders**

As a result of the consummation of the December 31, 1998 merger with our wholly-owned subsidiary, we have a payable to former preferred stockholders who have not yet tendered their shares as required by the terms of such merger. Amounts payable to former stockholders in our consolidated balance sheets at September 30, 2008 and December 31, 2007 are \$82,000.

**(18)**

**Business and Credit Concentrations**

For the nine months ended September 30, 2008 and 2007, two vendors in aggregate, accounted for 29% and 39%, respectively, of total purchases and, no single vendor accounted for more than 17% and 24%, respectively, of the Company's purchases. Management believes that alternative suppliers are available to meet the Company's purchasing needs at prices which would not significantly impair the Company's ability to compete effectively. No single customer accounted for more than 10% of the Company's net sales for the nine months or three months ended September 30, 2008 or 2007, respectively.

**(19)**

**Related Party Transactions**

We paid legal fees of \$127,000 and \$59,000 for the nine months and three months ended September 30, 2008, as compared to \$193,000 and \$70,000, respectively, for the same periods in 2007 to a law firm with which our Chairman



of the Board is affiliated. We had amounts payable to this law firm of approximately \$14,000 and \$32,000 at September 30, 2008 and 2007, respectively. Such fees were for services rendered by members and associates of such law firm other than our Chairman.

The Chairman of the Board is entitled to receive deferred compensation of \$30,000 per year plus the related investment income for the years 2004 through 2009. The outstanding balance of deferred compensation was \$141,000 and \$131,000 at September 30, 2008 and 2007, respectively.

We paid lease payments for the use of a distribution facility to the former owner of a business acquired by us in the amount of \$23,000 in 2007.

**(20)**

### **Income Taxes**

Due to the uncertainty of our realization of net deferred tax assets, the Company recorded a valuation allowance of \$694,000 in the first quarter of 2008.

**(21)**

### **Subsequent Events**

In October 2008, we received an offer from the Mississippi Department of Transportation (the MDOT ) under the laws of eminent domain to purchase our Gulfport, Mississippi facility. The amount of the offer was approximately \$2,800,000 of which, approximately \$400,000 will be used to pay-off the existing mortgage on the properties resulting in net cash proceeds to the Company of approximately \$2,400,000. We have accepted the MDOT 's offer. The closing and payment of the purchase price is expected in late 2008 or early 2009.

**IMPERIAL INDUSTRIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

Notwithstanding such sale, the Company will continue to operate a distribution facility in Gulfport, Mississippi and we have begun to search for a new site. The cost of relocation will be borne by the MDOT.

In November 2008, we sold our Winter Springs, Florida manufacturing facility under the terms of a sales-leaseback agreement for the gross sales price of \$1,290,000. The Company generated net cash of approximately \$692,000 from the sale of the facility, after paying off the existing mortgages, closing costs and other adjustments. In connection with such closing, Premix entered into a five year lease. The lease contains two five year renewal options, and also provides the Company with an option to repurchase the facility at a price defined in the agreement at any time after two years, during the term of its lease period.

In addition, in November 2008, the Company received net cash proceeds of \$243,000 from additional mortgage financing on its real property located in Tampa, Florida. In connection with the new mortgage financing, the maturity date of the existing mortgage debt with a principal balance of \$149,000 at September 30, 2008, was extended from March 10, 2009 to November 7, 2011, to correspond to the maturity date of the new mortgage debt.

**Item 2.**

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

*The following discussion of the Company's financial condition should be read in conjunction with the Company's consolidated financial statements and notes thereto and related Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Form 10-K/A as of and for the year ended December 31, 2007. This discussion contains forward-looking statements that involve significant risks and uncertainties. As a result of many factors, such as those set forth under Special Note Regarding Forward-Looking Statements and Item 1A Risk Factors and elsewhere in this Form 10-Q, the Company's actual results may differ materially from those anticipated in these forward-looking statements. As used in the Quarterly Report on Form 10-Q, the Company, we, us, and our refers to Imperial Industries, Inc. and its subsidiaries, unless the context otherwise requires.*

**Special Note Regarding Forward-Looking Statements**

This Form 10-Q contains certain forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations and business of the Company, and our subsidiaries, including statements made under Management's Discussion and Analysis of Financial Condition and Results of Operations. These forward looking statements involve certain risks and uncertainties. No assurance can be given that any of such matters will be realized. Factors that may cause actual results to differ materially from those contemplated by such forward looking statements include, among others, many of which are beyond our control, the following: realization of tax benefits; impairment of long-lived assets; the ability to collect accounts or note receivables when due or within a reasonable period of time after they become due and payable; the increased cost of capital and related fees; the outcome of any current or future litigation; the adequacy or availability of insurance coverage for certain types of future product damage claims; the competitive pressure in the industry; unexpected product shortages, or changes in the terms of purchasing products or raw materials that may not be favorable to us, or changes in policies of our vendors that may not be favorable to us; general economic and business conditions; unforeseen weather conditions in our market areas that adversely affects the construction industry; the effectiveness of business strategies and development plans; estimates in capital expenditures; quality of management; business abilities and judgment of personnel; changes in accounting policies and practices in internal controls and requirements, and disclosure controls and procedures and related requirements as may be adopted by regulatory agencies, as well as the Financial Accounting Standards Board, that may adversely affect our costs and operations; the adequacy of our accounting estimates; availability of qualified personnel; and labor and employee benefit costs. (See Item 1A. Risk Factors contained in our 2007 Form 10-K/A Report and herein for a more complete description of risk factors.)

These risks are not exhaustive. We operate in a continually changing business environment, and new risks emerge from time to time. We cannot predict such risks nor can we assess the impact, if any, of such risks on our business or the extent to which any risk, or combination of risks may cause actual results to differ from those projected in any forward-looking statements. For example, financial results for any quarter are not necessarily indicative of results to be expected in future fiscal quarters or for the full year, due to any number of other factors, including the effect weather can have on construction activity. Accordingly, investors and all others are cautioned not to place undue reliance on such forward-looking statements.

These forward-looking statements speak only as of the date of this document. We do not undertake any obligation to update or revise any of these forward-looking statements to reflect events or circumstances occurring after the date of this document or to reflect the occurrence of unanticipated events. Any forward-looking statements are not guarantees of future performance. Investors should carefully consider the risks and uncertainties described below, together with

all of the other information in this quarterly report on Form 10-Q and in other documents that the Company files with the SEC, before making any investment decision with respect to our securities. If any of the following risks or uncertainties actually occur or develop, our business, financial condition, results of operations and future growth prospects could change. Under these circumstances, the trading prices of our Company's common stock could decline, and investors could lose all or part of their investment in our Company's common stock.

### **Critical Accounting Policies**

The discussion and analysis of our results of operations, financial condition and liquidity are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of such consolidated financial statements requires

management to make estimates and assumptions. As with all estimates and assumptions, they are subject to an inherent degree of uncertainty. Management bases these estimates on historical estimates and assumptions on historical results and known trends, as well as, forecasts as to how these might change in the future. Actual results could differ from these estimates and assumptions. We believe the following critical accounting policies have a higher degree of judgment and complexity.

***Revenue Recognition and Allowance for Doubtful Accounts***

We recognize revenue when the following four criteria are met:

.

Persuasive evidence of an arrangement exists;

.

Delivery has occurred or services have been rendered;

.

Seller's price to the buyer is fixed or determinable; and

.

Collectability is reasonably assured.

We generally recognize revenue, net of discounts and allowances, at the point of sale or upon delivery to the customer's site. For goods shipped by third party carriers, we recognize revenue upon shipment since the terms are FOB shipping point.

Provisions for the estimated allowance for doubtful accounts are recorded in selling, general and administrative expense at the end of each reporting period. The allowance for doubtful accounts is based on an analysis of the aging of accounts receivables, the Company's collateral, if any, securing the amount due, the subsequent collections of the receivables, the current financial condition of the customers with aged receivables, including credit terms offered (most invoices are due within 30 days of receipt) payment history, purchase history and direct communication, and other factors that include changes in (1) general business conditions, such as competitive conditions in the market, and (2) the economic condition of the residential and commercial construction industry. The aging of accounts receivables is based on the number of days an invoice is past due and invoices in the same past due ranges are aggregated. At the end of each fiscal quarter, the Company identifies all customers with significant invoices more than 90 days past due. For each customer, the Company then evaluates each of the factors noted above to arrive at a specific reserve. The Company then considers historical bad debt rates to arrive at a reserve for receivables not over 90 days past due. The aggregate of the specific reserve for over 90 day past due receivables and the reserve for the receivables not yet over 90 days past due represents the Company's allowance for doubtful accounts as of the end of the reporting period. Additionally, at the end of each reporting period, we analyze the historical trend of various ratios including charges to bad debt expense compared to net sales, bad debt write-offs to net sales and the balance of the allowance for doubtful accounts to net sales to determine whether the calculated allowance appears adequate. The primary assumption we use for determining our allowance for doubtful accounts is the historical rate of bad debt write offs as a percentage of

sales.

As a result of our analysis of accounts receivable and our current business environment, we have increased our bad debt provision \$418,000 and wrote-off accounts totaling \$344,000 for the three months ended September 30, 2008. We believe our receivables, net of the allowance for doubtful accounts, are collectible.

Judgment is required in evaluating all of these factors and in determining the appropriate amounts to record in the allowance for doubtful accounts. Additionally, such judgments may prove to be incorrect in the future. We believe that our procedures for estimating such amounts are reasonable and historically have not resulted in material adjustments in subsequent periods. However, if actual market conditions are less favorable than those assumed by management, or if the financial condition of customers were to unexpectedly deteriorate, resulting in an impairment of their ability to make payments, additional provisions may be required. As a result, our financial condition, results of operations and cash flow could be adversely affected.

### *Inventory Valuation*

Inventories are valued at the lower of cost or market using the average cost basis. We record a provision to reserve for obsolete and slow moving inventory so that our inventory is reported at estimated net realizable value. The provision is determined by identifying obsolete and slow moving inventory by comparing quantity on hand to historical and projected sales activity. We also consider future sales and price levels at which certain high dollar inventory is expected to be sold in the normal course of business. This information is aggregated and the estimated provision is determined. Judgment is required in evaluating these factors and in determining the appropriate amounts to record in the provision because management must use judgment to estimate when the inventory will be sold and

the quantities and prices at which the inventory will be sold in the normal course of business. Accelerating the disposal process or incorrect estimates of future sales potential may cause the actual results to differ from the estimates at the time such inventory is disposed or sold. We believe that our procedures for estimating such amounts are reasonable and historically have not resulted in material adjustments in subsequent periods. However, if actual market conditions are less favorable than those assumed by management, additional inventory write-downs may be required. As a result, our financial condition, results of operations and cash flow could be adversely affected.

### ***Litigation***

On an ongoing basis, we assess the potential liabilities related to any lawsuits or claims brought against us. While it is typically very difficult to determine the timing and ultimate outcome of such action, we use our best judgment to determine if it is probable that we will incur an expense related to the settlement or final adjudication of such matters and whether a reasonable estimation of such probable loss, if any, can be made. We accrue legal fees and a loss contingency when we believe a loss is probable and the amount of loss and legal fees can be reasonably estimated. Due to the inherent uncertainties related to the eventual outcome of litigation, it is possible that certain matters may be resolved for amounts materially different from any provisions or disclosures that have been previously made.

### ***Asset Impairment***

Whenever events or changes in circumstance indicate that the carrying amount of our assets may not be fully recoverable, we do an initial analysis of long-lived assets whereby we estimate the undiscounted future cash flow of these assets. If such analysis indicates that a possible impairment may exist, we are required to then estimate the fair value of the asset, principally determined either by third party appraisals, sales price negotiations or estimated discounted future cash flows, which includes estimating the timing of the future cash flows, discount rates and reflecting varying degrees of perceived risk.

The determination of fair value includes numerous uncertainties. We believe that we have made reasonable estimates and judgments in determining whether our long-lived assets have been impaired. However, if there is a material change in the assumptions used in our determination of fair values or if there is a material change in the conditions or circumstances influencing fair value, we could be required to recognize a material non-cash impairment charge.

### ***Income Taxes***

We account for income taxes using the liability method. This method requires that the deferred tax consequences of temporary differences between the amounts recorded in our Consolidated Financial Statements and the amounts included in our federal and state income tax returns be recognized in the balance sheet. As we generally do not file our income tax returns until after the closing process for the year end financial statements is complete, the amounts recorded at year end reflect estimates of what the final amounts will be when the actual income tax returns are filed for that fiscal year. In addition, estimates are often required with respect to, among other things, the appropriate state income tax rates to use in the various states in which we and our subsidiaries are required to file, the potential utilization of any operating and capital loss carry-forwards for both federal and state income tax purposes and valuation allowances required, if any, for tax assets that may not be realizable in the future. We believe that it is more likely than not that the amounts recorded as deferred income tax assets will not be recoverable through future taxable income generated by us. As a result, the Company recorded a 100% valuation allowance against our net deferred tax assets. We believe the procedures and estimates used in our accounting for income taxes are reasonable and in

accordance with established tax law.

**General and Recent Developments**

We are engaged in the manufacture and distribution of building materials to contractors, subcontractors, building materials dealers and others located primarily in the Southeastern United States. We have two manufacturing plants and eight (seven effective November 2008) distribution facilities through which we market our products. Our business is driven primarily by the level of residential and commercial construction activity in our trade markets, particularly in the states of Florida, Georgia (facility closed in September 2008), Mississippi, Alabama and Louisiana. The level of construction activity is dependent on many factors including, but not limited to, the general state of the economy, credit markets, population growth, inventory of available residential and commercial units, government growth policies and construction funding.



We have experienced six consecutive quarters of operating losses and reductions in sales when compared to prior quarters for the same period. Applications for building permits for construction of new residential units are considered a strong indicator for future construction activity. According to the U.S. Census Bureau, building permits for the construction of new residential units in Florida decreased 39.4% in the nine months ended September 30, 2008 as compared to the same period in 2007. Florida is our largest market, representing 57.5% of our consolidated net sales. Also, building permits by metropolitan area for the construction of new residential units in our gulf coast trade area which includes Gulfport, Mobile and New Orleans decreased 30.2% in the nine months ended September 30, 2008 as compared to the same period in 2007. Our gulf coast trade area represents 36.4% of our consolidated net sales for the nine months ended September 30, 2008.

We operate in the residential and commercial construction industry which is down sharply over the last two years. In addition, the current credit crisis in the United States is expected to further negatively impact the condition of our industry for an extended period of time. As a result, our current business environment is depressed and we expect construction activity to continue to be slow. The depth and duration of the decline cannot be predicted. A continued depressed residential and commercial construction market has and is expected to continue to have an adverse effect on our liquidity, capital resources and results of operations

In an effort to cut costs and conserve liquidity, we permanently closed satellite facilities located in St. Augustine, Brooksville and Ocala, Florida in late 2007 and closed additional facilities in Panama City, Florida in May 2008, Norcross, Georgia in September 2008 and Tampa, Florida in November 2008.

### **Our Ability to Continue as a Going Concern**

Our independent registered public accounting firm issued its report dated March 31, 2008 in connection with the audit of our financial statements as of December 31, 2007 that included an explanatory paragraph describing the existence of conditions that raise substantial doubt about our ability to continue as a going concern. Our consolidated financial statements as of December 31, 2007 and September 30, 2008 have been prepared under the assumption that we will continue as a going concern. We have and are taking several steps that management believes will be sufficient to allow the Company to continue as a going concern as described in Note 3 to the accompanying consolidated financial statements appearing elsewhere in this Form 10-Q. There can be no assurance that such actions will be effective. Our financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### **Results of Operations**

#### ***Three Months and Nine Months Ended September 30, 2008 compared to 2007***

Net sales decreased \$11,784,000 and \$2,652,000 for the nine months and three months ended September 30, 2008, or 26.8% and 19.2%, respectively, compared to the same periods in 2007. The decrease in net sales was principally due to a reduction in demand for our products in the residential and commercial construction markets related to the decline in construction activity in the Southeast United States.

The new distribution facility located in New Orleans, Louisiana (opened February 2008) accounted for \$822,000 and \$462,000 in additional sales for the nine months and three months ended September 30, 2008, respectively. These increases were offset by decreases from facilities located in St. Augustine, Brooksville and Ocala, Florida which were permanently closed in late 2007, which had aggregate net sales of \$1,976,000 and \$541,000 for the nine months and three months ended September 30, 2007, respectively. Additionally, our facility located in Panama City was closed in May 2008 and had net sales of \$517,000 during the three months ended September 30, 2007.

Gross margin as a percentage of net sales was approximately 25.6% and 21.4% for the nine months and three months September 30, 2008 compared to 28.7% and 27.7% for the same period of 2007. The decrease in gross margin was primarily due to a lower margin in manufactured products because of fixed plant overhead being allocated over lower production volume; pricing pressures from more intense competition for the sale of all products resulting from the overall condition of the industry; sale of inventory at a discount; a higher percentage of sales to commercial customers which generally are at lower margins than residential customers; sales of certain new product lines at margins that are generally lower than historical margins of existing products; and higher product costs. In the first nine months of 2008 and 2007, the sale of our manufactured products represented approximately 24.2% of our consolidated net sales. We expect the reduced levels of demand and intense competitive conditions from the decline in construction activity to continue to cause pressure on our gross margins through the remainder of 2008 and for the foreseeable future.

In the first quarter of 2008, we initiated a plan to broaden our product lines and hire additional sales people in an effort to increase sales to existing customers and to attract new customers. As a result, we have invested in inventory and new sales personnel in an effort to gain these additional new product sales to improve operating results. We believe the new product lines have improved our sales and our ability to service existing customers and have attracted new customers at a number of our facilities even though consolidated sales for the quarter ended September 30, 2008 are down compared to the second quarter of 2008 and the third quarter of 2007. We believe consolidated sales are down due to the continued deterioration of the residential and commercial construction industry and that the overall reduction in sales would have been worse had we not adopted our plan to broaden the sale of our products.

We continuously assess the recoverability of our inventory and have established a provision for obsolete and slow moving inventory so that the net inventory reported is fully recoverable. The provision is determined by identifying obsolete and slow moving inventory by comparing quantity on hand to historical and projected sales activity. We also consider future sales and price levels at which certain high dollar inventory is expected to be sold in the normal course of business. This information is aggregated and the estimated provision is determined. This provision calculation considers our current business environment because historical and projected sales activity are a major component of our calculation.

Selling, general and administrative expenses includes the amortization of a previously deferred gain from the sale of certain assets of \$128,000 and zero for the nine months and three months ended September 30, 2008, compared to \$637,000 and \$349,000 for the nine and three months ended September 30, 2007. Without the offset of this gain, selling, general and administrative expenses decreased \$319,000 and \$376,000 for the nine and three months ended September 30, 2008.

The decrease in selling, general and administrative expenses for the nine months ended September 30, 2008 compared to the same period in 2007 was due primarily to a decrease in payroll and related costs of \$534,000 from closing facilities and reducing headcount in existing locations; decrease of \$182,000 in insurance expense resulting from the reduction in sales and number of operating facilities; decrease in royalties of \$126,000 from selling less product for which we pay a royalty and a decrease in professional fees of \$84,000; These decreases were partially offset by an increase in bad debt expense of \$364,000 because of the construction slow-down and credit conditions within the industry; increase in delivery and fuel charge of \$232,000; and an increase of \$160,000 in closure costs related to closing facilities.

The decrease in selling, general and administrative expenses for the three months ended September 30, 2008 compared to the same period in 2007 was due primarily to a decrease in payroll and related costs of \$247,000 from closing facilities and reducing headcount in existing locations; decrease of \$70,000 in insurance expense resulting from the reduction in sales and number of operating facilities; decrease in royalties of \$17,000 from selling less product for which we pay a royalty, and a decrease in professional fees of \$41,000; These decreases were partially offset by an increase in bad debt expense of \$193,000, increase in delivery and fuel charge of \$78,000 and an increase of \$69,000 from closing facilities.

The new distribution facility located in New Orleans, Louisiana (opened February 2008) accounted for \$548,000 and \$224,000 in additional selling, general and administrative expenses for the nine months and three months ended September 30, 2008, respectively.

Selling, general and administrative expenses as a percentage of net sales for the nine months and three months ended September 30, 2008 were 40.3% and 36.3% compared to 28.4% and 28.7% for the same periods in 2007. The increases in both the nine months and three months ended September 30, 2008 were due primarily to fixed costs being

spread over lower sales volume. A significant portion of our selling, general and administrative expenses are fixed costs which do not fluctuate directly with changes in net sales.

Operating losses increased \$4,880,000 from earnings of \$160,000 for the nine months ended September 30, 2008 and increased \$1,527,000 for the three months ended September 30, 2008. The increased losses are due primarily to reductions in revenue, reductions in gross profit margins combined with an increase in selling, general and administrative expense as a percentage of sales due to a significant portion of our selling, general and administrative expenses being fixed in nature as discussed above.

Interest expense increased \$1,000 and \$20,000 for the nine and three months ended September 30, 2008. The increase was due primarily to increased levels of outstanding debt.

Miscellaneous income, net of expenses, decreased \$245,000 and \$55,000 for the nine and three months ended September 30, 2008 compared to the same period in 2007. The decrease is due primarily to the recognition of \$183,000 of other income from the settlement of product liability litigation against DFH in the first quarter in 2007 compared to zero in the same period in 2008 and an increase in the losses from the sale of fixed assets.

For the nine and three months ended September 30, 2008, we recognized an income tax benefit of \$385,000 and zero compared to an income tax benefit of \$14,000 and \$136,000 in the same periods of 2007. This change is due primarily to a pretax loss of \$4,981,000 for the nine months ended September 30, 2008 compared to pretax income of \$143,000 in the same period of 2007 and an income tax credit of \$62,000 recorded in the third quarter of 2007. Due to the uncertainty of our realization of net deferred tax assets, the Company recorded a valuation allowance of \$694,000 in the first quarter of 2008. This expense was offset by an income tax benefit of \$1,079,000 related to an income tax receivable.

For the three months ended September 30, 2008, there was no income tax benefit compared to an income tax benefit of \$136,000 in the same period of 2007. The Company has the ability to carry-back the loss of up to approximately \$3.3 million for the year ended December 31, 2008 and receive an income tax refund of approximately \$1.1 million, if such loss is incurred.

As a result of the above factors, we had a net loss of \$4,596,000 and \$1,810,000 for the nine months and three months ended September 30, 2008, or \$1.83 and \$0.72 per diluted share, respectively.

### **Liquidity and Capital Resources**

At September 30, 2008, we had working capital of \$2,532,000 compared to working capital of \$9,092,000 at December 31, 2007. The decrease in working capital was due primarily to the reclassification of the line of credit to a current liability, the full valuation allowance against the deferred tax asset and the increase in accounts payable partially offset by the increase in accounts receivable, inventory and income tax receivable.

At September 30, 2008, we had cash and cash equivalents and restricted cash of \$708,000 compared to cash and cash equivalents and restricted cash of \$1,164,000 at December 31, 2007.

Net cash used in operating activities for the nine months ended September 30, 2008 was \$2,625,000 compared to net cash provided by operations of \$1,394,000 for the same period of 2007. The decrease in cash from operations was due primarily to the loss in the nine months ended September 30, 2008 of \$4,596,000 compared to net income of \$157,000 in the same period of 2007. In addition, cash from operations decreased due to the increase in accounts receivable, inventory and income tax receivable offset by the cash provided by the increase in accounts payable.

Net cash used in investing activities in the nine months ended September 30, 2008 was \$578,000 compared to net cash used in investing activities of \$279,000 for the same period of 2007. The increase was due primarily to an increase in investment in property, plant and equipment in 2008 compared to 2007 for facility improvements and equipment to support our new product offerings in the beginning of the year.

Net cash provided by financing activities in the nine months ended September 30, 2008 was \$2,725,000 compared to net cash used in financing activities of \$1,238,000 for the same period of 2007. The increase was due primarily to the increase in notes payable line of credit of \$3,516,000 in the first nine months of 2008, compared to a decrease of \$1,238,000 in the same period of 2007. In the nine months ended September 30, 2008, restricted cash increased \$22,000 compared to a decrease of \$703,000 in same period in 2007.

**Future Commitments and Funding Sources**

Our primary sources of cash are proceeds from sales to customers and our \$9,000,000 line of credit. Trade accounts receivable represent amounts due primarily from subcontractors, contractors and building materials dealers located principally in Florida, Alabama, Mississippi, Georgia (facility closed September 2008) and Louisiana that have purchased products on unsecured open accounts. Accounts receivable, net of allowance, was \$5,988,000 and \$5,069,000 at September 30, 2008 and December 31, 2007. Collections of accounts receivable have remained slow through the first nine months of 2008 primarily due to the financial difficulties our customers are experiencing, who generally are small to midsize contractors and subcontractors, because of the severe slow-down and credit conditions prevalent in the residential and commercial construction industry. We continue to vigorously collect past

due accounts. Our line of credit provides us with up to \$9,000,000 in borrowing capacity and is collateralized by eligible accounts receivable and inventory. Generally, accounts not collected within 120 days are not eligible under our borrowing agreement. The line of credit bears interest at a variable rate at our option of prime or Libor plus the applicable margin (currently Libor + 3.5%), which is 6.32% at September 30, 2008. Annualized interest expense based on the outstanding balance of the line of credit would be approximately \$294,000. At September 30, 2008, the outstanding balance on the line of credit was approximately \$4,651,000 and we were eligible to borrow \$6,775,000 resulting in excess availability of approximately \$2,124,000, prior to the \$900,000 threshold. If availability on the line of credit falls below \$900,000, the Company must comply with certain restrictive loan covenants or be in default. Excess availability at November 11, 2008 was \$2,922,000, prior to the \$900,000 threshold. At September 30, 2008, the Company had \$1,126,000 of income tax receivable.

In October 2008, we received an offer from the Mississippi Department of Transportation (the MDOT ) under the laws of eminent domain to purchase our Gulfport, Mississippi facility. The amount of the offer was approximately \$2,800,000 of which, approximately \$400,000 will be used to pay-off the existing mortgage on the properties resulting in available cash to the Company of approximately \$2,400,000. We have accepted the MDOT 's offer. The closing and payment of the purchase price is expected in late 2008 or early 2009. Notwithstanding such sale, the Company will continue to operate a distribution facility in Gulfport, Mississippi and we have begun to search for a new site.

In November 2008, we sold our Winter Springs, Florida manufacturing facility under the terms of a sales-leaseback agreement for the gross sales price of \$1,290,000. The Company generated net cash of approximately \$692,000 from the sale of the facility, after paying off the existing mortgages, closing costs and other adjustments. In connection with such closing, Premix entered into a five year lease. The lease contains two five year renewal options, and also provides the Company with an option to repurchase the facility at a price defined in the agreement at any time after two years, during the term of its lease period.

In addition, in November 2008, the Company received net cash proceeds of \$243,000 from additional mortgage financing on its real property located in Tampa, Florida. In connection with the new mortgage financing, the maturity date of the existing mortgage debt with a principal balance of \$149,000 at September 30, 2008, was extended from March 10, 2009 to November 7, 2011, to correspond to the maturity date of the new mortgage debt.

We presently are focusing our efforts on increasing sales of our expanded product offerings marketed through our distribution facilities, enhancing customer service, increasing market share by expanding our outside sales staff at several of our facilities to generate additional sales from the commercial and residential markets and improving working capital. We expect reduced capital expenditures for the next 12 months to approximate \$60,000 and to be funded by our line of credit.

The new distribution facility located in New Orleans, Louisiana (opened February 2008) accounted for \$822,000 and \$462,000 in additional sales for the nine months and three months ended September 30, 2008, respectively. These increases were offset by decreases from facilities located in St. Augustine, Brooksville and Ocala, Florida which were permanently closed in late 2007, which had aggregate net sales of \$1,976,000 and \$541,000 for the nine months and three months ended September 30, 2007, respectively. Additionally, our facility located in Panama City was closed in June 2008 and had net sales of \$517,000 during the three months ended September 30, 2007. As a result of these closures and the closure of our facility in Norcross, Georgia in September 30, 2008, we recorded closure costs of

\$159,000 and \$560,000 in selling, general and administrative expenses and in accrued expenses and other liabilities at September 30, 2008 and December 31, 2007, respectively. At September 30, 2008, the balance remaining in accrued expenses and other liabilities was \$435,000.

Beginning March 15, 2004, we were forced to renew our products liability coverage with an exclusion for EIFS exposure. Due to the uncertainty and unpredictability of litigation, there can be no assurances as to when or if any future uninsured claims may be filed, and if they are, to not be material. While we do not believe the outstanding insured EIFS claims against DFH will have a material effect on our financial position, there can be no assurance of this because of the uncertainty of litigation. See Part II, Item 1 Legal Proceedings .

In connection with the BASF Sales Agreement, we ceased manufacturing operations at our Kennesaw, Georgia facility in the fourth quarter of 2005. Ceasing manufacture of DFH products for which we were not able to obtain insurance for EIFS exposure reduces our litigation risk for that product line in the future. In addition, as part



of the BASF Sales Agreement, Just-Rite entered into a Distribution Agreement with BASF, in which BASF has agreed to indemnify Just-Rite against any product liability claims for products manufactured by BASF and sold by Just-Rite.

We are taking various steps in an effort to improve our operating results and financial condition. These steps include:

·  
Investments in inventory and new sales personnel to enable the Company to sell a broader range of products in both the residential and commercial construction markets thereby generating more sales from our existing customers and to attract new customers;

·  
Closure of underperforming distribution facilities located in St. Augustine (December 2007), Brooksville (December 2007), Ocala (December 2007), Panama City Beach (May 2008), Florida, Norcross, Georgia (September 2008) and Tampa, Florida (November 2008);

·  
Implementation of cost reduction initiatives to reduce unnecessary costs in our operations and to conserve working capital;

·  
Implementation of more stringent credit and collection procedures and controls in an attempt to reduce days outstanding of trade accounts receivable and improve working capital;

·  
Sales of certain real property in Winter Springs, Florida, Gulfport, Mississippi and Tampa, Florida;

·  
Refinancing of existing mortgage indebtedness on Company real properties to take advantage of what we believe is significant equity available in excess of the amount of our existing mortgage debt;

·  
Obtain financing from other sources, including the possibility of refinancing equipment, or the sale of equity, to generate additional funds for operations and to take advantage of lower interest rates.

Based upon the steps outlined above being successful, we believe our cash on hand and the maintenance of our borrowing arrangement with our commercial lender will provide sufficient cash to meet current obligations for our operations and support the cash requirements of our capital expenditure programs during the next 12 months. Our ability to maintain and improve our long-term liquidity is primarily dependent on our ability to successfully achieve profitable operations, maintain favorable terms with our suppliers, obtain additional financing and resolve litigation on

terms favorable to us.

There can be no assurance that any such financing will be available or that we could obtain any such financing on terms suitable to us. The extent construction industry conditions continue to deteriorate due to the unprecedented adverse economic conditions now existing in the general economy and its effect on demand for our products and results of operations cannot be determined.

#### **Item 4.**

##### **Controls and Procedures**

*a.*

##### *Evaluation of disclosure controls and procedures*

We have established disclosure controls and procedures to ensure that material information relating to us, including our consolidated subsidiaries, is made known to the officers who certify our financial reports, as well as to other members of senior management and the Board of Directors.

Our management, under the supervision of our Principal Executive Officer and Chief Financial Officer, have evaluated the effectiveness of our disclosure controls and procedures as defined in Securities and Exchange Commission ( SEC ) Rule 13a-15(e) as of the end of the period covered by this report ( Evaluation Date ). Management has concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act is communicated to management, including the Principal Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure and is recorded, processed, summarized, and reported within the time periods specified in the SEC s rules and forms.

*b.*

*Changes in internal controls*

There were no changes in our internal controls over financial reporting that occurred during our last fiscal quarter that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

- 27 -

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## PART II. OTHER INFORMATION

### Item 1.

#### Legal Proceedings

See notes to Consolidated Financial Statements, Note 16 (a), set forth in Part I Financial Information.

### Item 1A.

#### Risk Factors

We have included in Part I, Item 1A of our Annual Report on Form 10-K/A for the year ended December 31, 2007, a description of certain risks and uncertainties that could affect our business, future performance or financial condition (the Risk Factors). The Risk Factors are hereby incorporated in Part II, Item 1A of this Form 10-Q. Investors should consider the Risk Factors prior to making an investment decision with respect to our stock. There have been no material changes in Risk Factors as documented in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2007, except as follows:

*Our Common Stock may not meet minimum listing requirements to remain on the NASDAQ Capital Market in the future.*

Our Common Stock is traded on the NASDAQ Capital Market under the symbol **IPII**. Rule 4310 of the NASDAQ Stock Market sets forth certain criteria in order for securities, including our common stock, to continue to qualify for listing on the NASDAQ Capital Markets. These criteria include among other things, (a) the requirement to maintain a minimum bid price per share of \$1.00 for a period of 30 consecutive business days; and (b) either (i) stockholder's equity of \$2.5 million; (ii) market value of listed securities of \$35 million; or (iii) net income from continued operations of \$500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years.

The bid price of our common stock has recently been under \$1.00 per share. The price of our common stock has been adversely affected by a number of factors, including operating results, conditions in the construction industry and financial markets, among many other items, some of which may be unrelated to our performance, or outside our control. Due to the recent turmoil in the global stock markets, on October 16, 2008, NASDAQ suspended the enforcement of the minimum per share bid price requirement (as well requirement to maintain the minimum market value of publically held shares) until January 16, 2009 as to all NASDAQ listed securities. There can be no assurance the Company will be able to meet the minimum per share bid price requirement following reinstatement on January 16, 2009 of such criteria by NASDAQ, or the other continued listing requirements, in order for our common stock to remain listed on NASDAQ. We would have a period of time following any determination that the common stock does

not satisfy such requirements (180 days following notification of such failure if it is for the failure to maintain the minimum bid price). If our common stock cannot thereafter satisfy the minimum listing requirements with NASDAQ, our common stock could be delisted. Such delisting may cause the price of our common stock to decline further and make it more difficult for investors to trade our common stock.

***Our business is dependent on demand for construction, renovation and repair of residential and commercial buildings. Such demand is influenced by changes in the overall condition of the U. S. economy including credit availability, interest rates, job formation, consumer confidence and other important factors.***

The building products industry is cyclical in nature and sensitive to changes in general economic conditions, including, in particular, conditions in the residential and commercial construction markets. Prices for our products and services are affected by overall supply and demand in the market for our products and for our competitors' products. In particular, market prices of building products historically have been volatile and cyclical, and we, like other companies, may have limited ability to control the timing and amount of pricing changes for our products. Future economic downturns could result in prolonged periods of weak demand or excess supply which could negatively affect our revenues and margins and adversely affect our liquidity, financial condition and operating results.

The markets we serve, principally the residential housing and commercial construction markets, are significantly affected by the movement of interest rates. Significantly higher interest rates or lack of available credit for construction could weaken demand for construction activities, which could lower demand for the Company's products. Other factors beyond our control may also impact demand for the Company's products, including, but not limited to new housing starts, which are influenced by availability of financing, housing affordability, demographic

trends, employment levels, unforeseen inflationary pressures and consumer confidence. Since our operations occur in a variety of geographic markets in the Southeast United States, our businesses are subject to the economic conditions in each such geographic market. General economic downturns or localized downturns in the regions where we have operations could have a material adverse effect on our business, financial condition and operating results.

During the second quarter of 2006, residential construction demand began to be impacted by a number of factors, including higher interest rates, an increase in available inventory of unsold new and existing homes, and homebuilders reporting lower order rates for new homes. As a consequence, residential construction activity, and applications for building permits for new residential units, considered a strong sign for future construction activity, began to decline sharply in Florida commencing the last six months of 2006. The significant decline in building permits continued in the Florida market through 2008 which indicates that future residential construction activity and demand for our products will remain weak into 2009 in such market. The depth and duration of the decline in construction activity cannot be predicted.

In addition, the current economic climate in the United States including the credit crisis within and outside the financial services industry has and is expected to continue to reduce credit available to contractors and construction development companies for an extended period of time. The inability of our customers to obtain credit for construction projects would negatively impact our sales and results of operations.

***Our business has substantial fixed costs, and as a result, our operating income is sensitive to changes in net sales. Declines in net sales would adversely affect operating results.***

A significant portion of our expenses are fixed and do not fluctuate with variations in net sales. A decline in net sales is expected to cause a greater proportional decline in operating income. For example, for the nine months ended September 30, 2008, sales and operating income decreased significantly compared to the same period in 2007. The reduction in operating income is attributable to primarily the decrease in sales and gross margin. A continuing reduction in net sales would have an unfavorable effect on future operating income due to the negative operating leverage.

***We require a significant amount of liquidity to service our debt, fund operations and meet cash requirements of capital expenditures.***

We require a significant amount of liquidity to service our indebtedness and fund operations and capital expenditures. Our ability to fund our operations, capital expenditures and other corporate expenses, including repayment of our indebtedness, depends on our ability to generate cash through future operating performance, which is subject to economic, financial, competitive and other factors. Many of these factors are beyond our control. We cannot assure that our business will generate sufficient cash flow from operations or that future borrowings will be available to us in an amount sufficient to fund our needs.

Any curtailment of operations, reduction or delay in planned capital expenditures may materially and adversely affect our future revenue prospects. In addition, we cannot assure that we will be able to raise additional equity capital, restructure or refinance any of our indebtedness or obtain additional financing on commercially acceptable terms or at all.

***If we are unable to meet the financial covenants under our line of credit, the lender could elect to accelerate the repayment of the outstanding balance and, in that event, we would be forced to seek alternate sources of financing.***

We are party to a \$9,000,000 asset-based borrowing agreement which contains a minimum fixed charge coverage ratio that is required if our excess availability, as defined in the agreement, is less than \$900,000. This agreement matures in June 1, 2009. At September 30, 2008, our excess availability was approximately \$2,124,000. Due to the Company's operating results in the nine months ended September 30, 2008, excess borrowing availability decreased \$2,722,000 from \$4,846,000 at December 31, 2007. If the Company's operating results do not improve, without raising additional financing or generating cash from the sale of real property, the Company's borrowing availability under the line of credit will continue to decrease.

We can give no assurance that we will be able to achieve sufficient financial results necessary to satisfy the fixed charge coverage ratio covenant if it were required to be tested. If we were unable to maintain excess borrowing availability of more than \$900,000 and we were unable to comply with the financial covenant, we would be in

default and our lender would have the right, but not the obligation, to terminate the loan commitment and accelerate the entire amount outstanding under the line of credit. The lender could also foreclose on our assets that secure our line of credit. In that event, we would be forced to seek alternative sources of financing which may not be available on terms acceptable to us, or at all.

## Item 6.

### Exhibits

Certain of the following exhibits, designated with an asterisk (\*), are filed herewith. The exhibits not so designated have been filed previously with the Commission, and are incorporated herein by reference to the documents indicated in parentheses following the descriptions of such exhibits.

| Exhibit No. | Description  |
|-------------|--|
| 3.1         | Certificate of Incorporation of the Company, (Form S-4 Registration Statement, Exhibit 3.1).   |
| 3.2         | Amendment to Certificate of Incorporation of the Company. (Incorporated by reference to Form 10-K dated December 31, 2001, Exhibit 3.2)  |
| 3.3         | By-Laws of the Company, (Form S-4 Registration Statement, Exhibit 3.2).  |
| 3.4         | Amendment to Certificate of Incorporation of the Company. (Incorporated by reference to Form 10-K dated December 31, 2004, Exhibit 3.4)  |
| 3.5         | Amendment to Certificate of Incorporation of the Company (Incorporated by reference to Form 10-Q for the quarter ended June 30, 2007, Exhibit 3.5).  |
| 10.1        | Consolidating, Amended and Restated Financing Agreement by and between Congress Financial Corporation and Premix-Marbletite Manufacturing Co., Acrocrete, Inc., and Just-Rite Supply, Inc. dated January 28, 2000. (Incorporated by reference to Form 10-K for the year ended December 31, 1999, Exhibit 10.1)   |
| 10.2        | Employment Agreement dated July 26, 1993 between Howard L. Ehler, Jr. and the Company. (Form 8-K dated July 26, 1993)  |
| 10.6        | Distribution Agreement between Degussa Wall Systems, Inc. and Just-Rite Supply, Inc. dated July 25, 2005, effective as of October 1, 2005. (Incorporated by reference to Form 8-K dated June 11, 2008, Exhibit 10.1)   |
| 10.7        | Amendment No.8 to Consolidating, Amended and Restated Financing Agreement by and between Wachovia Bank, National Association, successor by merger to Congress Financial Corporation, and Premix-Marbletite Manufacturing Co., DFH, Inc., formerly Acrocrete, Inc, and Just-Rite Supply, Inc. (Incorporated by reference to Form 10-K/A dated December 31, 2007, Exhibit 10.15) |



- 10.8 2006 Stock Award and Incentive Plan (Incorporated by reference to Form 8-K dated June 1, 2007).  
21 Subsidiaries of the Company.
- \*31.1 Certification of the Company's Chief Operating Officer/Principal Executive Officer pursuant to Rule 13a-14(a).
- \*31.2 Certification of the Company's Chief Financial Officer/Principal Accounting Officer pursuant to Rule 13a-14(a).
- \*32.1 Certification of the Company's Chief Operating Officer/Principal Executive Officer pursuant to Section 1350.
- \*32.2 Certification of the Company's Chief Financial Officer/Principal Accounting Officer pursuant to Section 1350.

**SIGNATURES**

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

**IMPERIAL INDUSTRIES, INC.**

By: /s/ HOWARD L. EHLER, JR.  
Howard L. Ehler, Jr.  
Chief Operating Officer/  
Principal Executive Officer

By: /s/ STEVEN M. HEALY, CPA  
Steven M. Healy, CPA  
Chief Financial Officer/  
Principal Accounting Officer

November 14, 2008